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CEO Power and Financial Reporting Quality: Investigating the Mediating Role of Audit Committee Effectiveness in Non-Financial Firms of Pakistan

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ABSTRACT

This study investigates the association between financial reporting quality (FRQ), and CEO power in non-financial firms that are enlisted on the Pakistan Stock Exchange (PSX) and to explore whether the audit committee effectiveness (ACE) mediates the relationship between CEO Power and FRQ. The study uses a fixed-effects regression model to investigate the direct and indirect effects of CEO power on FRQ using a sample taken from the KSE 100 Index over a ten-year period from 2014 to 2023, comprising 604 firm year observations. The findings corroborate the predictions of agency theory by showing that CEO power has a negative impact on both FRQ and audit committee effectiveness. Additionally, mediation analysis highlights the relevance of governance systems in financial reporting oversight by confirming that ACE partially mediates the relationship between CEO Power and FRQ. Furthermore, the robustness model confirms the relationship between CEO power and FRQ as well as the mediation of ACE. The study offers implications for business scholars, leaders, and professional managers around the world as well as in Pakistan and contributes to the governance literature by documenting how concentrated managerial power weakens reporting quality. As per our findings which have theoretical and practical ramifications for shareholders, regulators, and legislators, stronger governance frameworks are necessary to reduce CEO dominance and improve the quality of financial reporting in Pakistan.

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INTRODUCTION

According to Bandara and Falta (2021), reliability, comparability, verifiability, and relevance are the characteristics of good financial reporting quality (FRQ). Financial statements act as a communication tool between firms and stakeholders and a lot of stakeholders like investors, creditors, and managers make key decisions based on financial statements, so poor-quality reports can lead to bad decisions and harm firm performance and economic growth (Biddle et al., 2009; Verdi, 2006).

A growing body of research done by academia links impairments in FRQ to corporate governance issues, particularly the concentration of power in the hands of CEOs (Donelson et al., 2017). They are of the view that powerful CEOs may wield disproportionate influence over boards, internal controls, and financial reporting choices. In response, regulators around the world have placed a strong emphasis on strengthening oversight systems like the audit committee (AC), which is crucial to guaranteeing the accuracy of financial statements Raimo et al. (2020). The relationship between CEO power and AC effectiveness (ACE) is still poorly understood both theoretically and practically, and there is still conflicting empirical data regarding the effect of CEO power on FRQ.

Such governance challenges are especially pertinent to Pakistan, where previous research has shown structural problems such CEO duality, family-controlled businesses, concentrated ownership, and restricted board independence (Javeed & Lefen, 2019; Tariq & Abbas, 2013; Yasser et al., 2017). The Securities and Exchange Commission of Pakistan's (SECP) reports also point to ongoing challenges with board supervision, audit committee operations, and governance code enforcement. Such institutional deficiencies elevate the danger that influential CEOs may influence reporting outcomes while simultaneously diminishing the efficacy of monitoring organizations like the AC.

Against this backdrop, one empirical concern becomes clear: the extent to which CEO power influences financial reporting quality in Pakistan, and whether this influence operates through audit committee effectiveness, remains largely unexplored. International studies have looked at audit committees, CEO power, and FRQ separately, but they have rarely combined these three constructs into a single model—especially in emerging nations where governance dynamics are very different from those in industrialized economies (Lopes et al., 2023).

This investigation, which is based on agency theory (Jensen & Meckling, 1976), stakeholder salience theory (Mitchell et al., 1997), and managerial discretion theory (López-Cotarelo, 2018), suggests that CEO Power may affect FRQ by weakening monitoring systems. An effective AC is predicted to decrease such

risks, however its possible mediating role has not been empirically explored in the context of Pakistan.

This research contributes to the literature in four ways, firstly it provides first empirical evidence from Pakistan on ACE as a mediator between CEO power and FRQ. Secondly, it enhances theoretical knowledge, applying multiple governance theories in the Pakistani context. Thirdly it offers practical insights for regulators and firms to strengthen ACs and limit excessive CEO power and fourthly it expands literature on CEO power, ACE, and FRQ, specifically for developing economies.

The paper is structured as follows: Section 1 introduces FRQ, CEO power, and the audit committee. Section 2 discusses theory and literature. Section 3 details methodology. Section 4 presents results, and Section 5 concludes the study.

LITERATURE REVIEW

Theoretical framework

The agency theory

The theory of agency (Jensen & Meckling, 1976) as well as the notion of stakeholder. identification and salience. (Mitchell et al., 1997) may serve as the foundation for a framework that could be helpful in comprehending the quality of financial reporting. Agency theory, which has its roots in information economics (Turnbull, 1997) , tackles the situation where the principal agrees to pay for monitoring expenses like internal audit in order to report functionally to the board's audit committee. This ensures that the financial statements and other accounting information are scrutinized to make sure that there are no significant misstatements. Nonetheless, as a significant internal stakeholder, the CEO has the power to rewrite the laws, customs, values, and guidelines that direct her or his behavior (Krause et al., 2016). The theoretical viewpoint of the agency suggests a relationship between ACE and FRQ should also take into account the impact of the third variable, CEO power, as the latter view point is suitable for countries with underdeveloped nations. So far, the previous research have failed to consider the impact of CEO power on FRQ and the mediating role of ACE between the relationship between FRQ and CEO power.

The Stakeholders Identification and Salience Theory

According to this theory, if a CEO has the ability to affect the company, he or she can be designated as an important internal stakeholder (Mitchell et al., 1997). According to Mitchell et al. (1997), the foregoing study only looks at

actors, in this case the influential CEO who is in charge of disclosing profits and financial results. As per Freeman et al. (2018), the stakeholder theory takes into account three different points of view: the managerial theory perspective, which investigates verifiable statements regarding the real actions of managers and companies; the instrumental perspective, which concentrates on the results of particular behavior of managers and the ethics perspective, which challenges what managers of corporations should do. This study adheres to the managerial perspective due to its capacity to address concerns regarding stakeholder power (here the CEO is a significant internal stakeholder) and how it impacts the CEO's capacity to meet stakeholder expectations, such as disclosing good quality earnings (Baker et al., 2019). According to our logic, a strong CEO is more likely to obscure the environment of financial reporting by withholding correct earnings data that stakeholders would need to make decisions.

Literature Review and Development of Hypotheses

CEO Power and financial reporting quality

According to the theory of stakeholder. identification and salience. (Mitchell et al., 1997), the CEO is the most influential person in a company since he is a substantial internal stakeholder having the ability. to affect organizational financial results. Some studies. (Baker et al., 2019; Feng et al., 2021) show a significant association between FRQ and CEO power but found mixed results. According to Baker et al.'s (2019) investigation into the impact of CEO and CFO power on accruals and FRQ, having a strong CEO in a company results in higher-quality earnings. In a similar vein, Shiah-Hou and Shin-Rong (2021) found a positive correlation between CEO ownership power and FRQ in the United States. However, Feng et al. (2021) came to the conclusion that a high level of CEO influence increases the likelihood of accounting manipulations i,e. poor FRQ . According to Cormier et al. (2016), of Canada's 16 publicly traded companies, those accused of financial misreporting have substantial CEO power. Celebrity CEOs are more prone to manipulate reported profitability by controlling earnings to satisfy the market's greater expectations, according to Malmendier and Tate (2009). Given Pakistan's concentrated ownership, family-controlled firms, and relatively weaker monitoring mechanisms, CEO dominance may have more harmful consequences for FRQ. Based on this institutional logic, we expect CEO power to be associated with lower FRQ.

H1. There is a negative link between FRQ and CEO power

CEO Power and ACE

According to agency theorists, an organization's financial reporting system should be objectively assessed and monitored by efficient audit committees. In real life, they carefully examine financial statements and other accounting information outputs to make sure there are no significant misstatements. Nonetheless, as a key stakeholder inside the firm, the CEO has the power to rewrite the laws, customs, values, and guidelines that direct her or his behavior (Krause et al., 2016). They go on to say that CEO authority could lead to an audit committee that seems functional in theory but not in reality. The reasoning given by Pearce and Zahra (1991) is that the CEO is regarded as the primary actor in the employment of director as well as selection, even in the case of nominating boards Murphy (2008); even if the board is mostly composed of external members, it relies on the CEO's information (Aram & Cowen, 1983). Both individually and combined, these factors reduce the AC's effectiveness as a crucial tool control (Krishnan, 2005), as the CEO bears a major portion of the responsibility for determining the terms and salary of outside members in audit committee (Bruynseels & Cardinaels, 2014). Lisic et al. (2016) further argue that when CEOs hold substantial influence, the AC may appear effective on paper but function weakly in practice.

These patterns are especially relevant in developing economies, where board independence and transparency mechanisms are still emerging. Thus, CEO dominance is expected to diminish AC effectiveness. So, it is hypothesized that

H2: A negative association exists between CEO power and ACE

ACE and FRQ

Strong audit committees increase FRQ by strengthening oversight and preventing profits manipulation, according to previous studies (Bilal et al., 2018; Mardessi, 2022).

Nevertheless, significant contradictions are also highlighted in the literature. Only certain AC attributes, including financial expertise, have a considerable impact on FRQ, according to some research (Alawaqleh & Almasria, 2021); other studies show no influence at all (Hamdan, 2020).

These conflicting results highlight the need for a more thorough analysis of ACE, taking into account a variety of traits rather than just one. Given the AC's main monitoring role, we expect ACE to be positively correlated with FRQ. We thus propose that

H3. ACE has a positive association with FRQ

The role of ACE as mediation in the nexus between CEO power and FRQ

The theoretical foundation for mediation is the notion that CEO power may influence internal monitoring systems rather than directly impacting FRQ. According to agency theory, CEOs who have too much power may obstruct oversight duties, especially those of the AC.

Stakeholder salience theory confirms that strong stakeholders have an impact on internal governance structures, which in turn shapes outcomes. The notion explains how strong stakeholders, like CEOs, can influence governance structures and, in turn, impact outcomes like the effectiveness of audit committees and the quality of financial reporting.

Although some studies address moderating impacts of CEO power on AC performance (Lisic et al., 2016), very few evaluate whether AC effectiveness serves as a pathway through which CEO power eventually influences FRQ. This gap is problematic because ignoring the indirect effect may produce incomplete or misleading conclusions (Friedrich, 1982). Importantly, a negative mediation pathway is theoretically plausible:

As CEO power $\rightarrow$ reduces ACE and ultimately Reduced ACE $\rightarrow$ lowers FRQ.Thus, ACE can serve as a mediator even if the indirect effect is negative.

Given this reasoning and limited evidence in developing economies, we test whether ACE functions as a conduit through which CEO power influences FRQ.

H4: ACE mediates in the relation between CEO power and FRQ

RESEARCH DESIGN

Data collection and Sampling

the study used the unbalanced panel data of Pakistani non-financial firms listed on PSX and included in KSE-100 index. It comprises Pakistan's top 100 enterprises that are enlisted on Pakistan Stock Exchange (PSX). Therefore, the KSE-100 Index is considered an important measure of the Pakistan stock market and plays a significant role in the economy of Pakistan along with its contribution to the global economy. Data for 10 years from 2014 to 2023 had been collected and excluded financial firms due to their unique regulatory environment and firms with missing data on key variables. The sample comprising of 687 firm year observations and by eliminating the firms with missing or incomplete data were excluded and final sample consists of 604 firm year observations. Data was manually collected from firms' annual reports and cross verification was performed by comparing the reported figures with disclosures given in the notes to the accounts with data from the Pakistan Stock Exchange and company

websites to ensure reliability.

Econometric Technique and Variables

The variables which have been omitted and having the impact on both the CEO Power and financial reporting quality may result in spurious correlations between the CEO Power and financial reporting quality. For instance, certain businesses may be more progressive than others, which could lead to better governance and a decreased risk of financial misreporting. This study chose between fixed. effect and random variables using the Hausman test in order to overcome the omitted variable bias. Because fixed effect or random effect regression is resilient in preventing the impact of omitted variables, researchers in this field have frequently used it (e.g., (Adams & Ferreira, 2009; Farag & Mallin, 2017)).

Moreover, an endogeneity problem could arise from reverse causality and unobservable variability between CEO power and earnings management. One of the best statistical methods for handling heterogeneity, endogeneity, and estimate bias is the system.generalized method of moments (GMM) estimator (Sarwar et al., 2020; Ullah et al., 2018). By using internal tools generated from the lagged values of dependent variables, the system GMM estimation technique resolves endogeneity concerns Ullah et al. (2018). Additionally, excessive data loss can be avoided with the use of the two-step GMM model Ullah et al. (2018). Given these advantages, system GMM serves as more appropriate approach for testing the study's relationships than the traditional mediation techniques such as Baron and Kenny or the Sobel test, which are not suitable for panel data and cannot adequately address endogeneity.

Model Estimation

The multivariate regression model is specified as follows:

$$FRQi,t = \beta 0 + \beta 1 CEO\_Pit,+ \beta 2 CEO\_Pit, + P\beta i,t Control\eth \varepsilon i,t$$

In these variables, t stands for the fiscal year, i for the firm, and ε for the residual term. FRQ is the dependent variable. ACE is represented for the variable AC effectiveness (e.g., log of audit fee). The regression model incorporates firm-specific attributes and board independence as control variables in addition to ACE. We include industry- and year-fixed effects and employ five control variables. The definitions of each variable and the data sources are compiled in Table 2. In accordance with the AC and FRQ literature (Ahmed, 2023; Raimo et al., 2020), ordinary least squares (OLS) regression is used in the present study. When

the control variables are present, the first model determines the connection between CEO Power and the FRQ (H1). The model is the following:

$$FRQi,t = \beta 0 + \beta 1 CEO\_ Poweri,t + \sum \beta\ i,t Control + \varepsilon\ i,t \quad (1)$$

where the dependent variable is FRQ (financial reporting quality), CEO Power extends to cpr (CEO pay ratio), Ex_own (Executive Ownership) CEO_D (CEO Duality). Control also stands for control variables used in the analysis. This study uses five control variables to eliminate specification errors in the estimated model, account for the impact of CEO Power on the FRQ, and eliminate spurious correlation among the variables (Udin et al., 2017). As per previous research Yeh (2019) , (e.g., Bravo et al., 2021; Yeh, 2018), the control variables comprised of firm size (FS), firm leverage (F_Lev), return on assets (ROA), board size (BS), and board independence (BI).

In all models, the likelihood of declining FRQ rises as F_Lev and FS levels rise (Astuti et al., 2020; Nugrahanti, 2023) and falls as BI, BS, and ROA levels rise Astuti et al. (2020) .

rovides definitions for these variables.Using the given below equation model, we estimate the following in order to test our H2 hypothesis (i.e., the impact of CEO power on ACE):

$$ACEi,t = \beta 0 + \beta 1 CEO\_ Poweri,t + \sum \beta\ i,t Control + \varepsilon\ i,t \quad (2)$$

Further, to determine the effects of ACE on FRQ (H3), we estimate the following regression model:

$$FRQi,t = \beta 0 + \beta 1 ACEi,t + \sum \beta\ i,t Control + \varepsilon\ i,t \quad (3)$$

Lastly, we construct the g empirical model, given below, to examine the mediating role of ACE on the connection between CEO Power and FRQ in order to test our H4 hypothesis:

$$FRQi,t = \beta 0 + \beta 1 CEO\_ Poweri,t + \beta 2 ACEi,t + \sum \beta\ i,t Control + \varepsilon\ i,t \quad (4)$$

In order to mitigate the potential effect of outliers and extreme values, all continuous variables are winsorized at the 5th and 95th percentile levels.Table 2 defines how all of the study variables employed in the aforementioned empirical models are measured.

RESULTS AND DISCUSSIONS

Descriptive Statistics

The mean value of FRQ is 0.076 ranging from 0.014 to 0.681, having a standard deviation of 0.917. Similar findings are done by (Younis et al., 2020). They found

Table 1.
Variable Description

Variables	Symbols	Measurement of Variables
Dependent variable		
Financial Reporting Quality	FRQ	TA =$\beta_0 + \beta_1 \triangle \text{Sales}_{i,t} + \beta_2 \text{PPE}_{i,t} + \beta_3 \triangle \text{CFO}_{i,t} + \varepsilon_{i,t}$ (Dechow et al., 1995; Kothari et al., 2005)
Independent variables (CEO Power)		
CEO Pay Ratio	Cpr	Ratio of CEO compensation with total of top 5 executives
Executive Owner-ship	Exe-own	Holding of shares by CEO
CEO Duality	CEO_D	Whether CEO holds both chairman and CEO position, 1 if yes, 0 otherwise
Mediating variable		
Audit commit-tee Effective-ness	ACE	Log of Audit fee Wan Mohammad et al. (2018).
Control variables		
Firm size	FSIZE	Calculated using the natural log of the firm's total assets.(Ayuba et al.;) (Hirdinis, 2019)
Board size	BSIZE	Total members on board of directors(Ali et al., 2021; Naveed et al., 2023)
Return on assets	ROA	Computed by the ratio of net income of a firm to its total assets(Ali et al., 2021; Naveed et al., 2023)
Firm's leverage	F-LEV	Obtained by calculating the ratio of total liabilities to total assets(Ali et al., 2021; Shahab et al., 2018)
Board indepen-dence	B-IND	Measured by the ratio of independent directors to total no. of directors(Ali et al., 2021; Naveed et al., 2023)

(Source: author's own work)

that the mean value of accrual quality is 0.07 in contexts of Pakistan-listed firms.

The correlation between model's explanatory variables is found to be poor. All of the correlation coefficients are less than the (0.7) limit set by Kervin (1992) Kervin (1992), demonstrating that there is no issue with the existence of multicollinearity. All values are less than 0.7; therefore, the result indicates that there is no existence of a multicollinearity problem in our data. Because correlation does not always imply causation (Woolridge, 2019), regression analysis is required to determine the causal relationship. As a result, panel

Table 2.
Descriptive Statistics

Variable	Obs.	Mean	Std. Dev.	Min	Max
Dependent variable					
FRQ	604	0.076	0.917	0.014	0.681
Independent variables					
Cpr	604	.125	.141	.001	.938
Exe-own	604	.544	.498	0	1
CEO_D	604	1	.258	0	7
Mediating Variable					
ACE	604	0.432	0.125	0.123	0.913
Moderating variables					
F_Own	604	0.621	0.471	0	1
Control variables					
FSIZE	604	6.783	0.745	3.881	9.632
BSIZE	604	8.247	1.442	6	15
ROA	604	7.431	13.854	-87.66	123.87
F-LEV	604	2.865	5.78	0	87.09
B-IND	604	5.433	1.562	3	8

Note. Please see Table 1 for variable definitions.
(Source: author's own work)

Table 3.
Correlation Matrix

Variables	VIF	FRQ	Cpr	Exe-Own	CEO-D	FSIZE	BSIZE	ROA	F-LEV	B-IND
FRQ	-	1.00								
Cpr	1.35	-0.05*	1.00							
Exe-Own	1.12	-0.14	0.16	1.00						
CEO-D	1.24	0.02	0.12*	0.07*	1.00					
FSIZE	1.34	-0.56	-0.05	0.03	0.02*	1.00				
BSIZE	1.21	-0.02*	-0.07	0.04	-0.05	0.29*	1.00			
ROA	1.37	0.15*	0.04*	0.05	0.06*	-0.05	-0.19	1.00		
F-LEV	1.27	0.27	-0.05	0.06*	-0.05	0.21*	0.14*	-0.07	1.00	
B-IND	1.04	0.02*	-0.02	-0.02	0.02*	0.04*	-0.21	0.02	-0.49	1.00

*Significant at 5% level.
Note. Please see Table 1 for variable definitions
(Source: author's own work)

regression is used. If the correlation between independent variables is more than 0.7, Multicollinearity is considered an issue (Cooper & Schindler, 2003). Despite the strong correlation coefficients, the researchers computed the variance inflation factor (VIF) to see if the estimates were Multicollinearity. The VIF values are less than 10, there is a no issue of multicollinearity (Hair et al., 2008).

Table 4.
Fixed Effect regression results

Variables	FRQ (1)	ACE (2)	FRQ (3)	FRQ (4)	ACE (5)	FRQ (6)	FRQ (7)	ACE (8)	FRQ (9)	FRQ (10)
Cpr		-0.286**	-1.683***	-0.511**						
		-0.027	-0.656	-0.034						
Exe-Own					-0.371**	-0.284**	-0.177**			
					-0.042	-0.148	-0.055			
CEO-D								-0.269*	-0.279**	-0.132**
								-0.096	-0.182	-0.056
ACE/Audit fee	0.679***			0.067**			0.043**			0.032**
	-0.022			-0.144			-0.027			-0.113
FSIZE	0.372***	0.257***	0.369**	0.332***	0.234**	0.563*	0.488*	0.336***	0.277**	0.346*
	-0.161	-0.233	-0.124	-0.168	-0.259	-0.197	-0.243	-0.312	-0.261	-0.122
BSIZE	-0.023*	0.064**	-0.059**	-0.018**	0.042**	0.043**	-0.014*	0.041***	0.037**	-0.029*
	-0.035	-0.064	-0.057	-0.032	-0.051	-0.049	-0.037	-0.047	-0.064	-0.039
ROA	-0.016	-0.012	-0.025*	-0.032	-0.021	-0.052	-0.027*	-0.051	-0.037	-0.015*
	-0.132	-0.312	-0.211	-0.143	-0.412	-0.413	-0.287	-0.417	-0.322	-0.241
F-LEV	0.015**	0.002	0.021*	0.013**	0.005*	0.003	0.024*	0.014	0.007	0.022*
	-0.472	-0.318	-0.357	-0.336	-0.365	-0.674	-0.424	-0.241	-0.341	-0.312
B-IND	0.114**	0.136*	0.137**	0.167**	0.131*	0.296*	0.151**	0.241*	0.114*	0.175**
	-2.39	-2.41	-2.48	-2.24	-2.12	-2.51	-2.51	-3.32	-2.6	-2.45
Constant	-0.583**	-0.809**	-0.893**	-0.712*	-0.654**	-0.687*	-0.461*	-0.622**	-0.823*	-0.417*
	1.724	1.213	1.311	0.213	1.765	0.989	1.541	1.515	1.375	1.525
Year dummies	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	604	604	604	604	604	604	604	604	604	604

Continued on next page

Table 4 continued

Variables	FRQ (1)	ACE (2)	FRQ (3)	FRQ (4)	ACE (5)	FRQ (6)	FRQ (7)	ACE (8)	FRQ (9)	FRQ (10)
Adjusted R2	0.249	0.244	0.228	0.43	0.56	0.476	0.231	0.221	0.213	0.206
No. of companies	79	79	79	79	79	79	79	79	79	79

Table 5.
Endogeneity test for mediation using two-step system GMM regression

Variables	FRQ (1)	ACE (2)	FRQ (3)	FRQ (4)	ACE (5)	FRQ (6)	FRQ (7)	ACE (8)	FRQ (9)	FRQ (10)
Lagged of DV's	0.324**	0.785***	0.308**	0.0302**	0.675**	0.344***	0.312**	0.811**	0.326**	0.305**
	-0.097	-0.066	-0.091	-0.093	-0.075	-0.095	-0.091	-0.068	-0.097	-0.092
Cpr		-0.279**	-1.411**	-0.389***						
		-0.048	-0.451	-0.041						
Exe-Own					-0.432**	-0.261***	-0.381*			
					-0.039	-0.136	-0.057			
CEO-D								-0.378**	-0.076*	-0.498**
								-0.072	-0.163	-0.062
ACE/Audit fee	0.249***			-0.012*			-0.011*			-0.014*
	-0.087			-0.165			-0.283			-0.132
FSIZE	0.374**	0.269***	0.373**	0.313***	0.247**	0.512*	0.416*	0.374***	0.289**	0.375*
	-0.162	-0.243	-0.121	-0.188	-0.229	-0.198	-0.213	-0.392	-0.267	-0.152
BSIZE	-0.013*	0.068**	-0.069**	-0.014**	0.049**	0.053**	-0.017*	0.047***	0.047**	-0.019**
	-0.039	-0.061	-0.067	-0.042	-0.059	-0.041	-0.038	-0.048	-0.062	-0.037
ROA	-0.017	-0.022	-0.026*	-0.021	-0.031	-0.062	-0.024*	-0.054	-0.039	-0.016*
	-0.142	-0.382	-0.262	-0.138	-0.442	-0.43	-0.269	-0.413	-0.372	-0.242
F-LEV	0.012*	0.002	0.022*	0.011**	0.003*	0.004	0.006*	0.013	0.005	0.026*
	-0.492	-0.388	-0.353	-0.376	-0.341	-0.654	-0.452	-0.245	-0.343	-0.392
B-IND	0.124***	0.127*	0.134**	0.131**	0.139*	0.297*	0.156**	0.213*	0.154*	0.127**
	-2.33	-2.49	-2.78	-2.48	-2.32	-2.54	-2.61	-3.41	-2.62	-2.31
Constant	-0.472**	-0.817**	-0.413*	-0.368**	-0.627**	-0.653*	-0.478*	-0.634**	-0.816*	-0.462*
	1.694	1.334	1.483	1.721	1.624	0.989	1.542	1.552	1.356	1.594

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Table 5 continued

Variables	FRQ (1)	ACE (2)	FRQ (3)	FRQ (4)	ACE (5)	FRQ (6)	FRQ (7)	ACE (8)	FRQ (9)	FRQ (10)
Year effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	604	604	604	604	604	604	604	604	604	604
Adjusted R2	6.789	6.895	6.471	6.512	6.687	6.477	6.522	6.698	6.564	6.603
(p value)	0	0	0	0	0	0	0	0	0	0
Hansen's J (p value)	0.157	0.146	0.165	0.109	0.175	0.191	0.156	0.143	0.132	0.121
No. of companies	79	79	79	79	79	79	79	79	79	79

Table 6.

Description of path	Coefficients	SE	T statistic
Cpr -> ACE -> FRQ	0.0284***	0.0044998	6.564640
Ex_Own -> ACE -> FRQ	0.0358***	0.0031976	5.353780
CEO_D -> ACE -> FRQ	0.0327***	0.0033492	4.364741

Note. Please see Table 1 for variable definitions, ***p < 0.01
(Source: author's own work)

Regression Results

resents the fixed-effect model's findings. The DV is the FRQ, the ACE is the mediating variable, and the three dimensions of CEO power—Cpr, Ex_own, and CEO_D—are used to assess the CEO power (IV) in Models 1–10 of Table 4.

In model 1 audit committee effectiveness positively affects FRQ (β = 0.679, p < 0.05). This suggests that higher ACE is associated with higher financial reporting quality our results are in line with the prior studies the (Bilal et al., 2018; Hamdan, 2020). H3 proposes that the ACE is positively linked with FRQ.

The CEO Power proposed a negative relationship with FRQ and a negative relationship with ACE. H1 proposes that the CEO Power leads to lower FRQ. Model 3 in Table 4 shows that CEO Power (Cpr) has significant and negative coefficient with FRQ together with all control variables as anticipated (β = -1.683, p < 0.05), showing a negative relation between CEO Power and financial reporting quality and Our results are consistent with earlier studies (Kalembe, Nkundabanyanga, et al., 2024; Sheikh & Shoukat, 2025; Shiah-Hou & Shin-Rong, 2021) showing that powerful CEOs deteriorate FRQ due to their opportunistic behavior and agency perspective issues arise. Similarly, the model 6 and 9 show that the other two proxies of CEO Power (Exe_own, CEO_D) have statistically significant and negative coefficient with FRQ together with all control variables as predicted (β = -0.284, p < 0.05), (β = -0.279, p < 0.05), showing a negative association between CEO Power and FRQ.

H2 predicts that a negative relation exists among CEO power and ACE. Models 2, 5, and 8 of the Table 4 are showing that CEO power has a significant and negative effect on audit committee effectiveness together with all control variables as anticipated (β = -0.386, p < 0.05; β = -0.371, p < 0.05; β = -0.269, p < 0.01). The negative coefficients represent that more CEO power (Cpr, Ex_own, CEO_D) is harmful for audit committee effectiveness to perform its oversight function. These results demonstrate how the existence of CEO power can reduce the efficacy of the AC and, in fact, Lisic et al. (2016); Ojeka et al. (2019). The findings

also support other recent researches (Lee & Ryu, 2019; Shira, 2019).

Furthermore, H4 envisages that the relationship between CEO power and FRQ is mediated by the audit committee effectiveness. We use hierarchical regression analysis to examine the mediation in accordance with the guidelines provided by Baron and Kenny (1986). The mediation requirements are as follows: (i) the independent variable CEO Power has a significant effect on the DV i.e. financial reporting quality; (ii) the independent variable CEO Power has a significant effect on the mediating variable audit committee effectiveness; (iii) the mediating variable audit committee effectiveness has a significant impact on the DV i.e. financial reporting quality; and (iv) the cumulative effect of the independent variables CEO Power and audit committee effectiveness is exercised after completing the three mediation conditions mentioned above.

Table 4 indicates that all of the mediation requirements for direct relationships are met. Additionally, combined regression findings about the influence of IV and mediating variables (such as CEO power and audit committee effectiveness) on our dependent variable (i.e., financial reporting quality) are shown in Models 4, 7, and 10 of Table 4. The influence of CEO Power (Cpr, Ex_own, CEO_D) on financial reporting quality remains negative but reduces and significant statistically in the all given models, as predicted (β = -0.511, p < 0.01; β = -0.177, p < 0.05; β = -0.132, p < 0.05) respectively, while audit committee effectiveness as the mediator effect on the financial reporting quality also becomes negative and significant in all the models, as predicted (β = -0.067, p < 0.05; β = -0.043, p < 0.05; β = -0.032, p < 0.05). So we observe that the direct effect weakens but remains significant after including the mediator, it suggests partial mediation which indicates that the AC acts as a mediator in the relationship between CEO power and FRQ. Resultantly, when the audit committee's effectiveness is considered as a mediator, it also negatively affects financial reporting quality in all models, and this effect is statistically significant. This suggests that even though the audit committee is meant to improve financial reporting, its effectiveness may be weakened in firms with powerful CEOs.

Additionally, to examine the mediating role of ACE between CEO Power and FRQ, the Sobel test, as proposed by Baron and Kenny (1986) is used. Table 6's results show that ACE mediates the link between CEO Power and FRQ as expected (β = 0.0284, p < 0.01; β = 0.0358, p < 0.01; β = 0.0327, p < 0.01).

Therefore, these findings supported the findings of previous research (Kalembe, Kaawaase, et al., 2024; Shiah-Hou & Shin-Rong, 2021) that suggested using mediating variables to find out how CEO power lowers FRQ. Overall, the anticipated results are aligned with the agency's theory that the performance of the audit committee is compromised by CEO influence, which lowers FRQ. ultimately, the study's findings suggest that the effectiveness of audit

committees acts as a mediator. Hypothesis 4 is thus validated.

Resolving Endogeniety Issue

Moreover, prior research has demonstrated the existence of an endogenous problem, that is simultaneity and causality, between CEO power, ACE, and financial reporting quality (Bernile et al., 2018; Yeh, 2019). To address the potential endogenous issue, we used Roodman (2009) two-stage GMM framework regression (i.e., Cpr, Ex_own and CEO_D are endogenously resolute by omitted variables which are theoretically related with the financial reporting quality of the firm). Using ACE as a mediating variable,Table 5 presents the findings of a two-step system GMM for the direct and indirect association between CEO power and FRQ.

Financial reporting quality has a positive relationship with Cpr, Ex_own, and CEO_D, respectively, as seen in Table 5's columns 3, 6, and 9, indicating that CEO power lowers financial reporting quality. Furthermore, the Hansen test and Arellano Bond (AR-2) p-values verified that the probable endogeneity issue had been successfully addressed. In addition, Table 5 discloses the mediating impact of ACE between CEO power (i.e., Cpr, Ex_own and CEO_D) and financial reporting quality. The findings in Table 5 confirm the results shown in Table 4 that, the CEO power is more influential to deteriorate FRQ not only directly but through the audit committee effectiveness as well. Furthermore, the study's findings demonstrate that the relationship between CEO power and earnings quality is mediated by the effectiveness of the audit committee. This indicates that the relationship between CEO power and FRQ is mediated by the effectiveness of the AC. Therefore, the findings clarify show the effectiveness of the audit committee translates the inputs of CEO power into the output of compromised FRQ.

CONCLUSION AND IMPLICATIONS

This study offers insightful information about the intricate connections among financial reporting quality, audit committee effectiveness, and CEO power. The results emphasize how crucial it is to take into account both direct and indirect effects when figuring out what factors influence CEO power and the quality of financial reporting. The study's objective was to determine the connection between FRQ, audit ACE and CEO power. Through the mediating function of ACE, this study investigated the relation between CEO power and the quality of financial reporting of Pakistani companies listed on the PSX 100 Index.

The study examined the suggested hypothesis using a unique combination of observations and sophisticated scientific tools. Consequently, the research

findings are consistent with our theoretical framework, which incorporates ideas from the theory of agency and managerial discretion theory as well as the stakeholder theory of salience and identification.

As a result, this study offers fresh empirical insights into the literature on CG. According to the study's findings, the ACE mediates the negative association between financial reporting quality and CEO power (i.e., CEO pay ratio, Executive ownership, and CEO Duality). The results of the study also align with previous studies on CEO power, which has documented the detrimental effects of CEO power on the quality of financial reporting Shiah-Hou and Shin-Rong (2021) .

According to the findings, CEO power lowers the quality of the company's financial reporting because powerful CEOs have the potential to undermine the efficacy of governance monitoring systems and audit committees. The findings support agency theory, which advises shareholders to designate a board with a strong audit committee as a check on the agent's opportunistic behavior, such as a strong CEO.

There are some significant ramifications from this study's findings.

In terms of theory, this study has shown that the effects of CEO power, FRQ, and ACE may be examined using a multi-theoretic approach that incorporates agency, theory as well as stakeholder identification and salience theories. The present findings are consistent with agency theory, as ACs play a crucial role in a company and have the ability to mediate the relationship between FRQ and CEO authority. For researchers, the findings imply that audit committee effectiveness is more crucial for FRQ, but the opportunistic behavior of CEOs with undue power can become the reason for inefficient audit committee. The study's findings also help executives and shareholders understand how an effective audit committee may protect businesses from financial results manipulation and boost their value by preventing the CEO from having excessive control and power.

Lastly, our results have implications for the board's compensation and nominating committees. The nominating committee continues to have a significant impact on how the board operates, including hiring directors for the audit committee, managing director succession, recruiting, training, and evaluations. The results of the study specify that the nominating committee ought to give top priority for enhancing director independence. Similarly, remuneration committee remains influential for fixation of remuneration of CEO on reasonable grounds so that he or she may not become so powerful to influence effectiveness of AC and manipulate financial results of the company.

FUTURE RESEARCH

In non-financial enterprises listed on the PSX, this study offers a solid basis for comprehending the connection between CEO power, ACE, and FRQ. To expand on the findings and improve our comprehension of corporate governance dynamics, a number of areas are still up for future study. First, the generalizability of these findings in various institutional contexts may be investigated in future studies. Replicating this study in various economic and regulatory situations may offer deeper insights into how CEO power affects FRQ in various scenarios, as corporate governance structures and regulatory regimes fluctuate among nations.

Second, although the CEO pay ratio, executive ownership, and CEO duality are the three aspects of CEO power that are examined in this study, future research may include other aspects like tenure, political ties, or network centrality to present a more complete picture of CEO influence. Determining the broader effects of CEO dominance on governance systems may be made easier by looking at these additional variables. Third, audit fees are used in this analysis as a proxy for the effectiveness of the audit committee. For a more comprehensive understanding of audit committee efficacy in reducing CEO influence, future research might examine different metrics including the frequency of AC meetings, the financial expertise of members, or the quality of internal control. Fourth, future research could use sophisticated statistical techniques like structural equation modeling (SEM) or machine learning algorithms to analyze complex relationships and identify non-linear interactions between CEO power, ACE and FRQ, given that this study uses the Baron and Kenny (1986) approach and the Sobel test for mediation analysis. Fifth, future studies should look at how external governance mechanisms, such shareholder activism, regulatory scrutiny, and institutional investors, effect the nexus between CEO power and the quality of financial reporting. Policymakers and regulators may find useful insights from an understanding of how external influences impact corporate governance arrangements.

In conclusion, qualitative research methods, such conducting interviews with executives, board members, and auditors, may enhance quantitative results by providing detailed insights into the ways in which audit committees manage power relationships with CEOs. To fill up knowledge gaps regarding the behavioral aspects of governance structures, a mixed-methods approach may be useful. In order to help businesses, investors, and regulators improve the integrity of financial reporting, future research can fill these gaps and add to the current conversation on CG and financial transparency.

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