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AUDIT COMMITTEE AND REGULATORY SCRUTINY

Comitê de auditoria e escrutínio regulatório

Comité de Auditoría y Control Regulatorio

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ABSTRACT

This paper examines the relationship between audit committee characteristics and regulatory scrutiny. Comment letters issued by the Securities and Exchange Organization of Iran were used to measure regulatory scrutiny. Empirical results show that audit committee financial expertise increases (decreases) regulatory scrutiny when audit committee independence is low (high). This paper informs the cost-benefit debate on audit committee financial expertise. It contributes to the literature by showing that regulatory scrutiny is jointly influenced by the audit committee independence and financial expertise. The paper is of interest to researchers and shareholders, boards of directors, and other practitioners who wish to improve the composition and quality of audit committees, especially in emerging markets where corporate governance codes are still developing.

Keywords: financial expertise, independence, comment letter, audit committee, regulatory scrutiny.

RESUMO

Este artigo examina a relação entre as características do comitê de auditoria e o escrutínio regulatório. Para medir o escrutínio regulatório, o documento atual usa cartas de comentários emitidas pela Organização de Valores Mobiliários do Irã. Os resultados empíricos mostram que a expertise financeira do comitê de auditoria aumenta (diminui) o escrutínio regulatório quando a independência do comitê de auditoria é baixa (alta). Este artigo informa o debate de custo-benefício sobre a expertise financeira do comitê de auditoria e contribui para a literatura ao mostrar que o escrutínio regulatório é influenciado em conjunto pela expertise financeira e independência do comitê de auditoria. O artigo é de interesse de pesquisadores, bem como de acionistas, conselhos de administração e outros profissionais que desejam melhorar a composição e a qualidade dos comitês de auditoria, especialmente em mercados emergentes onde os códigos de governança corporativa ainda estão em desenvolvimento.

Palavras-chave: *Expertise financeira, independência, carta de comentário, comitê de auditoria, escrutínio regulatório.*

RESUMEN

Este documento examina la relación entre las características del comité de auditoría y el escrutinio regulatorio. Para medir el escrutinio regulatorio, el presente documento utiliza cartas de comentarios emitidas por la Organización de Bolsa y Valores de Irán. Los resultados empíricos muestran que la experiencia financiera del comité de auditoría aumenta (disminuye) el escrutinio regulatorio cuando la independencia del comité de auditoría es baja (alta). Este documento informa el debate costo-beneficio sobre la experiencia financiera del comité de auditoría y contribuye a la literatura al mostrar que el escrutinio regulatorio está influenciado conjuntamente por la experiencia e independencia financiera del comité de auditoría. El documento es de interés tanto para investigadores como para accionistas, consejos de administración y otros profesionales que deseen mejorar la composición y calidad de los comités de auditoría, especialmente en mercados emergentes donde los códigos de gobierno corporativo aún se están desarrollando.

Palabras clave: *experiencia financiera, independencia, carta de comentarios, comité de Auditoría, control Regulatorio.*

INTRODUCTION

Security commissions in capital markets periodically scrutinize corporate reporting and submit comment letters to firms. This regulatory scrutiny motivates the firms to better address corporate reporting issues that lead to higher information quality for stakeholders (Bills, Cating, Lin, & Seidel, 2020; Kubic & Toynbee, 2021). However, managers view this scrutiny as an important matter, demanding their awareness as the review processes need substantial time and effort to deal with the issues and are likely to lead to negative outcomes such as negative investor perceptions (Shroff, 2020). Therefore, managers attempt to find courses of action to mitigate the regulatory scrutiny. Accordingly, this study examines how the regulatory review process is associated with financial expertise of firm's audit committees and their independence.

Theoretically, corporate governance attributes generally and audit committees particularly contribute to strengthening financial reporting quality, mitigating restatements in financial statements (e.g., Piot & Janin, 2007), and safeguarding auditors' independence (Carcello et al., 2011). On the other hand, the audit committee's effectiveness mainly depends on financial expertise and independence. Regulators acknowledge the importance of financial experts and independent members in audit committees in order to enhance corporate governance and audit committees' oversight processes (e.g., Sarbanes-Oxley Act [SOX], 2002; Securities and Exchange Organization of Iran [SEO], 2013). In this respect, previous studies explore the relation between audit committee attributes and financial statements restatements (Carcello et al., 2011). Other studies focus on the influence of financial statements restatements on the regulatory review process (DeFond et al., 2003).

Nevertheless, prior research provides mixed evidence on how financial expertise affects the financial reporting process and, thus, the regulatory review process. On the one hand, a greater level of financial expertise in audit committees enforces corporate reporting (Bilal, Chen, & Komal, 2018). On the other hand, higher financial expertise in audit committees provides an opportunity for poor financial corporate reporting (e.g., Malik, 2014). Under these situations, this paper argues that regulatory reviewers rely more on financial expertise when audit committees are independent. Specifically, this paper expects that audit committees' independence has a moderating role in the association of financial expertise and regulatory scrutiny.

The research sample includes firms listed on the Iranian capital market for the period 2011-2019. This is an appropriate setting for the following reasons. First, Iran is a developing country in which research data on comment letters is available. Second, the capital market in Iran is comparable to most large developing capital markets (e.g., Hesarzadeh & Rajabalizadeh, 2020). Third, similar to many developing countries (e.g., Yang, 2020), the key source to frame the review procedure in Iran's capital market is the US regulatory scrutiny. Fourth, the Iranian capital market contains not only mature, large companies but also a significant proportion of young, small companies. Hence, this research setting enables us to generalize research results to a variety of cases, ranging from high-growth, young and small companies to stable, large, and mature companies.

Using comment letters issued by the Securities and Exchange Organization of Iran, this paper finds that audit committee financial expertise can increase (decrease) regulatory scrutiny on firms when the independence of the audit committee is low (high). In addition, supplemental analyses reveal that this interactive effect is stronger under higher agency conflicts and regulatory reviewers' workload compression.

This study contributes to corporate governance literature in many respects. First, this paper is the first empirical study to document the association of audit committee characteristics and regulatory scrutiny. Second, this study adds to the literature by revealing that regulatory reviewers' workload compression and agency conflicts are significant variables in the joint association of financial expertise and independence of audit committees with regulatory scrutiny. Third, to the best of our knowledge, the majority of the studies on regulatory scrutiny through comment letters are from the US and large capital markets (e.g., Ballestero & Schmidt, 2019; Cassell, Cunningham, & Lisic, 2019; Cunningham, Johnson, Johnson, & Lisic, 2020). Therefore, this article provides new evidence on regulatory scrutiny from a non-US and developing financial market where the inequality of insiders and outsiders is severe. Hence, on the one hand, the article is of interest to many emerging market regulators who use SEC-style comment letters as a public enforcement tool because comment letters probably have a bigger impact in emerging markets due to the poorer institutions, private enforcement, and disclosure quality (Yang, 2020). On the other hand, the paper is also of interest to shareholders, boards of directors, and other practitioners who wish to improve the composition and quality of audit committees, especially in emerging markets where corporate governance codes are still developing.

BACKGROUND AND HYPOTHESES DEVELOPMENT

Overview of Iran's capital market

Iran's Capital Market was established in 1968 and is currently a member of the Federation of Euro-Asian Stock Exchanges. The market is relatively comparable to most large developing capital markets (e.g., Hesarzadeh & Rajabalizadeh, 2020). From a macro view, starting in the late 1980s, the Government of Iran implemented macro stabilization programs, which liberalized their financial systems, leading to the proper market infrastructure and institutions for capital markets to flourish. These reforms gradually increased the average ratio of total market capitalization to Iran's GDP to about 25% (Tehran Stock Exchange, 2017).[1] From a micro view, the number of companies in the market is about 300 and these companies are characterized by relatively high concentrated ownership structures. Over the past decades, institutional investors have significantly increased their market participation and consequently helped to create a more stable demand for securities. In the context of corporate reporting, the Iranian accounting and auditing standards are mainly

1 . Iran's market capitalization and GDP were about USD 106 and 445 billion in 2017. The equivalent numbers were about 19 and 235 for Egypt, 100 and 210 for Kuwait, 445 and 954 for Brazil, and 888 and 1300 for Spain.

based on international standards. Further, Iranian listed firms are required to establish audit committees to oversee the internal control process and financial affairs (SEO, 2013).

Regulatory scrutiny

Securities commissions have usually designed the regulatory review process to ensure information quality and protect investors (e.g., Duro, Heese, & Ormazabal, 2019). They periodically review several financial reports to ensure compliance with disclosure requirements. In this respect, if an information is deemed insufficient in some way or if the securities commissions desire further data, they issue CLs requiring firms to clarify or change publicly reported information or provide additional data (Bills et al., 2020). Consequently, firms should provide written responses and additional information (Cunningham et al., 2020).

Regarding the regulatory review process in Iran, it is similar to some extent to the U.S. securities commission (SEC) review procedure, as the key source to frame review procedure in Iran's financial market, is the SEC review procedure. According to Iran's Capital Market Act (see Islamic Consultative Assembly, 2005; SEO, 2013), the mission of SEO is to protect investors and enhance market efficiency. Therefore, as part of this mission, the SEO must review/scrutinize the financial reports. The SEO review process involves evaluating the financial reports from an investors' perspective and asking questions that investors might ask when reading the disclosure. Upon scrutiny of corporate reports, if questions arise, the SEO issues a CL, including possible disclosure deficiency and concerns. The firms' responses must include supplementary or new disclosures in the financial reports (Hesarzadeh & Rajabalizadeh, 2020). The SEO considers the responses and their supplementary or new disclosures and may issue new CLs until all potential deficiencies are resolved. The CL procedure is likely to end with the SEO recommending the matters of financial reporting misstatements to the process of regulatory enforcement and sanctions.

Hypotheses development

Regulatory scrutiny through comment letters is crucial in developing markets where information intermediaries, audit quality, or legal systems for protecting high-quality corporate reporting are poor (Yang, 2020). Nevertheless, the regulatory scrutiny usually faces significant financial and nonfinancial constraints (e.g., Hesarzadeh & Rajabalizadeh, 2020). That is why regulatory reviewers use heuristic cues such as cognitive processing shortcuts to improve the quality of their scrutiny. For example, past literature shows that entities with stronger overall corporate governance are less likely to be interred in a regulatory review process (e.g., Cassell et al., 2019; Cunningham et al., 2020). In psychology, the cognitive processing shortcuts are mental, simple, and efficient cues, which people usually employ to form judgments and make decisions (e.g., Lewis, 2008). Audit committee attributes may be a significant cognitive shortcut, as the audit committee is regarded as a key corporate governance mechanism responsible for overseeing the

corporate reporting. Audit committee attributes, such as independence and financial expertise, significantly influence corporate reporting (e.g., Bédard & Paquette, 2021). Hence, the perceived attributes of audit committees, namely independence and financial expertise are presumed to influence regulatory scrutiny (Alderman & Jollineau, 2020; Shroff, 2020).

Particularly, financial expertise is regarded as a significant attribute that influences the financial reporting process. However, theoretical and empirical studies provide mixed evidence on how financial expertise affects the financial reporting process. Thus, there are two competing arguments about how audit committee financial expertise influences regulatory scrutiny. On the one hand, audit committees with higher financial expertise tend to evaluate the accuracy of estimates and proper application of accounting policies and understand the audit process. As such, a greater level of financial expertise enforces corporate reporting (e.g., Bilal et al., 2018), resulting in fewer comment letters from regulatory reviewers. On the other hand, audit committee members' knowledge of particular accounting standards, internal control, and audit processes is likely to provide an opportunity for financial statements misstatements (e.g., Alderman & Jollineau, 2020), leading to more comment letters from regulatory reviewers. Thus, based on these discussions, the financial expertise of the audit committee may have positive or negative impacts on regulatory scrutiny. Accordingly, the first hypothesis is unidirectionally developed as follows:

> H1: There is a significant relationship between audit committee financial expertise and regulatory scrutiny.

An audit committee with independent members can play an important role in balancing differences of opinions between management and auditor and accordingly enhance the financial reporting process (Chy & Hope, 2021; Kronenberger, Kronenberger, & Ye, 2020). For instance, Kronenberger et al. (2020) theoretically highlight that the role of audit committee independence is to reduce disagreements between managers and external auditors. Extant empirical studies in both developed and emerging economies have shown that audit committees with independent members add considerable value to management and stakeholders (e.g., Al-Hadrami, Rafiki, & Sarea, 2020; Mohammad et al., 2020). In addition, it is well known that audit committees with independent members are significant in enhancing the auditor's independence. Relatedly, Alderman and Jollineau (2020) argue that the audit committee could be seen as essentially acting in the management's best interest when overseeing corporate reporting if the audit committee is not considered independent of management. These positive impacts of audit committee independence on the quality of financial statements and auditor independence probably reduce regulatory scrutiny. In this respect, there is indirect empirical evidence supporting this claim. Thus, based on the discussions above, this paper forms its second hypothesis as below:

> H2: There is a significant positive relation between audit committee independence and regulatory scrutiny.

As previously mentioned, audit committees with financial experts and independent members are expected to significantly participate in improving corporate reporting quality and external auditor's independence and quality (e.g., Bala, Amran, & Shaari, 2019; Chy & Hope, 2021; Piot & Janin, 2007). However, we know little about the moderating role of audit committee independence on their financial expertise (e.g., Liu, Lobo, & Yu, 2020). This moderating role is important, especially in the context of our research question. Consistent with theoretical arguments supporting the first hypothesis, the financial expertise of audit committees is regarded as a "double-edged sword" as it likely provides an obstacle *or* opportunity for fraudulent financial reporting, and hence, regulatory scrutiny. Theoretically, this paper expects that when regulatory reviewers perceive audit committees as independent of management, they are more likely to rely on audit committee members' financial expertise. Previous literature shows that when audit committee members are independent, audit committees' negative influence on auditor's decisions is lower. Audit committees comprised of financial experts but less independent members are likely to make regulatory reviewers perceive corporate reporting quality as impaired (Alderman & Jollineau, 2020). Borrowing heuristic cues theory from psychology (Hesarzadeh & Rajabalizadeh, 2020), regulatory reviewers use some heuristic cognitive cues while conducting their oversight role and choosing firms for regulatory security. Reasonably, it can be argued that when audit committees appear to be independent of management, the presence of financial experts on their members is likely to provide a more positive heuristic cognitive cue and thus, reduce regulatory scrutiny. This leads to the following hypothesis:

> H3: Audit committee independence moderates the relationship between the financial expertise of audit committees and regulatory scrutiny.

METHOD

Sample

The research sample focuses on Iran's capital market, namely Tehran Securities Exchange (TSE), for the period 2011 to 2019. The initial research sample comprises 2,853 firm-years observations. This paper excludes financial/utility firms (1,242 observations) because of the dissimilarity in various metrics (e.g., Bills et al., 2020; Yao & Xue, 2019). The paper further eliminates company-years (990 observations) with low trade levels (less than 20 trades) and company-years lacking the essential data to measure research variables. The final sample includes 621 observations, including 137 CL observations and 484 non-CL observations.

MEASURING VARIABLES

Financial expertise/independence of audit committee

Based on past research (e.g., Bilal et al., 2018; Lee & Park, 2019), the measure of financial expertise of audit committees (*Expert*) is defined as the proportion of financial expert members on the

firm's audit committee. Furthermore, the measure of audit committee independence (*Indep*) is defined as the percentage of independent members on the company's audit committee.

Regulatory scrutiny

Following extensive relevant works (e.g., Cassell, Dreher, & Myers, 2013; Cassell et al., 2019; Cunningham et al., 2020), this paper operationalizes the regulatory scrutiny on firms by SEO CL. Specifically, the CL (*CL*), is coded as "1" ("0") if a firm receives (does not receive) a CL on the corporate reports in year t.

Test models

As previously mentioned, consistent with *H1* and *H2*, this paper examines whether the financial expertise and independence of audit committees affect regulatory scrutiny. Thus, the predicted variable is regulatory scrutiny (*CL*). Moreover, the test variables are the financial expertise of audit committees (*Expert*) and audit committee independence (*Indep*). The paper assesses the statistical relationship between *CL* and both *Expert* and *Indep* by estimating this regression:

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_2 Indep_{it} + \gamma_3 EM_{it} + \gamma_4 ICW_{it} + \gamma_5 Rest_{it} + \gamma_6 Vol_{it} + \gamma_7 MC_{it} + \gamma_8 Age_{it} + \gamma_9 Loss_{it} + \gamma_{10} ROA_{it} + \gamma_{11} BR_{it} + \gamma_{12} SG_{it} + \gamma_{13} EF_{it} + \gamma_{14} Big_{it} + \gamma_{15} AT_{it} + \gamma_{16} IO_{it} + \gamma_{17} Dual_{it} + \gamma_{18} CP_{it} + \gamma_{19} BIndep_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it} \quad (1)$$

In the logistic regression above, based on prior work – see, for example, Cassell et al. (2013; 2019) for a detailed discussion of this issue – this study includes diverse control variables that affect CL. These control variables are categorized under four general dimensions, including financial reporting, corporate governance, corporate characteristics, and internal control quality.

Furthermore, consistent with *H3*, this study examines whether audit committee independence moderates the association of financial expertise of audit committees and regulatory scrutiny. Thus, this study empirically examines the relation between CL and the "interaction of financial expertise and independence of audit committees." Technically, the paper assesses the moderating roles of audit committee independence (*Indep*) by estimating this regression:

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_2 Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it} \quad (2)$$

In the logistic regressions above, Controls include all control variables in Equation (1). Notably, to decrease the impact of outliers on results, observations are winsorized at 1% of continuous distributions.

This paper defines all variables in Exhibit 1.

Exhibit 1. Definition of variables

Variable	Definition
Regulatory scrutiny = CL	1= Company received an SEO CL in year t, 0 = otherwise
Expert	The percentage of financial expert members on the company's audit committee
Indep	The percentage of independent members on the company's audit committee
Control variables:	
AT	Auditor tenure in years
EM	The earnings manipulations computed exactly as in Dechow et al. (1995)
Age	The number of years the company has been listed on TSE
BIndep	The percentage of independent (non-executive) directors
BR	1= Altman's Z score (DeFond & Hung, 2003) is greater than median, 0= otherwise
Big	1= auditor is a big audit firm, 0= otherwise
CP	1= CFO is an executive director, 0= otherwise
Dual	1= CEO is the chairman of the board of directors, 0= otherwise
EF	Sum of external financing (equity + debt) divided by total assets
Vol	The volatility of daily returns for the year t
IO	The percentage of shares owned by institutional investors
Loss	1= operational profit is negative, 0= otherwise
MC	Market capitalization, i.e., Ln (the number of shares outstanding × share price)
ICW	1= audit report is revealed an internal control weakness in year t, 0= otherwise
Rest	1= company with restatement, 0= otherwise
ROA	Operational profit divided by total assets
SG	Change in sales from year t-1to year t

Note: This box describes the measurement of variables. This paper acquires the SEO comment letter information from the SEO's Division of Auditing and Corporate Reporting. The data for the other variables are retrieved from the Rahavard-e-Novin software. The data are also available at the CODAL, i.e., the Iranian Comprehensive Database Of All Listed Companies (www.codal.ir).

EMPIRICAL FINDINGS

Univariate analysis

Table 1 displays the basic features of variables. As shown in the table, the average of *Expert* is approximately 48% and 45% for two subsamples: CL companies (*CL*= 1) and no-CL companies (*CL*= 0), respectively. The statistically insignificant difference (p-value = 0.396) between the two subsamples reveals that audit committee financial expertise is not higher for the two subsamples.

Similarly, the average of *Indep* is approximately 46% and 82% for the two subsamples, and this difference is statistically significant (p-value=0.031), indicating that audit committee independence is likely higher for the no-CL companies. The table further displays that the average of internal control weakness (*ICW*), the restatement of financial statements (*Rest*), external financing (*EF*), audit tenure (*AT*), CEO duality (*Dual*), and board independence (*BIndep*) are significantly different between the two subsamples.

Table 1. Descriptive statistics

	CL= 1					*CL= 0*					
	Mean	Median	S.D	Max	Min	Mean	Median	S.D	Max	Min	p-value
Expert	0.476	0.330	0.404	1.000	0.000	0.454	0.660	0.404	1.000	0.000	0.396
Indep	0.460	0.330	0.380	1.000	0.000	0.816	1.000	0.380	1.000	0.000	0.028**
EM	-0.005	0.020	0.098	0.200	-0.313	0.005	0.005	0.098	0.220	-0.313	0.218
ICW	0.263	0.000	0.442	1.000	0.000	0.060	0.000	0.442	1.000	0.000	0.000***
Rest	0.212	0.000	0.410	1.000	0.000	0.066	0.000	0.410	1.000	0.000	0.000***
Vol	0.015	0.008	0.016	0.106	0.000	0.013	0.007	0.018	0.116	0.000	0.918
MC	11.625	11.740	1.689	16.540	8.234	11.771	11.620	1.689	16.668	8.234	0.578
Age	21.812	21.000	10.042	50.000	10.000	21.236	19.000	10.348	51.000	6.000	0.946
Loss	0.088	0.000	0.284	1.000	0.000	0.099	0.000	0.284	1.000	0.000	0.345
ROA	0.157	0.150	0.163	0.520	-0.514	0.157	0.152	0.158	1.320	-0.520	0.378
BR	0.511	1.000	0.502	1.000	0.000	0.486	0.000	0.502	1.000	0.000	0.620
SG	0.784	0.264	1.966	11.720	-0.990	0.789	0.170	1.966	14.270	-0.990	0.893
EF	0.028	0.000	0.087	0.420	-0.130	0.021	0.000	0.087	0.620	-0.130	0.099*
Big	0.373	0.000	0.386	1.000	0.000	0.399	0.000	0.460	1.000	0.000	0.201
AT	2.595	4.000	2.056	9.000	1.000	3.871	4.000	2.003	11.000	1.000	0.058*
IO	73.503	80.660	24.410	98.480	9.180	72.581	80.660	23.596	95.574	8.180	0.993
Dual	0.160	0.000	0.368	1.000	0.000	0.045	0.000	0.208	1.000	0.000	0.000***
CP	0.109	0.000	0.313	1.000	0.000	0.121	0.000	0.327	1.000	0.000	0.236
BIndep	0.592	1.000	0.396	1.000	0.000	0.879	1.000	0.340	1.000	0.000	0.085*
N	137					484					

Note: This table reports summary statistics of predicted/test/control variables.

Definition of variables: *CL* is a binary variables coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee; *EM* reflects the earnings manipulations computed exactly as in Dechow et al. (1995); *ICW* is a binary variables coded one when the audit report is revealed an internal control weakness; *Rest* is a binary variables coded one for a company with restatement; *Vol* denotes the volatility of daily returns; *MC* is market capitalization, i.e., Ln (the number of shares outstanding × share price); *Age* is the number of years the company has been listed on TSE; *Loss* equals one when the operational profit is negative; *ROA* is operational profit divided by total assets; *BR* equals one when the Altman's Z score (DeFond & Hung, 2003) is greater than median; *SG* reflects the percentage of the changes in annual sales; *EF* equals external financing divided by total assets; *Big* equals one if the auditor is a big audit firm; *AT* denotes auditor tenure in years; *IO* is the percentage of shares owned by institutional investors; *Dual* equals one if CEO is the chairman of the board of directors; *CP* equals one if the CFO is an executive director; *BIndep* reflects the percentage of independent directors.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

MULTIVARIATE ANALYSIS

Test of *H1* and *H2*

H1 and *H2* predict that audit committee financial expertise and independence are associated with CL. Table 2 shows related empirical findings. The statistics on the goodness of fit — including Cox and Snell, Nagelkerke, p-value on the Hosmer-Lemeshow, and ROC curve — show that the test model fits the data well and is comparable to prior research (e.g., Cassell et al., 2013, 2019). Further, all VIFs are smaller than 2.7, with a mean score of 1.5; hence, multicollinearity is a minor concern.

Moreover, the relationship between *Expert* and *CL* is statistically insignificant (p-value = 0.138). Hence, inconsistent with *H1*, higher audit committee financial expertise is not generally associated with CL. This paper will provide further evidence on this issue in the next section.

The findings show that the relationship between *Indep* and *CL* is statistically significant (p-value = 0.017). Moreover, this association is negative (-1.988), suggesting that the higher *Indep* correlated with less *CL*. Thus, consistent with hypothesis *H2*, firms enjoying more audit committee independence are less likely to receive a CL.

Evidence also shows that, comparable to the literature (e.g., Cassell et al., 2013), internal control weakness (*ICW*; p-value = 0.000) and restatement (*Rest*; p-value = 0.000) are significantly linked to *CL*. Therefore, generally, reporting/internal control quality may affect the CL. The evidence shows that some firm features, such as market capitalization (*MC*; p-value = 0.035) and return on assets (*ROA*; p-value = 0.056) are linked to *CL*. In addition, the evidence demonstrates that firms with higher external financing (*EF*; p-value = 0.045) experience less *CL*. The CEO duality (*Dual*; p-value = 0.009) and board independence (*BIndep*; p-value = 0.046) also have a significant association with *CL*, collectively suggesting that strong corporate governance may decrease *CL*. The results are comparable to the findings of Cassell et al. (2013), who suggest that financial reporting, corporate governance, quality of internal control, and corporate features may affect CL.

Table 2. Audit committee characteristics and CL

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_2\ Indep_{it} + \sum_{\gamma k}\mathbf{Controls}_{it} + \sum_{\gamma i}\mathbf{Firm}_{i} + \sum_{\gamma t}\mathbf{Year}_{t} + \varepsilon_{it}$$

Indep.Var	Exp.	Coef.	VIF	p-value
Expert	?	0.483	1.262	0.138
Indep	-	-1.988**	1.654	0.017
Controls:				
EM	+	2.743	2.083	0.102
ICW	+	2.073***	1.151	0.000

Continue

Table 2. Audit committee characteristics and CL

Concludes

$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_2\ Indep_{it} + \sum_{\gamma k}\mathbf{Controls}_{it} + \sum_{\gamma i}\mathbf{Firm}_i + \sum_{\gamma t}\mathbf{Year}_t + \varepsilon_{it}$				
Indep.Var	Exp.	Coef.	VIF	p-value
Rest	+	1.482***	1.104	0.000
Vol	+	-1.534	1.120	0.814
MC	+	-0.186**	1.299	0.035
Age	+	0.019	1.283	0.131
Loss	+	-0.585	1.625	0.276
ROA	+	2.648*	1.534	0.056
BR	+	0.606*	1.710	0.057
VA	+	-0.038	1.157	0.448
SG	+	1.240**	1.657	0.045
Big	-	-0.548	1.686	0.104
AT	-	-0.103	1.284	0.250
IO	-	-0.008	1.093	0.167
Dual	+	1.254***	1.283	0.009
CP	+	-0.121	2.698	0.803
BIndep	-	-0.148**	1.068	0.046
Constant		1.382		0.263
$\sum\gamma_i$Firm$_i$	Included			
$\sum\gamma_t$Year$_t$	Included			
N	621			
Cox and Snell	31%			
Nagelkerke	45%			
Hosmer-Lemeshow p-value	0.341			
ROC curve	81%			

Note: This table displays the logistic estimation of CL (*CL*) on audit committee financial expertise (*Expert*) and audit committee independence (*Indep*).

Definition of variables: *CL* is a binary variables coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee; *EM* reflects the earnings manipulations computed exactly as in Dechow et al. (1995); *ICW* is a binary variables coded one when the audit report is revealed an internal control weakness; *Rest* is a binary variables coded one for a company with restatement; *Vol* denotes the volatility of daily returns; *MC* is market capitalization, i.e., Ln (the number of shares outstanding × share price); *Age* is the number of years the company has been listed on TSE; *Loss* equals one when the operational profit is negative; *ROA* is operational profit divided by total assets; *BR* equals one when the Altman's Z score (DeFond & Hung, 2003) is greater than median; *SG* reflects the percentage of the changes in annual sales; *EF* equals external financing divided by total assets; *Big* equals one if the auditor is a big audit firm; *AT* denotes auditor tenure in years; *IO* is the percentage of shares owned by institutional investors; *Dual* equals one if CEO is the chairman of the board of directors; *CP* equals one if the CFO is an executive director; *BIndep* reflects the percentage of independent directors.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

Test of *H3*

Consistent with *H3*, this paper predicts that audit committee independence moderates the association of audit committee financial expertise and CL. Table 3 presents the empirical evidence. The findings demonstrate that the coefficients of both *Expert* and *Indep* are significant (p-value= 0.000 & 0.002). The coefficients on *Expert* and *Indep* are positive (1.305) and negative (-1.182), respectively. These coefficients represent the "conditional effect" of *Expert* and *Indep*, as coefficients on *Expert* is conditional on the level of *Indep*, and vice versa (see, for example, Burks, Randolph, and Seida (2019) for detailed discussions). The evidence further shows the coefficient on "*Expert* × *Indep*" is significant (p-value= 0.000) showing that consistent with *H3*, audit committee independence moderates the relation between CL and audit committee financial expertise. Notably, the significant positive conditional effect of *Expert* on *CL* (=1.305) and negative coefficient on interaction (= -1.525) shows that, first, when audit committee independence is very weak (i.e., close to zero), higher audit committee financial expertise is associated with more regulatory scrutiny. Second and more importantly, when audit committee independence is high, the estimated conditional influence of *Expert* is about -0.220 (=1.305 - 1.525), indicating that audit committee financial expertise is associated with less regulatory scrutiny. Thus, findings indicate that audit committee financial expertise might increase (decrease) regulatory scrutiny as audit committee independence is low (high).

Table 3. Moderating role of audit committee independence

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k \mathbf{Controls}_{it} + \sum \gamma_i \mathbf{Firm}_i + \sum \gamma_t \mathbf{Year}_t + \varepsilon_{it}$$

Indep.Var	Exp.	Coef.	p-value
Expert	?	1.305**	0.000
Indep	-	-1.182***	0.002
Expert×*Indep*	-	-1.525***	0.000
$\sum \gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum \gamma_i Firm_i$	Included		
$\sum \gamma_t Year_t$	Included		
N	621		
Cox and Snell	33%		
Nagelkerke	48%		
Hosmer-Lemeshow p-value	0.386		
ROC curve	84%		

Note: This table displays the logistic estimation of CL (*CL*) on the interaction of audit committee financial expertise and audit committee independence (*Expert* × *Indep*).

Definition of variables: *CL* is a binary variable coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee. Controls reflect control variables as defined in Box 1.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

ROBUSTNESS ANALYSIS

Difference-in-differences analysis

This paper uses a difference-in-differences approach to address concerns stemming from non-random treatment effects in our statistical analysis. First, we developed dichotomous versions of both test variables, i.e., financial expertise and independence of audit committee, based on their median values. Second, we estimated the logistic regression of the dichotomous variables on the variables that largely influence financial expertise and independence of audit committee, including the percentage of independent directors, CEO duality, the percentage of shares owned by institutional investors, market capitalization, and the previous restatement of financial statements (e.g., Adams & Neururer, 2020; Broye & Johannes, 2021). Third, we calculated the fitted values for all observations, and matched each observation to an observation with the closest fitted value in the same year and industry, following prior research (e.g., Cunningham et al., 2020; Shipman, Swanquist, & Whited, 2017). Finally, we re-tested *H1* to *H3*. Table 4 briefly represents the results. Particularly, Panel A (B) reports the findings concerning the re-examination of *H1* and *H2* (*H3*). The findings, consistent with previous results, reveal that the association of CL and financial expertise (independence of audit committee) is not (is) statistically significant —i.e., p-value = 0.539 (0.007). Moreover, the results in the second panel show that audit committee independence moderates the relationship between the financial expertise of audit committee and regulatory scrutiny (p-value = 0.000). Collectively, the results are consistent with the previous findings, suggesting that the potential non-random treatment effects do not significantly influence main results.

Table 4. Difference-in-differences analysis

Panel A. Audit committee characteristics and CL

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_2 Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$$

Indep.Var	Exp.	Coef.	p-value
Expert	?	0.215	0.539
Indep	-	-1.073***	0.007
$\sum \gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum \gamma_i Firm_i$	Included		
$\sum \gamma_t Year_t$	Included		
N	284		
Cox and Snell	23%		
Nagelkerke	30%		
Hosmer-Lemeshow p-value	0,185		
ROC curve	77%		

Continue

Table 4. Difference-in-differences analysis

Concludes

Panel B. Moderating role of audit committee independence

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$$

Indep.Var	Exp.	Coef.	p-value
Expert	?	1.007**	0.038
Indep	-	-1.679**	0.016
Expert×*Indep*	-	-1.857***	0.000
$\sum \gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum \gamma_i Firm_i$	Included		
$\sum \gamma_y Year_t$	Included		
N	284		
Cox and Snell	26%		
Nagelkerke	37%		
Hosmer-Lemeshow p-value	0,216		
ROC curve	79%		

Note: In this table, employing difference-in-differences analysis, Panel A reports the results concerning the re-examination of the relationship between CL (*CL*), audit committee financial expertise (*Expert*) and audit committee independence (*Indep*). Similarly, Panel B reports the results concerning the re-examination of the moderating effect of audit committee independence (*Indep*).

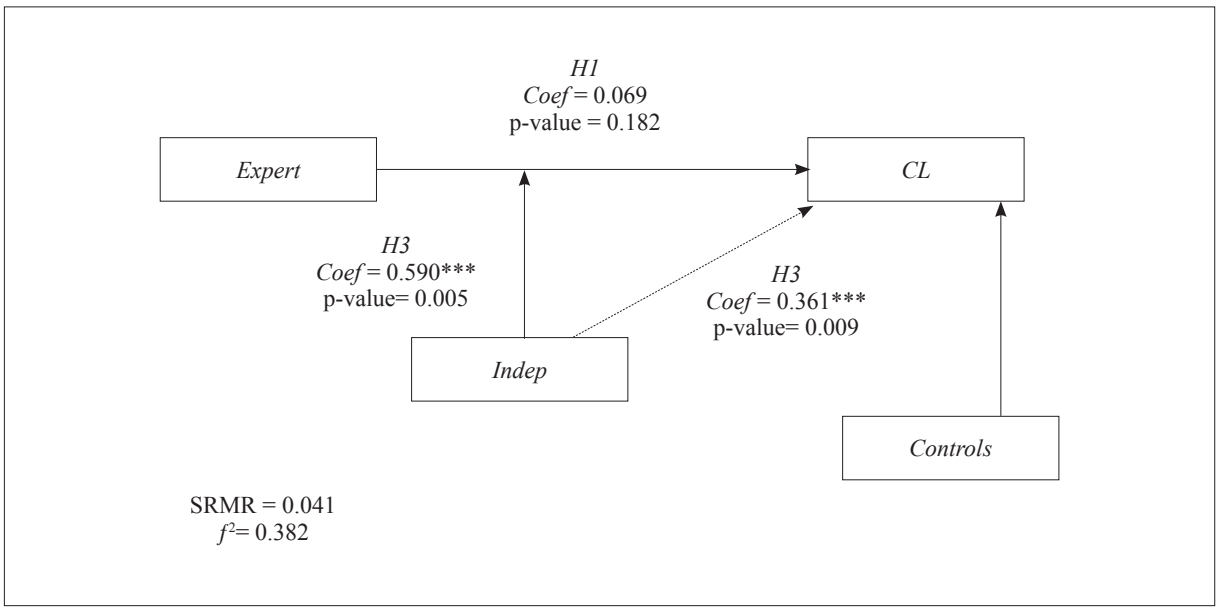
Definition of variables: *CL* is a binary variable coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee. Controls reflect control variables as defined in Exhibit 1.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

Structural equation modeling

Gow, Larcker, and Reiss (2016) argue that accounting research would benefit from structural equation modeling (SEM) to better draw causal inferences. Hence, as a robustness analysis, we employed SEM and re-examined *H1* to *H3*. Figure 1 displays the results. Standardized Root Mean Square Residual (SRMR) is 0.041, which is less than 0.08 degrees, indicating an appropriate goodness of fit (Henseler & Sarstedt, 2013). Furthermore, consistent with previous results, the path analysis suggests that there is not (is) a significant association between financial expertise (independence) of audit committee and CL. In addition, the figure shows a significant moderating effect (p-value = 0.005) for independence (*Indep*).

Figure 1. Structural equation modeling



Note: This figure outlines the association of audit committee financial expertise (*Expert*), audit committee independence (*Indep*), and CL (*CL*).

Definition of variables: *CL* is a binary variable coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee. Controls reflect control variables as defined in Exhibit 1.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

Out-of-sample analysis

To avoid the potential bias inherent in our in-sample prediction, following prior literature (e.g., Canela, Alegre, & Ibarra, 2019), we conducted an out-of-sample evaluation. We re-test *H1* to *H3* in year 2020. Table 5 briefly shows the results. Panel A (B) reports the results concerning the re-examination of *H1* and *H2* (*H3*). The results, consistent with previous findings, reveal that the relationship between CL and financial expertise (independence) is not (is) statistically significant — i.e., p-value = 0.689 (0.012). The results further show that audit committee independence significantly moderates the association of financial expertise and regulatory scrutiny (p-value = 0.009). Hence, the evidence from this out-of-sample analysis is consistent with previous results.

Table 5. Out-of-sample analysis

Panel A. Audit committee characteristics and CL

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_2 Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$$

Indep.Var	Exp.	Coef.	p-value
Expert	?	0.103	0.689
Indep	-	-0.563**	0.012

Continue

Table 5. Out-of-sample analysis

Concludes

$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_2 Indep_{it} + \sum\gamma_k Controls_{it} + \sum\gamma_i Firm_i + \sum\gamma_t Year_t + \varepsilon_{it}$			
Indep.Var	Exp.	Coef.	p-value
$\sum\gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum\gamma_i Firm_i$	Included		
$\sum\gamma_t Year_t$	-		
N	102		
Cox and Snell	20%		
Nagelkerke	28%		
Hosmer-Lemeshow p-value	0,142		
ROC curve	75%		

Panel B. Moderating role of audit committee independence

$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum\gamma_k Controls_{it} + \sum\gamma_i Firm_i + \sum\gamma_t Year_t + \varepsilon_{it}$			
Indep.Var	Exp.	Coef.	p-value
Expert	?	0.716**	0.047
Indep	-	-0.783**	0.024
Expert×*Indep*	-	-0.995***	0.009
$\sum\gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum\gamma_i Firm_i$	Included		
$\sum\gamma_t Year_t$	-		
N	102		
Cox and Snell	22%		
Nagelkerke	31%		
Hosmer-Lemeshow p-value	0,192		
ROC curve	78%		

Note: In this table, H1 to H3 are tested using an out-of-sample period, i.e., year 2020. Panel A reports the results concerning the re-examination of the relationship between CL (*CL*), audit committee financial expertise (*Expert*) and audit committee independence (*Indep*). Similarly, Panel B reports the results concerning the re-examination of the moderating effect of audit committee independence (*Indep*).

Definition of variables: *CL* is a binary variable coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee. Controls reflect control variables as defined in Exhibit 1.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

SUPPLEMENTAL ANALYSIS

The impact of agency conflicts

Managers may follow opportunistic behaviors under lower or higher agency conflicts (e.g., Areneke, Yusuf, & Kimani, 2019). Thus, the different levels of agency conflicts might give diverse heuristic cues for regulatory reviewers, in the sense that regulatory reviewers are more or less likely to rely on the independence of audit committees as a significant determinant of corporate reporting. Therefore, consistent with the arguments presented in support of the third hypothesis, this paper predicts that the moderation influence of audit committee independence on the link between the financial expertise of audit committees and regulatory scrutiny is stronger (weaker) under higher (lower) agency conflicts. To provide empirical evidence on this conjecture, the sample in this study is categorized into two groups of company-year: (1) Company-years face high agency problem; and (2) Company-years face low agency conflicts. Then, The Test Model was re-estimated. Notably, to measure agency conflicts, following past studies (e.g., Judd, Olsen, & Stekelberg, 2017), this study operationalizes agency problem by the aggregation of five binary variables: CEO duality, low independent directors, high external block holders, CEO Narcissism, and corporate governance quality. Consequently, observations with codes 0 to 2 (3 to 5) are considered as observations having low (high) agency conflicts.

Table 6 reports the results. Panel A (B) displays the moderation effect of audit committee independence on the relation between CL and audit committee financial expertise for firms with high (low) agency conflicts. As shown in the panels, the coefficient on "*Expert* × *Indep*" is significant in both panels. However, the coefficient in Panel B (-1.738) is significantly stronger than the equivalent in Panel A (-0.683), which is also represented by an untabulated significant p-value on Z-test (p-value = 0.016). This points out that the moderation effect of audit committee independence on the link between the financial expertise of audit committees and regulatory scrutiny is stronger under higher agency conflicts.

Table 6. The moderation effect of audit committee independence under low versus high agency conflicts
Panel A. Company-years with low agency conflicts

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$$

Indep.Var	Exp.	Coef.	p-value
Expert	?	0.125	0.431
Indep	-	-0.645*	0.058
Expert×*Indep*	-	-0.683**	0.045
$\sum \gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum \gamma_i Firm_i$	Included		
$\sum \gamma_t Year_t$	Included		

Continue

Table 6. The moderation effect of audit committee independence under low versus high agency conflicts

Concludes

$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$			
Indep.Var	Exp.	Coef.	p-value
N	298		
Cox and Snell	25%		
Nagelkerke	36%		
Hosmer-Lemeshow p-value	0.241		
ROC curve	79%		

Panel B. Company-years with high agency conflicts

$CC_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$			
Indep.Var	Exp.	Coef.	p-value
Expert	?	-0.984*	0.057
Indep	-	-1.084**	0.039
Expert×*Indep*	-	-1.738***	0.000
$\sum \gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum \gamma_i Firm_i$	Included		
$\sum \gamma_t Year_t$	Included		
N	298		
Cox and Snell	30%		
Nagelkerke	43%		
Hosmer-Lemeshow p-value	0,329		
ROC curve	81%		

Note: This table displays the logistic estimation of CL (*CL*) on the interaction of audit committee financial expertise and audit committee independence (*Expert* × *Indep*) in two sub-sample: firms with high agency problem versus companies with low agency conflicts.

Definition of variables: *CL* is a binary variable coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee. *Agency conflicts* is calculated by the aggregation of five binary variables: CEO duality, low independent directors, high external block holders, CEO Narcissism, and corporate governance quality. Controls reflect control variables as defined in Exhibit 1.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

The influence of regulatory reviewers' workload compression

In line with the heuristic cues theory from psychology (Bazerman, 2017), under workload compression, regulatory reviewers are more likely to explore heuristic cues to fast and efficiently conclude whether auditing is high quality. In this situation, regulatory reviewers are more likely to rely on the independence of audit committees as a significant determinant of financial reporting. Hence, consistent with the arguments presented in support of the third hypothesis, this paper expects that the moderation impact of audit committee independence on the link between the financial expertise of audit committees and regulatory scrutiny is stronger (weaker) under higher (lower) regulatory reviewers' workload compression. To provide empirical evidence on this issue, the sample in this study is categorized into two groups of companies (company-year): (1) companies with an *Esfand* — the last month of Iranian calendar — fiscal year-end (i.e., high workload pressure sample); and (2) companies with a non-*Esfand* fiscal year-end (i.e., low workload pressure sample). Then, we re-estimate the Test Model (2).

Table 7 reports the results. Panel A (B) displays the moderation impact of audit committee independence on the link between CL and audit committee financial expertise for the firms with an Esfand (a non-Esfand) fiscal year-end (i.e., high (low) workload pressure sample). As shown in the planes, the coefficient on "*Expert* × *Indep*" is significant in both panels. However, the coefficient in Panel A (-1.936) is significantly stronger than the equivalent in Panel B (-1.154). In this respect, the untabulated test also reveals a significant p-value on Z-test at 5%. This suggests that the moderation effect of audit committee independence on the relationship between the financial expertise of audit committees and regulatory scrutiny is stronger under higher regulatory reviewers' workload compression.

Table 7. The moderation effect of audit committee independence under high versus low regulatory reviewers' workload compression

Panel A. firms with an Esfand fiscal year-end

$$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k \mathbf{Controls}_{it} + \sum \gamma_i \mathbf{Firm}_i + \sum \gamma_t \mathbf{Year}_t + \varepsilon_{it}$$

Indep. Var.	Exp.	Coef.	p-value
Expert	?	1.466***	0.000
Indep	-	-1.455***	0.000
Expert×*Indep*	-	-1.936***	0.000
$\sum \gamma_k \mathbf{Controls}_{it}$	Included		
Constant	Included		
$\sum \gamma_i \mathbf{Firm}_i$	Included		
$\sum \gamma_t \mathbf{Year}_t$	Included		

Continue

Table 7. The moderation effect of audit committee independence under high versus low regulatory reviewers' workload compression

Concludes

$CL_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum \gamma_k Controls_{it} + \sum \gamma_i Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$			
Indep. Var.	Exp.	Coef.	p-value
N	432		
Cox and Snell	36%		
Nagelkerke	51%		
Hosmer-Lemeshow p-value	0.593		
ROC curve	87%		

Panel B. Companies with a non-Esfand fiscal year-end

$CC_{it} = \gamma_0 + \gamma_1 Expert_{it} + \gamma_{21} Indep_{it} + \gamma_{22} Expert_{it} \times Indep_{it} + \sum_{\gamma k} Controls_{it} + \sum_{\gamma i} Firm_i + \sum \gamma_t Year_t + \varepsilon_{it}$			
Indep.Var	Exp.	Coef.	p-value
Expert	?	0.983**	0.024
Indep	-	-1.468**	0.038
Expert×*Indep*	-	-1.154***	0.008
$\sum \gamma_k Controls_{it}$	Included		
Constant	Included		
$\sum \gamma_i Firm$	Included		
$\sum \gamma_t Year_t$	Included		
N	189		
Cox and Snell	30%		
Nagelkerke	43%		
Hosmer-Lemeshow p-value	0.303		
ROC curve	80%		

Note: This table displays the logistic estimation of CL (*CL*) on the interaction of audit committee financial expertise and audit committee independence (*Expert* × *Indep*) in two sub-sample: companies with an Esfand fiscal year-end versus companies with a non-Esfand fiscal year-end.

Definition of variables: *CL* is a binary variable coded one for firms that receive an SEO comment letter; *Expert* denotes the percentage of financial expert members on the company's audit committee; *Indep* is the percentage of independent members on the company's audit committee. Workload compression is operationalized by companies with an Esfand – the last month of the Iranian calendar – fiscal year-end (i.e., high workload pressure sample). Controls reflect control variables as defined in Exhibit 1.

p-value: ***p < 0.01, **p < 0.05, *p < 0.1.

CONCLUSION

Prior research provides mixed evidence on how financial expertise affects the corporate reporting process and, thus, regulatory scrutiny. This paper suggests that audit committees' independence has a moderating role in the association of financial expertise and regulatory scrutiny. Specifically, the paper shows that audit committee financial expertise can increase (decrease) regulatory scrutiny when the independence of audit committees is low (high). Furthermore, supplemental findings show that this interactive effect is stronger under higher agency conflicts and regulatory reviewers' workload compression. Collectively, the results suggest that, first, audit committees' financial expertise and independence have to be analyzed together as independence moderates the advantage of expertise. Second, the consideration of regulators' workload pressure and agency conflicts is essential in this analysis. The findings of this study may be useful for diverse parties in capital markets. For example, consistent with results, shareholders and boards of directors may reduce their regulatory costs by concentrating on the composition and attributes of audit committees, namely financial expertise and independence, as these factors impact corporate reporting and regulatory scrutiny.

Nevertheless, our paper faces important limitations. First, the sample in this research is homogeneous and focuses on one capital market. While the capital market is comparable to most large developing capital markets, the generalizability of our results to all developing markets cannot be overstated. Second, CL does not reflect all of the regulatory review risks. Thus, readers need to exercise caution when using the findings.

NOTA

Iran's market capitalization and GDP were about USD 106 and 445 billion in 2017. The equivalent numbers were about 19 and 235 for Egypt, 100 and 210 for Kuwait, 445 and 954 for Brazil, and 888 and 1300 for Spain.

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AUTHOR'S CONTRIBUTION

Reza Hesarzadeh worked on the conceptualization and theoretical-methodological approach, as well as theoretical review, data Collection, data analysis, and final revision of the manuscript. Ameneh Bazrafshan worked on the theoretical review, data Collection, as well as writing and final Review. Saher Aqel worked on the theoretical review.