THE IMPACT OF AUDIT COMMITTEE ON FINANCIAL REPORTING QUALITY

Rebaz Mohammed Hussein MOHAMMED,
University of Sulaimani, Sulaimani, Iraq
Rebaz.hussein@univsul.edu.iq

Abstract
The above research papers confirm the fact that the accuracy and credibility of financial reports issued by listed firms are crucial for an efficient and viable stock market. Unfortunately, accounting fraud and other financial market misconduct are prevalent in the global market, and have seriously damaged the interests of shareholders around the world. To prevent this bad phenomenon and to improve investor confidence, governments around the world have implemented a series of reforms to strengthen internal and external corporate governance mechanisms. Many of these regulatory changes have focused on the composition of an audit committee, a board sub-committee in charge of overseeing a firm’s financial reporting process, internal control structure, internal audit functions, and external audit services. Thus, the aim of this paper is to show the relationship between the impacts of audit committee on financial reporting quality. To achieve the objectives of the paper, the researcher relied on reviewing 15 related studies that were published in different journals and by different authors for time periods (2016 - 2020).

Keywords: Audit Committee, Financial Reporting Quality, Credibility.

DOI: 10.31039/jgeb.v3i11.91

1. Introduction
The accuracy and credibility of financial reports issued by listed firms are crucial for an efficient and viable stock market (Rashid, 2019 and Sabir, 2022). Unfortunately, accounting fraud and other financial market misconduct are prevalent in the global market, and have seriously damaged to prevent financial misconduct and to improve investor confidence, governments around the world have implemented a series of reforms to strengthen internal and external corporate governance mechanisms (Mustafa et al., 2022). Many of these regulatory changes have focused on the composition of an audit committee.
committee, a board sub-committee in charge of overseeing a firm’s financial reporting process, internal control structure, internal audit functions, and external audit services (Jaf et al., 2019).

The Sarbanes-Oxley Act also specifically states that an audit committee in a listed company should consist entirely of independent directors. In addition, each member of the audit committee must be financially literate with at least one being a financial expert (Rashid, 2018). The primary objective of this paper therefore is to examine factors affecting the effectiveness of audit committees in assuring financial reporting quality and reducing the occurrence of financial restatements in the post-SOX era to explore whether more stringent corporate governance regulations indeed strengthen functions and authority of listed firms’ audit committees beyond bringing symbolic changes to their structure.

Extant studies on audit committees are mostly built on agency theory to examine the committee’s role in mitigating managerial opportunism arising from the separation of ownership and control (Budur et al., 2018; Mohammed et al., 2020). The standard agency model posits a risk-neutral principal (shareholders) who delegates jobs to a risk-averse agent (management) (Sabir, 2022).

Moral hazard occurs when managers act to gain private interests at the cost of shareholders, e.g., by manipulating or misreporting financial statements. A major task of shareholders therefore is to implement effective corporate governance mechanisms to monitor managerial activities or grant management incentives to align their interest with those of shareholders (Rashid, 2020). Consequently, audit committees with certain characteristics are argued to be able to provide higher quality monitoring to reduce information asymmetry, improve financial reporting quality, and ultimately decrease the probability of accounting fraud and misreporting as manifested in financial restatements. Accordingly, most of the studies that have been reviewed on this subject confirmed that the existence of the audit committee has a clear effect on the quality of financial reports. He, Yang, & He, (2018).
2. Literature Review

This study examines the effect of audit committee connectedness through director networks on financial reporting quality, specifically the misstatement of annual financial statements. Using network analysis, this paper examine multiple dimensions of connectedness and find that after controlling for operating performance and corporate governance characteristics, firms with well-connected audit committees are less likely to misstate annual financial statements. In addition, this study demonstrates that audit committee connectedness through director networks moderates the negative effect of board interlocks to misstating firms on financial reporting quality. This study conduct several tests to address identification concerns and find similar results. Findings suggest that firms with better-connected audit committees are less likely to adopt reporting practices that reduce financial reporting quality (Omer, Shelley, & Tice, 2020).

This study examines whether information technology expertise on audit committees impacts the reliability and timeliness of financial reporting. This paper find a reduction in the likelihood of material restatement, a reduction in the likelihood of information technology-related material weaknesses (which account for 55 percent of all reported material weaknesses), and more timely earnings announcements at firms with audit committee information technology expertise. This findings are robust to controlling for a firm's other information technology attributes, as well as when using entropy balanced samples, and mitigate endogeneity concerns with evidence that findings hold in a subsample of firms that all possess overall high-quality information technology. Finally, a difference-in-differences analysis, inclusion of firm fixed effects, and a falsification test largely support assertion that the quality of financial reporting is significantly improved by the presence of an audit committee information technology expert (Ashraf, Michas, and Russomanno, 2020).

This study sought to investigate the effect of the audit committee on Financial Reporting Quality (FRQ), explicitly focuses on the period pre- and post-mandatory IFRS adoption in Malaysia. The Financial Reporting Quality in this study peroxided by earnings management Malaysian. The sample study has covered 81 listed companies on Bursa Malaysia, with 567 observations, which examined the time of 2009 to 2015. The relationship was analyzed by statistical multiple regression linear methods and also examined the significance of differences between pre and post IFRS adoption by paired
sample t-test. The main finding reveals that the relationship between the audit committee and financial reporting quality after IFRS adoption in Malaysia has more significant. However, empirical evidence showed that the post period of mandatory IFRS evidently no significant difference level of earnings management practice. This result indicates that the IFRS adoption cannot reduce managerial discretion yet and the possibility for EM manipulation for Malaysian companies. This finding has critical implications for regulators and policymakers, that the consequences of Firs adoption do not increase the quality of financial reporting when EM practices still continue in the different forms. This study gives empirical evidence that there are differences in relationship level between audit quality and earnings management in the period before and after IFRS mandatory adoption in Malaysia companies (Jatiningrum, Fauzi, and Mujiyati, 2020).

The purpose of the study was to establish the moderating effect of firm characteristics on the association between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya. The study applied secondary data extracted from annual reports and audited financial statements of state-owned commercial enterprises in Kenya for the period between 2008 and 2018 using data capture forms. Several statistics and diagnostic tests were conducted to test the hypotheses including panel data regression models. Baron and Kenny (1986) approach was adopted to test for moderating effect of firm characteristics on the association between audit committee attributes and financial reporting quality. The results reveal that firm characteristics had no significant moderating effect on relationship between audit committee attributes and financial reporting quality of state-owned commercial enterprises in Kenya. However, the results also indicated that firm liquidity had statistically and significantly influenced the relationship between audit committee independence and financial reporting quality. The study focused on the state-owned commercial enterprises in Kenya and therefore, the results might not be representative for the all state-owned entities. Additional studies may be conducted incorporating all state-owned entities for a true reflection on the results. Further, the study also narrowed its data between 2008 and 2018 period. Future studies could be done for all state-owned entities including prior period before 2008 (Watonga et al., 2020).

State-owned Commercial Enterprises This research investigates the relationship between the expertise of female audit committee (AC) chairs and financial reporting
quality (FRQ). Also, it examines the moderating effect of the expertise of AC female chairs on the relationships between internal control (ICS), components of ICS, and FRQ. This study analyses 302 firms listed on the Pakistan Stock Exchange from 2010 to 2016. Data on ICS, FRQ, and other corporate governance indications are collected manually from annual reports. This study concludes that the accounting expertise of AC female chairs enhances FRQ better than their male counterparts. Also, the accounting expertise of AC female chairs improves corporate governance mechanisms and ICSs (i.e., Control Environment, Control Activities, and information and communication). This research offers implications for shareholders and regulators. The accounting expertise of female AC chairs (WACCH) improves monitoring that enhances shareholder value and investor confidence. The regulator needs to be stricter regarding the requirements for AC chairs (Us Din, et al., 2020).

This study investigates whether non-audit service (NAS) purchases are correlated among audit committee (AC) interlocked firms. The then examine whether financial reporting quality and future firm performance vary with the amount of correlated NAS purchases from the AC interlock. We find that firms in the AC interlock have positively correlated NAS for total NAS and three NAS sub-types – Tax, Assurance, and Other – in the overall sample period from 2000-2016, and in the pre-SOX and post-SOX sub-periods. Firms with a larger AC interlocked-NAS component have higher non-reliance restatements, fraud F-score, likelihood of meeting or beating analyst forecasts, and absolute discretionary accruals, lower incidence of internal control material weakness reporting by the auditor, consistent with lower financial reporting quality for such firm. Higher AC-interlocked NAS firms also have lower cumulative ROA in the future three years. Overall, the evidence suggests that AC interlocks encourage NAS contagion, and are associated with poorer financial reporting and poorer future performance. Thus, on net, the evidence is inconsistent with NAS in AC networks providing positive knowledge spillovers to benefit audit quality or firm performance, and instead, is consistent with interlocked-NAS impairing auditor independence (Shi, Teoh, & Zhou, 2020).

The main objective of this work is to study the effect of audit committee attributes on financial reporting quality of listed banks in Nigeria from 2009-2018. Expost facto research design is used and the data for analysis are obtained from annual reports of the sampled banks. 12 out of 13 banks is selected using Taro Yamani formula for determining...
sample size. Data is analysed using descriptive statistics, correlation and ordinary least square technique. The findings reveal that a well constituted as well as independent audit committee significantly influence financial reporting quality of listed Nigerian banks. The study also reveals that audit committee frequency of meeting may not influence financial reporting quality. This study recommends among that Nigerian bank should ensure that their audit committee as a matter of necessity update their functionality through regular training in order to meet up world class benchmark as what is obtainable in more advanced economies (Akpan & Nsenti, 2020).

This study has empirically provided evidence on the degree of relationship between audit committee characteristics peroxide by audit committee meeting, audit committee independence and audit committee financial expertise, and quality of financial reporting peroxide by discretionary accruals of quoted Fast Moving Consumer Goods companies in Nigeria. Consequently, based on the findings of the study, the following conclusions are drawn. The study reveals that audit committee meetings of up to four times may not result in more effective monitoring. This is the reason why this study found insignificant relationship between audit committee meetings and discretionary accruals of Fast Moving Consumer Goods companies in Nigeria. The degree of relationship between audit committee independence and discretionary accruals is quiet low. It is further established that the proportion of nonexecutive directors in the audit committee may not guarantee that managers would not manipulate earnings. The degree of relationship between audit committee financial expertise is also low. The presence of just one member of the audit committee with financial background is not enough in enhancing the quality of financial reporting (Nwakaego, Ikechukwu, & OnochieBD, 2019).

The purpose of this research paper was to investigate the relationship between audit committee composition, the board of directors’ characteristics and the quality of financial reports of commercial banks in Nigeria. The data for the study was collected from the annual reports of fifteen (15) commercial banks using the method of contents analyses and covered a period of ten (10) years from 2009 to 2018. The Jones quality of accruals model and the ordinary least square method of regression were used to analyze the data for the study. The findings of the research showed that the audit committee composed more of independent members have a positive effect on financial reporting quality. Furthermore, the numerical size of the board of directors also showed a positive
relationship with the quality of financial reports. Finally, the findings showed that board composition has a positive relationship with the quality of financial reports. Hence, it is concluded that the audit committee composition effect on the quality of financial reporting even though in the right direction is much too weak to deliver the desired results. In addition, the effect of the size and composition of the board of directors does not have much effect on the quality of financial reports of commercial banks. Consequently, there is a need to review and strengthen the composition and role of the audit committee especially as regards their monitoring and oversight function on the financial reports so as to improve the quality of financial reports. The size and composition of the board of directors in Nigerian commercial banks need to be reviewed and the board empowered to play a more active role in the financial reporting process. Keywords: Board characteristics, Audit committee composition, financial reporting (Moses, 2019).

Purpose the purpose of this paper is to investigate whether there is any relationship between the effectiveness of an audit committee and the financial reporting timeliness of Tunisian listed companies as proxied by external audit delay (AD). Analysis focuses on five audit committee characteristics: authority, financial expertise, independence, size and diligence. Empirical tests address 162 firm-year observations drawn from Tunisian listed companies during 2011-2013. Findings Multivariate analyses indicate that audit committees with members who have financial expertise are significantly associated with shorter AD. Thus, the results suggest that audit committee financial expertise contributes to the improvement of financial statements’ timeliness. The audit committee attributes examined in this study were based on dezoort et al. (2002) framework. There could be other aspects of audit committee effectiveness such as audit committee tenure and audit committee chair characteristics, which were not addressed in the present study. Thus, future research may consider and examine these other components of audit committee effectiveness. Findings have managerial implications. Companies can re-look into how to further improve audit committee composition in order to enhance the timeliness of financial reporting. The issues of audit committee effectiveness and timely reporting also affect regulators and policy makers since they need to play a role in the establishment of effective audit committees and the improvement of financial reporting timeliness. This study is one of few that have examined the impact of audit committee effectiveness on ADs in an emerging market country. Findings lend credence to the belief that audit committee members’ financial expertise enhances the quality of financial reporting by
firms in a North African market criticized for the lack of maturity of its corporate governance system (Oussii, & Taktak, 2018).

This research applies the three-tier agency theory and social exchange theory to study the role of audit committees in improving financial reporting quality and reducing the likelihood of earnings restatements. Utilizing a matched sample of restated and non-restated U.S. listed firms between 2002 and 2005, this paper finds that firms with a larger proportion of audit committee members appointed after the CEO are associated with higher incidences of restatements, while the presence of an all-independent nomination committee is associated with a lower likelihood of restatements. The paper also shows that firms whose audit committee members have longer average tenure and receive higher director compensation are associated with a smaller likelihood of restatements. Finally, the paper documents changes in the impact of audit committee characteristics on financial restatements after the enactment of the Sarbanes–Oxley Act. Overall, our results suggest that audit committees’ effectiveness in supervising financial reporting quality is affected by social exchange processes and the broad social context (He, Yang, & He 2018).

Codes of good practices provide a soft alternative to the hard legislation approach to corporate governance. These codes include a set of recommendations that companies are expected to follow in order to enhance governance structures and practices. Some of these recommendations specifically aim to improve the effectiveness of the audit committee. The paper investigate the relationship between the level of compliance with recommendations on the audit committee of the Spanish Unified Code and financial reporting quality, as measured by discretionary accruals and by the opinion of the audit report. The study use a sample of companies listed in the Spanish stock market for the years between 2007 and 2013. Results show a strong and positive relationship between the level of compliance with recommendations and the quality of financial reporting. The also report significant results for some specific recommendations. These results are robust to various checks. Therefore, the level of compliance with recommendations on the audit committee might provide a feasible and reliable indicator of the quality of financial reports released by the company (Garcia et al., 2018).

This study examines the impact of audit firm size on financial reporting quality of listed insurance companies in Nigeria. Data were collected from the annual reports and accounts of thirteen sampled insurance companies out of thirty-three listed insurance
companies on Nigerian Stock Exchange for the period of eight years (2008 to 2015). Empirical analyses were carried out using descriptive statistics, Pearson correlation and multiple regressions (Ordinary Least Square). The study found that audit firm size has a positive and significant impact on financial reporting quality. The study recommends that non-big4 accounting firm should invest more resources in technology and staff training, especially in specialized businesses (Insurance), so as to enable them to compete with other accounting firms in auditing (Jerry, & Saidu, 2018).

This study draws on social capital theory to examine the relationship between audit committee (AC) members’ social capital and financial reporting quality. Using US data for the period 2001–2010, our results suggest that non-AC directors’ social capital does not appear to be relevant to financial reporting quality. As far as AC members are concerned, our findings show a negative relationship between their social capital and financial reporting quality, suggesting a ‘dark side’ to social capital. Specifically, we find that sitting in multiple ACs (centrality) has a negative impact on reporting quality only for those AC members designated as financial experts. When other proxies for social capital are considered (connectedness, brokerage position and strong ties), our results show that the quality of financial reporting significantly decreases with the social capital of non-financial experts sitting in the AC. We contribute to prior research by: (i) relying on social capital theory, which is widely neglected in accounting research, (ii) using multiple metrics to capture the complex dimensions of social capital, and (iii) discriminating between the effects of financial and non-financial experts’ social capital on reporting quality. This paper results suggest policy-makers might wish to limit financial experts’ multiple directorships as well as assess the actual contribution of non-financial experts to AC effectiveness (Carrera, Sohail, & Carmona, 2017).

The objective of this study is to evaluate the impact of Audit Committee on financial reporting quality in Nigerian quoted companies. Data for the study were derived from annual reports of one hundred and thirty-one (131) companies quoted on the Nigerian Stock Exchange for the periods, 2006 to 2012. The data were analyzed using descriptive statistics as well as correlation and Ordinary Least Squares (OLS) regression. The multivariate regression technique was utilized to estimate the model. Using the panel regression estimation results, This study found that each of the identified audit committee attributes, such as: frequency of meetings, financial literacy, independence, size and
attendance at meetings had a positive significant effect on financial reporting quality. Based on these findings, the paper recommends the need for training and seminars to be organized for members of audit committee with a view to enabling them keep abreast of up to date information as regards their roles and responsibilities, to make them more effective and efficient in their assignments. In addition, the Securities and Exchange Commission of Nigeria should put in place a regulation, which ensures that audit committee members maintain at least, an attendance level of 85%, for them to be retained in the audit committee for the following financial year (Eriabie, 2016).

3. Discussion and Conclusion

The above research papers confirm the fact the audit committee function has become well recognized as one of the key governance mechanisms especially after what governments around the world have implemented a series of reforms to strengthen internal and external corporate governance mechanisms (Rashid, 2020). Many of these regulatory changes have focused on the composition of an audit committee, a board sub-committee in charge of overseeing a firm’s financial reporting process, internal control structure, internal audit functions, and external audit services (Rashid, 2017). Based on the above, the aim of this paper is to show the relationship between the impacts of audit committee on financial reporting quality. And that is through the researcher relied on reviewing 15 related studies that were published in different journals and by different authors for time periods (2016 - 2020).

The main limitation of current paper was time, cost, and not available some related source. Finally, the study reached a number of results based on the aforesaid studies, the most important of which is found that audit committee accounting expertise, audit committee busyness and audit committee meeting attendance has significant positive impact on the financial reporting quality. This implies that audit committee accounting expertise, audit committee busyness and audit committee meeting attendance enhance the quality of financial reporting (Jaf, 2015 and Sabir, 2022). Moreover findings suggest that firms with better-connected audit committees are less likely to adopt reporting practices that reduce financial reporting quality. Based on the above the study recommends among others those regulators such as Securities and Exchange Commission (SEC), Central Bank (CBN) and NDIC should emphasize that every audit committee must have at least one member with pure accounting qualification.
REFERENCES


Rashid, C. A. The Impact of Online Shopping in Boosting Sales and Cost Reduction in Commercial Companies.


