RELATIONSHIP OF THE AUDIT COMMITTEE WITH FINANCIAL REPORTING QUALITY: META-ANALYSIS

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ABSTRACT

This study aims to determine the effect of the audit committee variables, namely independence, financial expertise, and work experience, on the quality of financial reporting. This study identifies and integrates existing research results using the meta-analysis technique developed by Hunter et al. (1982) from 30 sample articles from 2005 until 2018. The article used is an article that examines the variables that affect the audit committee with independent variables, financial expertise, and work experience as research variables. This study indicates that financial expertise and work experience are variables that have a significant relationship with the quality of financial reporting. At the same time, the independent variable has no significant effect on the quality of financial reporting.

Keywords: Meta-analysis, Audit Committee, Independent, Financial Expertise, Work Experience, and Financial Reporting Quality

INTRODUCTION

The company's financial statements are important information for stakeholders regarding changes in finance, performance, and financial statement position. Issues regarding financial reporting have recently been carried out by state-owned airlines, which have greatly attracted the government's attention and other stakeholders (Liputan6, 2018). The financial statements at the beginning of 2019 had several irregularities that made state-owned airlines conduct internal audits with different KAPs. During the financial statement problems, the shares of state-owned airlines touched the lowest level (Liputan6, 2018).

The audit committee also plays a very important role within the company to ensure between the company's external and internal audits as a monitor for external financial reports, external auditors, and internal controls (lary, et al. 2012; Kalbers, et al. 1993). Lennox, et al. (2007) concluded that the audit committee is the most important governance mechanism concerning the audit committee due to the development of an audit committee responsible for overseeing external auditors and controlling audit quality. The audit committee is one of the elements responsible for paying attention to the interests of shareholders and supervising external audits to reduce fraud. Not surprisingly, a body of research examines the effectiveness of audit committees in improving the quality of financial reporting and audit quality (Salleh, et al. 2012).

The committee's effectiveness has three provisions in monitoring the performance of the company's executive and internal audits (lary, et al. 2012). First, Abbott, et al. (2003) consider the audit committee's effectiveness as the ability to maintain an independent external audit both in terms of financial statements or the results of the ratio of non-audit to audit service fees. Second, Abbott, et al. (2004) & Aier, et al. (2005) evaluated the audit committee's effectiveness as the ability to maintain the integrity of financial statements, as has been done to periodically restore financial statements. Fourth, Farber (2005) and Beasley (1996) also assess the audit committee's effectiveness as the ability to maintain the integrity of financial statements to be misused.

The independence of directors can be considered as a precedent concept in the context of good corporate governance. Independent directors are considered better equipped to maintain the integrity of external financial reports, because they have no personal or economic ties to executive management and are considered as professional referees whose role is to oversee and monitor the company's executive management (Bradbury, 2006). Therefore, audit committees with independent directors can be considered better equipped to maintain the company's financial reporting integrity.

The role of financial experts in financial reporting is very important in order to improve the quality of company reporting. The inclusion of financial experts in the company's audit committee is only limited to policies carried out by a company, evidence that directors with direct experience in making financial reports are better able to oversee financial statements (Joseph, et. al. 2006). In order to improve the quality of financial reporting, an audit committee that has financial experts is considered to be able to provide in-depth supervision of financial reports based on their knowledge. The quality of financial reporting is determined by the high ability and understanding of the audit committee in preparing financial statements.

The importance of making financial reports is supported by experience in the appropriate field for the company, prioritizing people who have a lot of work experience. The understanding in the audit committee is not only in the financial sector but also in the technical field of the industry that is carried out so that the financial statements can be explained according to the field. According to Cohen, et. al. (2014), that the combination of industry expertise and accounting expertise is more effective in limiting earnings management than accounting expertise alone. The need for work experience outside of finance in the audit committee other than as a monitor of the financial reporting process, according to Petri, et.al. (2010), the more experience in the industry an audit committee member has in terms of different years or companies, the better he or she is expected to improve monitoring of the financial reporting process.

Adoption of principles-based financial reporting standards is only one solution to improve financial reporting, requiring public companies to disclose whether at least one member of the audit committee has a financial expert. Archival studies have demonstrated the power of audit committees to have an effect on the financial reporting process in a rules-based standards environment (Klein 2002). However, evidence on their effect in a more principles-oriented environment and on the interactive effects of standard precision and audit committee power is lacking.

Meta-analysis is a systematic review that combines statistical results from previous studies based on their effect size (Sάnchez, et al., 2010). Effect size is the strength of a phenomenon that can be measured in various ways according to the research problem to be developed. Meta-analysis using statistical research on literature studies from previous researchers makes an interesting alternative, where the results of researchers related to factors that affect audit committees and audit reporting quality are tested empirically using the Meta-Analysis approach. Meta-analysis is a technique that combines the findings of previous research on a specific topic and evaluates the cumulative effect of the study (Bilala. Chena. & Komalb, 2018).

LITERATURE REVIEW

Articles Summary Results

In conducting meta-analysis research, of course, articles from primary research are needed to be used as research samples; in this study, the researchers tried to identify the relationship between audit committees and financial reporting quality. At the stage of collecting related articles, 114 articles were identified by the researcher. However, only 22 articles met the research criteria.

Financial Report

Financial reports are the primary basis for company reports which are very risky and require independent and quality supervision. Financial reports must have good quality information so that they can be used optimally by potential investors and other users. In assessing the quality of financial statements, there are two significant groups of valuation attributes, namely accounting-based attributes and market-based attributes (Francis et al., 2004). The quality attributes of financial statements based on accounting are the quality of accruals, persistence, predictability, and income smoothing. Then the quality attributes based on the market are value relevance, timeliness, and conservatism. In this study, the quality of financial statements is measured by the three details proposed by Francis et al. (2004) that are:

1. Persistence

   The description of the persistence of the company's financial statements is how earnings conditions can continue continuously. Good persistence will show that the profit in the current period is a reflection of the past period, which eventually repeats itself. Making the sustainability of a company continue to grow.

2. Predictability

   The predictability of a financial statement is how the ability of current earnings is able to predict the condition of the company in the future period based on the value of cash flows from operating activities (DeChow 2002). In its measurement, the predictive ability using a company's profit component for a certain year is scaled to the total assets owned by the company. Predictability is one of the attributes that contribute significantly to the assessment of the quality of financial statements viewed from the accounting aspect (Fanani et al., 2007).

3. Conservatism

   Conservatism can be defined as the tendency of an accountant to require a higher level of verification to recognize profits (good news in earnings) than to recognize losses (bad news in earnings). Traditionally, conservatism in accounting can be translated through the statement "not anticipating profits, but anticipating all losses." Currently, the concept of conservatism itself is closer to being cautious about the uncertainty of the risks involved (Ahmed 2002).

Financial Reporting Quality

The main function of financial reporting is to find out how much value the economic resources used in the company's operational activities, assess the condition of the financial statements, evaluate the efficiency and effectiveness of a financial reporting entity, and how high the level of compliance with applicable laws and regulations.

Companies need to account for the performance and budget of financial reporting as a form of corporate responsibility to meet the objectives of presenting financial statements, so the company's financial reporting must be prepared by meeting the quality characteristics of financial reporting as a normative measure that needs to be realized in accounting information according to applicable standards.

Audit Committee Characteristics

In view of the ability to designate audit committee members as financial experts based on various characteristics, it is important to examine the characteristics and qualifications of audit committee financial experts. The audit committee stated that the effectiveness of the audit committee depends on its characteristics (Akhtaruddin, et al., 2010; Dhaliwal, et al., 2010; Li et al., 2012). Therefore, a reliable mix of experience, expertise, and capabilities is essential to support the audit committee's ability to efficiently carry out its responsibilities (Madi, et al., 2014).

Independence

The issue of auditor independence has become one of the foundations for regulators, practitioners, and researchers. Auditor independence arises because the auditor plays an important role in proving the credibility of the company's financial statements. In order to perform this role, it is very important for an independent auditor of the company's management (Ahmad, 2012). However, the independence of the auditor is often disturbed by various parties with interest in the results of the auditor's work. In addition, auditors must also fulfill their personal ambitions in order to develop their careers. Various interests are faced by auditors, so that auditors are often in difficult situations (Kaplan, 2004).

Independence for an auditor is very important because independence is generally recognized as one of the central values or ideals that underlies the work and legitimacy of auditors (Sikka, et al. 1995), as the foundation or basis of the auditing profession (Gramling, et al. 2008), and is a central concept in the accounting profession (Gendron, et al. 2006). Independence means a mental attitude that is free from influence, not controlled by other parties, not dependent on others. Independence also means honesty in the auditor in considering facts and an objective, impartial consideration within the auditor in formulating and expressing his opinion (Mulyadi, 2002, p. 26).

H1: There is a positive influence between independent on the quality of financial reporting

Financial Skills

Knowledge is defined as the auditor's level of understanding of a job, both conceptual and practical. Expert auditors should have a broad knowledge base and strive to maintain and follow developments and current issues through continuing education and training (Abdolmohammadi, et al 1992). Using the basis of human capital theory, the auditor's knowledge can influence, either directly or indirectly, the quality of financial reporting, especially when auditing financial statements specifically.

The importance of financial expertise on the audit committee to improve the quality provided in the supervision of financial reporting. Companies that do not have financial experts serving on the audit committee must explain because financial expertise reflects characteristics relevant to the audit committee's supervisory function (Iyer, et al. 2013). An understanding of more basic accounting becomes the main spear to ask in-depth questions to determine the completeness and accuracy of the data.

H1: There is a positive influence between financial expertises on the quality of financial reporting

Work experience

Work experience is needed to support the ability of a professional audit committee. According to Petri, et.al. (2010) the more experience in the industry an audit committee member has in terms of different years or companies, the better he or she is expected to improve monitoring of the financial reporting process.

H1: There is a positive influence between work experiences on the quality of financial reporting

METHOD

Research Approach

This study maps out previous studies on the relationship between audit committees (AC) and financial reporting quality (FRQ). In this study, it is divided into three explanatory variables, namely independence, financial expertise, and work experience. Then the models are formulated to provide a more concrete visual picture related to the relationship between variables. In this study, researchers combined the correlation coefficient (r) and correlation coefficient (f). The overall effect size of the research mapped into the audit committee (AC) and financial reporting quality (FRQ).

Procedure Approach

In this study, the researcher refers to the research procedure developed by Hunter and Schmidt (1990), where the procedure to be carried out is as follows:

1. Define the problem to be researched.
   The problem to be studied is the audit committee factor to determine the level of financial reporting quality.
2. Determine the time period of the study results to be analyzed and become a source of sample data. Researchers limit the period of research results used, namely articles from 2005 to 2018, or the last 14 years.
3. Read the title, abstract, researched variables and research results to see the suitability of the content.
4. In analyzing, focusing more on research problems, research methodologies such as the type of research, place and time of research, methods, population, samples, sampling techniques, data analysis techniques, and results.
5. Categorize each study.
6. Comparing all research results according to the criteria.
7. Analyzing the conclusions found by reviewing research results and reviewing methods and data analysis in each study so that the weaknesses and strengths of previous studies can be identified.
8. Draw conclusions from this meta-analysis research based on the above steps.

Data Types and Sources

The object of this research is previous research which is empirical research on audit committees with financial reporting quality. Journals published in Indonesia and abroad. The selection of published journals is to get articles with consistent research quality, because they have gone through a good selection process. International proceedings and proceedings originating from the National Seminar on Accounting in Indonesia. These procedures are considered adequate both in quality and quantity to be included in the Meta Analysis of this study.

Population and Sample

The population in this study is all research on factors that relate the audit committee (CA) to the quality of financial reporting (FRQ), especially in developing countries, as many as 1337 research articles.

The sample used in this study was 22 articles, the articles were published by top journals that have been accredited to select studies that examine the determinants of corporate social disclosure in the context of corporate governance. The publishing period of the sampled articles is between 2005-2018.

Data analysis

Data analysis was carried out on the primary study in this study using a Microsoft Excel computer program, statistical tools using SPSS. Next is the data analysis stage which consists of:

1. Determine the criteria for the article to be analyzed, then collect the overall study results and then test the meta-analysis technique.

2. perform statistical analysis of the articles that have been determined. There are three stages carried out by researchers in carrying out statistical analysis, that is: Not all sample studies display ($\bar{r}$) but other statistics, such as t-statistics and p-values or significant values and F values. Therefore, to convert values that have not yet become r into t-statistics, the formula is used:

   1) *Statistic-t*

$$r = \sqrt{\frac{t^2}{t^2 + df}} = \frac{t}{\sqrt{t^2 + df}}$$

   2) *Chi-Square*

$$r = \sqrt{\frac{x^2}{n}}$$

   3) If the results of the study report the F value using only one-way ANOVA, then the statistical value of r is obtained from the formula:

$$r = \sqrt{\frac{F}{F + df}}$$

   4) *P-value* : first the P-value is converted to t-statistic then converted to r.

a. Accumulate the effect sizes and calculate the average correlation coefficient (r), using the formula. Accumulate the effect sizes and calculate the average correlation coefficient (r), using the formula:

$$\bar{r} = \frac{\sum(Niri)}{\sum Ni}$$

Explanation:

N_i : Number of subjects in the study.

r_i : The size of the influence of each research.

b. Once calculated, the next step is to calculate an unbiased estimate of population variance (S^2p) with formula:

$$S^2p = S^2r - S^2e$$

Explanation:

S^2r : total observed variance $S^2r = \frac{\sum Ni(ri - \bar{r})^2}{\sum Ni}$

S^2e : *sampling error* $S^2e = \frac{(1-\bar{r}^2)^2}{\sum(Ni-1)}$

c. Next, determine the 95% confidence interval, where the confidence interval is calculated based on the objective estimate of the standard deviation (Sp) and the mean correlation ($\bar{r}$), with the formula:

$$[\bar{r} - Sp(1.96), \bar{r} + Sp(1.96)]$$

After performing the statistical steps above, a data analysis will be generated that can answer the hypothesis test that has been made.

Hypothesis testing

Hunter and Schmidt (2000) use two stages to test the research hypothesis if the effect size is calculated using the r statistic, the two stages are:

1. Determine the relationship between each independent variable and the dependent variable using the formula:

$$rxy = \sqrt{\frac{t^2}{t^2 + df}}$$

The criteria for accepting or rejecting the hypothesis are:
Hypotheses 1,2,3,4, and 5 use a 5% confidence level, if r count > r table then the hypothesis is accepted, meaning that the independent variable has a significant effect on the dependent variable.

2. Interpret the significance and areas of acceptance or rejection of the hypothesis, then use the confidence interval using the formula:

$$z' = \bar{r} + 1{,}96\sqrt{s_p^2}$$

Or by formula: [$\bar{r}$–S_P(1.96),$\bar{r}$+S_P(1.96)
This study uses direct hypothesis testing, so the confidence interval used to determine the significance of the relationship between variables is 95%. A significant relationship is indicated by the average correlation distance (r) between the confidence interval area and the maximum and minimum area values which are all positive or negative. Otherwise, the results are not significant with respect to the mean correlation ($\bar{r}$).

3. Determine positive and negative values using the formula:

$$s_r^2 = \frac{\sum[N_i(r_i - \bar{r})^2]}{\sum N}$$

Because this study uses a direct hypothesis using directives, the value of r ranges from -1 to +1 including 0. The greater the value of r (closer to 1), the stronger the influence of the independent variable on the dependent. Conversely, the smaller the value of r or correlation (closer to 0), the weaker the influence of the independent variable on the dependent. A value of 0 means that there is no effect of the dependent variable on the dependent.
If the correlation coefficient (r) is positive, then the two variables have a unidirectional relationship. Conversely, if the coefficient (r) is negative, then the two variables have an inverse or unidirectional relationship (Sarwono, 2011).

ANALYSIS AND DISCUSSION RESULTS

Overview of Research Studies

This study entitled the relationship between audit committees and financial reporting quality: Meta analysis. This study uses a meta-analysis approach developed by Hunter et.al (1990) in revealing correlations by analyzing 22 primary studies that discuss issues related to the relationship between audit committees and financial reporting quality. Data collection is done by visiting the website using the keywords audit committee relationship with the quality of financial reports. Based on the procedures described in the research method, the analysis is carried out by determining the criteria for the articles to be tested in accordance with table 1 meta-analysis criteria.

Table 1
Effect Size ($\bar{r}$)

No.	Author	Articles	***Effect Size*** **($\bar{r}$)**		
			KI	**PK**	**KK**
1.	Agoglia, et.al. (2011)	*Principles-based versus rules-based accounting standards: the influence of standard precision and audit committee strength on financial reporting decisions*	0,58		
2.	Joseph, et.al. (2006)	*Audit committee financial expertise, competing corporate governance mechanisms, and earnings management*		-0,6529	0,0472
3.	Chandar, et.al. (2012)	*Does overlapping membership on audit and compensation committees improve a firm's financial reporting quality?*	0,08		
4.	Chang, et.al. (2010)	*Does the disclosure of corporate governance structures affect firm's earnings quality?*	0,324		-0,005
5.	Cohen, et.al. (2014)	*The effect audit committee industry expertise on monitoring the financial reporting process*		0,142	
6.	Erkens, et.al (2013)	*The role of firm status in appointments of accounting financial experts to audit committees*			0,297
7.	Hoag, et.al. (2017)	*Has Sarbanes-Oxley standardized audit quality?*		0,0141	0,0002
8.	McDaniel, et.al (2002)	*Evaluating financial reporting quality: the effects of financial expertise vs. financial literacy*			-0,8670
9.	Shireenjit, et.al (2013)	*Internal audit function, board quality evidence from malaysia*	0,075		
10.	Sun, et.al. (2012)	*Audit committee characteristics and loss reserve error*	0,0287		

11.	Oussii, et.al. (2016)	*Audit Committee effectiveness and financial reporting timeliness: the case of Tunisian listed companies*	0,3428		
12.	Zgarni, et.al. (2016)	*Effective audit committee, audit quality and earnings management*	0,0456		0,1478
13.	Kalelkar, (2017)	*Effect of audit and compensation committee membership overlap on audit fees*	-0,26		
14.	Krishnan, et.al. (2011)	*Lagel expertise on corporate audit committees and financial reporting quality*		-0,002	-0,002
15.	Kusnadi, et.al. (2015)	*Audit committees and financial reporting quality in singapore*	-0,006	-0,026	-0,051
16.	Lary, et.al. (2012)	*Governance characteristics and role effectiveness of audit committees*	0,039		
17.	Shiri, et.al. (2018)	*Family ownership and financial reporting quality: Iranian evidence*	-0,0245		
18.	Abdullah, et.al. (2010)	*Financial restatements and corporate governance among Malaysian listed companies*	0,53		
19.	Nehme, et.al. (2018)	*The efficiency of corporate boards and firms' audit fees: the case of the FTSE financial institutions*	0,4	0,17	
20.	Kang, et.al. (2011)	*The effectiveness of audit committees for low and mid-cap firms*	-0,1759	-0,1927	
21.	Srinivasan, (2005)	*Consequences of financial reporting failure for outside directors: evidence from accounting restatements and audit committee members*	0,13		0,1
22.	Hoitash, et.al. (2009)	*Corporate governance and internal control over financial reporting: a comparison of regulatory regimes*	-0,0009		

Source: Data Processed by Researchers

After calculating the effect size, then the overall meta-analysis is calculated. The following is table 2 of the results of the meta-analysis as a whole about the relationship between the variables of independence, financial expertise, and work experience on the quality of financial reports.

Table 2
General Meta-analysis

GENERAL META-ANALYSIS	**∑ NI**	**K study**	**R**	**S²r**	**S²e**	**S²p**	***Percentage Explained***	*95% Convident Interval*	
								MIN	**MAX**
Independent	17729	16	-0,0316	0,0352	0,0144	0,0208	0,1877	-0,3989	0,3369
Financial Skills	19691	9	0,0303	0,0072	0,0041	0,0031	0,0851	-0.1365	0,1971
Work experience	34300	7	0,0748	0,0092	0,0014	0,0078	0,0958	-0.113	0,2626

Source: Data Processed by Researchers

Independent Variable Meta Analysis Calculation Results

Based on the results of the calculation of the average coefficient value of r for the independent characteristic variables, the results obtained $\bar{r}$ amounted -0, 0316 and the magnitude of the correlation variance or (S^2_r) that is 0, 0352 with a standard deviation (Sd) of 0.1877 is at a 95% confidence interval, with an acceptance limit between -0, 3989 ≤ p ≤ 0, 3369; which means that the average correlation result is in the rejection limit, namely -0.0316. Based on these findings, it can be seen that independent characteristics have no effect on the quality of financial reporting. Furthermore, for the results of the calculation of the meta-analysis study, it was found that the magnitude (p) or the actual correlation obtained an estimate of -0.0845, and the variation in the true correlation or Var (p) was 0.1712 with the acquisition of a standard deviation (Sd) of 0.4138, which is in the interval 95% confidence with acceptance limit -0,8958 ≤ p ≤ 0,7264; which means, with a magnitude of (p) -0.0845, it is included in the acceptance interval limit. Based on these findings, it can be seen that independent characteristics do not have a negative relationship that is not in line with the quality of financial reporting.

Financial Expertise Variable Meta Analysis Calculation Results

Based on the results of the calculation of the average coefficient value of r for the financial expertise variable, the results obtained are $\bar{r}$ is 0, 0303 and the magnitude of the correlation variance or (S^2_r) that is 0, 0072 with a standard deviation (Sd) of 0.0851 is at a 95% confidence interval, with an acceptance limit between -0.1365≤ p ≤ 0, 1971; which means the average result of the correlation is at the limit of acceptance. Based on these findings, it can be seen that financial expertise has a significant effect on the quality of financial reporting. Furthermore, for the calculation results of the meta-analysis study, it was found that the magnitude of the real correlation or (p) obtained an estimate of 0.0991, and the variation of the true correlation or Var (p) of 0.0332 with the acquisition of a standard deviation (Sd) of 0.1821, namely is in the 95% confidence interval with the acceptance limit -0,2578 ≤ p ≤ 0,4560; which means, with a magnitude of (p) 0.0991 it is included in the acceptance interval limit. Based on these findings, it can be seen that the reliability of the independent variable and the dependent variable is positive or (not through the value 0). This means that financial expertise has a positive relationship in line with the quality of financial reporting.

Calculation Results of Meta Analysis of Work Experience Variables

Based on the results of the calculation of the average coefficient of r for the work experience variable, the results obtained are $\bar{r}$ is 0, 0748 and the magnitude of the correlation variance or (S^2r) which is 0.0092 with a standard deviation (Sd) of 0.0958 is at a 95% confidence interval, with an acceptance limit between -0, 1130 ≤ p ≤ 0, 2626; which means the average result of the correlation is at the limit of acceptance. Based on these findings, it can be seen that work experience has a significant effect on the quality of financial reporting. Furthermore, for the results of the calculation of the meta-analysis study, it was found that the real correlation or (p) was getting an estimate of 0.2218, and the variation in the real correlation or Var (p) was 0.0641 with the standard deviation (Sd) of 0.2533, which was at a 95% confidence interval with an acceptance limit -0, 2747 ≤ p ≤ 0, 7183; which means, with a magnitude of (p) 0.2218, it is included in the acceptance interval limit. Based on these findings, it can be seen that the reliability of the independent variable and the dependent variable is positive or (not through the value 0). This means that work experience has a positive relationship in line with the quality of financial reporting.

CONCLUSION

This study aims to examine the audit committee variables that affect the quality of financial reporting using meta-analysis. There are three variables studied, including independent variables, financial expertise, and work experience. The reason the author uses these three variables is based on previous research using only independence. Researchers add several other variables such as financial expertise and work experience. The findings of this study indicate that the independent variable has no significant negative effect on the quality of financial reporting. The financial expertise variable has a significant positive effect on the quality of financial reporting. Meanwhile, the work experience variable has a significant positive effect on the quality of financial reporting.

LIMITATION OF RESEARCH

This study has limitations, including:

1. The personality variable has no relationship with the career choice of accounting students to become professional accountants. This is due to sampling errors, measurement errors, and data errors caused by too few samples on the personality variable.
2. For the analysis used in this study, the audit committee variable is still incomplete and the number of samples is still too small.

SUGGESTION

Based on the limitations of the research described, the researcher recommends that:

1. Further researchers can examine more broadly about the characteristics of the audit committee as an improvement in the quality of financial reporting.
2. Researchers suggest that further researchers focus more on the research target, namely the quality of financial reporting.

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