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The Effect of the Effectiveness of the Audit Committee toward the Quality of Financial Reports

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Abstract: *This study aimed to analyse the effect of the effectiveness of the audit committee in terms of expertise, charter, a total of audit committees, total of audit committee meetings which are expected to influence the quality of financial reports. This research was conducted through quantitative methods using secondary data. Secondary data consisted of data on the date of issuance of the company's financial reports on the IDX website and annual reports of companies that had been listed on the IDX in 2018. The research population was all manufacturing companies listed on the IDX. The sample selection procedure used purposive sampling method with a total sample size of 96 companies, and the analysis technique used was multiple regression. The results proved that the expertise of the audit committee, the audit committee charter, the total of audit committees and the audit committee meetings had a significant effect on the quality of financial reports.*

Keywords: *The Quality of Financial Reports, Audit Committee Expertise, Audit Committee Charter, The Total of Audit Committees, Audit Committee Meetings.*

INTRODUCTION

The business development that continues to increase, it demands the businesspeople be able to compete in it. Therefore there are many competitors in the business world. Increasing the business competition, it encourages every company to give its best performance in attracting investors, especially those concerning financial reports. According to PSAK No. 1 (2018), the financial report is a structured presentation of the financial position and financial performance of an entity. Financial reports are reports that show the company's current financial condition or the next period (Kasmir, 2013). The purpose of financial reports is to provide information about the financial position, financial performance, financial performance and cash flow of an entity that is useful for most users of financial reports in making economic decisions.

Therefore, it is essential to provide relevant and reliable information in the making and presenting the condition of the company to users of financial reports, namely investors and creditors. The information contained in financial reports can be used as a measuring tool to assess the performance of the company. The presentation of financial reports states that there are four characteristics of financial reports that are asserted to be of quality. Financial reports are said to be of quality if it can be understood, relevant, reliable and comparable. For this reason, in order for the information presented to be of quality and useful to users, accounting information needs to be presented following the guidelines used as accounting standards (Kieso, 2014).

The managers will be motivated to improve the performance of the company when they realize the importance of a financial report. However, this motivation is sometimes undertaken in the wrong way. Manager instantly changes the financial reports to make it more attractive. This explanation is an act of fraud that is detrimental to both the company and its stakeholders. In Indonesia, there are several cases related to irrelevant and unreliable financial reports. The latest phenomenon of financial statements presented is irrelevant and reliable in the company of P.T. Tiga Pilar Sejahtera Food, Tbk (issuer code: AISA) was suspected of inflating Rp. 4 trillion in financial reports 2017. This data was revealed in the fact-based investigation report of PT Ernst & Young Indonesia (E.Y. on the new management of P.T. Tiga Pilar Sejahtera Food, Tbk in March 2019.

There are still practices that make investors lose due to the information contained in the financial reports is irrelevant and cannot be valid. A company is required to have and manage good corporate governance. One of the implementations of Good Corporate Governance is by establishing an Audit Committee and drafting an Audit Committee Charter following OJK Regulation No. 55 / POJK.04 / 2015 concerning the Establishment and Guidelines for the Work Implementation of the Audit Committee. The role of the Audit Committee in ensuring the quality of published financial reports is considered as one of the steps to reduce or even prevent corporate financial scandals. The quality of financial reports is considered to reflect the role of an efficient and effective audit committee.

The audit committee is responsible for fulfilling its duties in reviewing the company's compliance with applicable regulations, so that, the company is unlikely to be late in presenting audited financial reports (Ika and Ghazali, 2012). According to OJK Regulation No. 55 / PJOK.04 / 2015 pointed out that the issuer or company is required to have at least one member of the audit committee who has expertise in economics and accounting. With such obligations, it is expected that the making and presentation of quality financial reports can be realized. Furthermore, Akbar and Endang (2014) also argued that companies are required to have one financial expert who has the competence and knowledge in the fields of accounting, finance and auditing.

Research conducted by Kusnadi et al. (2015) shows that the quality of financial reports will be of higher value if the audit committee has a background in accounting education. Likewise, the results of research conducted by Mutmainah and Wardhani (2013) point out that the audit committee with a financial background significantly improves the quality of financial reports. To increase the effectiveness of the audit committee, one of them refers to the audit committee charter. An audit committee charter is a tool that can assist the audit committee members to concentrate on specific responsibilities and also serve as evaluation material for shareholders to determine the quality of the audit committee's performance (Akbar and Endang, 2014). Safira and Ardiyanto (2018) state that the existence of an audit committee charter will have an impact on the quality of financial reports.

Furthermore, according to DeZoort (2002) to create an influential audit committee. Thus, the audit committee must at least have sufficient and adequate members to hold meetings and exchange opinions with others so that the assigned tasks are carried out correctly and adequately. Based on OJK Regulation No. 55 / PJOK.04 / 2015 concerning the number of audit committees that must be fulfilled, namely a minimum of three people. The more members of the audit committee in a company. The coverage in monitoring aspects of the risks faced by the company is getting better. This situation will undoubtedly improve the quality of financial reports (Lin et al., 2006).

Lastly, an audit committee that meets regularly will be a better supervisor in overseeing the financial reporting process so that it has an impact on the quality of financial reports. Tiras (2004) also states that an audit committee that holds regular meetings or meetings will have a positive effect on the quality of the company's financial reports. The higher the intensity of the meetings held by the audit committee, the better the quality of the monitoring and this will undoubtedly improve the quality of the company's financial reports.

Based on the phenomena and cases that occur with the quality of financial reports, the researcher is interested in testing the development of financial report quality in terms of qualitative characteristics with the measurement guidelines developed by the Nijmegen Center for Economics (NiCE). Furthermore, the weakness of the audit committee implementation, especially in Indonesia, is interested in being examined. The examination is to understand the effectiveness of the audit committee which will be measured by the expertise of the audit committee, the audit committee charter, the total of audit committees and the total of audit committee meetings in carrying out all their duties and authorities on the presentation of financial reports. Also, the researcher adds several control variables, namely company size, company age, leverage and return on assets.

This study is replication research conducted by Ika and Ghazali (2012) on the effect of the effectiveness of the audit committee on the timeliness of financial reports with a sample of companies listed on the Indonesia Stock Exchange. The difference between this study and previous research measures the quality of financial reports through the measurement guidelines by the Nijmegen Center for Economics (NiCE). Furthermore, testing the effectiveness of the audit committee by using the elements developed by DeZoort one by one, namely the expertise of the audit committee, the audit committee charter, the size of the audit committee and the audit committee meetings. Based on the background of the above problems and the basis of differences in previous research, the researcher was motivated to conduct a study entitled “The Effect of the Effectiveness of the Audit Committee toward the Quality of Financial Reports”.

LITERATURE REVIEW, FRAMEWORK AND HYPOTHESIS

The Expertise of the Audit Committee

Following Ika and Ghazali (2012), the educational background of financial experts is essential to ensure the effectiveness of the audit committee, and this is an absolute requirement. This finding is in line with OJK Regulation No. 55 / PJOK.04 / 2015 which states that the issuer or company is required to have at least one member of the audit committee who has expertise in economics and accounting. To be able to assess the selection of accounting policies used by management, it is a must for audit committee members to have good analytical skills in the field of financial reporting in order to produce financial reports that are truly accountable and transparent (Rezaee, 2004).

Furthermore, according to Akbar and Endang (2014), companies are required to have one financial expert who has the competence and knowledge in the fields of accounting, finance and auditing. Audit committee members who have the expertise, experience as an audit committee and have independence have a negative relationship with audit report lag (Sultana et al., 2014). This result is in consort with the results of research conducted by Kusnadi et al. (2015) which states that the quality of financial reports will be of higher value if the audit committee has an accounting education background. An audit committee with a level of expertise in accounting and finance will have a positive effect on the quality of financial information presented by the company (McDaniel et al. 2004). Based on the description above, the following hypothesis can be formulated:

H1: The Expertise of the Audit Committee affects the Quality of the Financial Reports

The Charter of Audit Committee

Based on the OJK Regulation with No. 55 / POJK.04 / 2015 states that all issuers or public companies are required to have an audit committee charter. The charter of the audit committee can serve as a benchmark. The charter will give have adequate information about the company to shareholders and stakeholders. Also, the charter becomes a helper for the audit committee members to concentrate on the duties, responsibilities, and authority in evaluating the performance of the audit committee due to the audit committee gets clear directions and objectives based on the audit committee charter. The existence of an audit committee charter will have an impact on the quality of financial reports (Safira and Ardiyanto, 2018).

To increase the effectiveness of the audit committee, it refers to the audit committee charter. The audit committee charter provides definite and reliable direction and authority for the audit committee members to be able to carry out the duties and responsibilities written in the audit committee charter. Research conducted by Ika and Ghazali (2012) shows that the effectiveness of the audit committee has a significant effect on the timeliness of reporting. Based on the description above, the following hypothesis can be formulated:

H2: The Charter of Audit Committee affects the Quality of Financial Reports

Total of Audit Committees

Following DeZoort (2002) to create an influential audit committee, the audit committee must at least have sufficient and adequate members to hold meetings and exchange opinions with others so that the assigned tasks are carried out correctly and adequately. Based on OJK regulation No. 55 /POJK.04/2015 regarding the number of Audit Committee members that must be met, namely a minimum of three people. Concerning the increase in the number of auditor members in a company and the extensive monitoring coverage of risks, the company can be improved. This situation will undoubtedly improve the quality of financial reports (Lin et al., 2006).

This result is in line with research conducted by Ika and Ghazali (2012): Mutmainah and Wardhani (2013): Li, Mangena and Pike (2012): Kipkoech and Rono (2016): Safira and Ardiyanto (2018) and research from Novade and Laksito (2015) which shows that the size of the audit committee has a significant effect on improving the quality of financial reports. Furthermore, research conducted by Hastuti and Meiranto (2017) also indicates that the size of the audit committee has a negative impact on audit report lag. Based on the description above, the following hypothesis can be formulated:

H3: The Total of Audit Committees affects the Quality of Financial Reports.

Audit Committee Meetings

In general, the audit committee meets two to three times a year, namely before the financial report is issued, after the audit is conducted and before the financial report is issued, and before the Annual GMS (FCGI, 2002). Meanwhile, based on OJK Regulation No. 55 / POJK.04 / 2015 Article 13, the audit committee holds regular meetings at least once in three months or at least four times a year. Beasley et al. (2004) found that corporate audit committees that made errors in financial reporting had less meeting frequency than audit committees that did not make mistakes in financial reporting.

An audit committee that meets regularly will be a better supervisor in overseeing the financial reporting process so that it has an impact on the quality of financial reports. Tiras (2004) also states that an audit committee that holds regular meetings or meetings will have a positive effect on the quality of the company's financial statements. The higher the intensity of the meetings held by the audit committee, the better the quality of monitoring and this will improve the quality of the company's financial reports. Based on the description above, the following hypothesis can be formulated:

H4: Audit Committee Meetings affect The Quality of Financial Reports.

RESEARCH METHOD

The population in this study were all manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2018. The total population of manufacturing companies listed on the IDX was 165. The purposive sampling method is a sampling technique with specific considerations (Sugiyono, 2013: 122).

The sample of this study was all manufacturing companies listed on the Indonesia Stock Exchange with the following criteria: (1) The sample of this study used manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2018. (2) The sample of companies did not experience losses during the year observation. Companies that incurred losses will be excluded from the sample. (3) Samples were only from companies that presented financial reports in the rupiah currency. (4) Samples of companies that had published a complete and audited annual report during 2018. If the company did not provide a complete annual report on the website www.IDX.co.id, it would be not easy to measure the audit committee and quality. Financial statements. From the criteria in this study, the sample of this study was 96.

This study used secondary data and is collected through the website www.IDX.co.id. The secondary data required in this study were in the form of annual financial reports and audited financial reports of manufacturing companies listed on the Indonesia Stock Exchange (IDX) during 2018. Research hypothesis testing was carried out using the Statistical Product and Service Solutions (SPSS) approach.

Operational Definition of Research and Research Variables

The Quality of Financial Reports (Y)

The quality of financial reports is a list that is authentic, objective, and can be trusted in the presentation of financial reports. The quality of financial reports must have benefits as a means of decision making by stakeholders. The characteristics that a financial report must have in order to be said to be quality if it can be understandable, relevant, reliable/honest, and comparable.

The quality of financial reports in this study used a qualitative approach to measure the quality of financial reports. The qualitative measurement approach used was based on the measurement developed by the Nijmegen Center for Economics (NiCE). The NiCE developed comprehensive financial reporting quality measurements. The measurement is in an index measurement that has been adjusted to the provisions of the PSAK. It includes relevance, faithful representation, understandability, comparability, and timeliness.

The Expertise of the Audit Committee (X1)

Based on the regulations issued by OJK with No. 55 / POJK.04 / 2015 written that at least one of the members of the audit committee is the individual who has a background in accounting or finance education. The expertise of the audit committee in this study was measured using dummy measurements.

The Charter of Audit Committee (X2)

The regulation of OJK with No. Article 12 (1) 55 / POJK.04 / 2015 states that all issuers or public companies are required to have an audit committee charter. (DeZoort et al., 2002) points out that authority is a critical aspect of ensuring the quality of the audit committee's performance, this makes it easier for the board of commissioners to be able to assess the level of accountability for the performance of the audit committee and become a reference for the audit committee's duties. The audit committee charter in this study was measured using dummy measurements.

Total of Audit Committees (X3)

The regulation of OJK with No. 55 / POJK.04 / 2015 article 4 states that the Audit Committee consists of at least 3 (three) members who come from Independent Commissioners and Parties from outside the Issuer or Public Company. The size of the Audit Committee is the total number of audit committee members based on OJK regulations with No. 55 / POJK.04 / 2015 and informed by the company in the presentation of the annual financial reports. The size of the Audit Committee in this study was measured based on the number of members of the Audit Committee published in the company's annual financial reports.

Audit Committee meetings (X4)

Audit Committee meetings are meetings or face-to-face meetings held by the Audit Committee within one year, The regulation of OJK No. 55 / POJK.04 / 2015 article 13 The Audit Committee holds regular meetings at least once in three months. Or at least four times a year. Audit Committee meetings in this study were measured by the number of meetings held by members of the Audit Committee which are published in the company's annual financial reports.

The size of the company (Z1)

The size of the company shows how big the company is. The size of company can describe the coverage capacity of company's market. Total assets were calculated using logarithms so that the calculation results on the size did not have a range of numbers that were too far from the numbers in other variables. *Size: Log Total Aset*

The Age of Company (Z2)

The age of a company is a span of a company that is expressed in years. The age of the company can be determined from the date the company was founded. The formula calculated the age of the company in this study: Observation year - the year the company was established.

Leverage (Z3)

Financial leverage is a debt ratio that can show the amount of debt the company has that is used in the capital structure. The existence of high financial leverage causes a high increase in capital, accompanied by a high increase in debt. The formula used to measure the leverage variable is: *Debt to Equity Ratio = Total Debt / Total Assets*

Return on Asset (ROA)

The rate of return on assets is often called profitability. To measure how efficient a company in managing its assets to generate profits. The rate of return on assets is calculated based on the company's net income with its total assets, and the result will be a percentage.

ROA = Net Income / Total Asset x 100%

FINDING AND DISCUSSION

The Effect of the Audit Committee's Expertise on the Quality of Financial Reports.

It obtained t value for audit committee expertise was 3.592 and t table value was 1.988, it means that H1 is accepted and H0 is rejected. Likewise, the significant value was 0.001 where this number was smaller than α, namely 0.05, so it can be concluded that the expertise of the audit committee had a significant effect on the quality of financial statements with company size, company age, leverage and ROA as control variables.

The results of these studies indicated that the relationship between the expertise of the audit committee and the quality of financial reports is significant. Ika and Ghazali (2012) also said that the educational background of financial experts was essential to ensure the effectiveness of the audit committee, and this was an absolute requirement. The results of this study supported the research conducted by Mutmainah and Wardhani (2013), which pointed out that the audit committee with a financial background significantly improved on the quality of financial reports. Likewise, with the results of research conducted by Kusnadi et al. (2015), which indicated that the quality of financial reports would be of higher value if the audit committee had a background in accounting education.

The Effect of the Audit Committee Charter on the Quality of Financial Reports.

T value for the audit committee charter was obtained of 2.088, and the t table value was 1.988, it indicates H2 is accepted and H0 is rejected. Likewise, the significant value was 0.040, where this number was smaller than α, namely 0.05, so it can be concluded that the audit committee charter had a significant effect on the quality of financial reports with company size, company age, leverage and ROA as control variables.

The results of the research above indicated that there was a significant effect between the audit committee charter and the quality of financial reports. The audit committee charter provided absolute and powerful direction and authority for the audit committee members to be able to carry out the duties and responsibilities written in the audit committee charter. Safira and Ardiyanto (2018) also said that the existence of an audit committee charter would have an impact on the quality of financial reports. The results of this study supported the research conducted by Ika and Ghazali (2012), which showed that the effectiveness of the audit committee had a significant effect on the timeliness of reporting.

The Effect of the Total of Audit Committees on the Quality of Financial Reports.

T value for the total of the audit committee was 2.157, and t table value was 1.988, which means H3 is accepted, and H0 is rejected. Likewise, the significant value was 0.034 where this number was smaller than α, namely 0.05, so it can be concluded that the total of audit committees had a significant effect on the quality of financial statements with company size, company age, leverage and ROA as variables.

The results of the above research indicated that there was a significant relationship between the number of audit committees and the quality of financial reports. The more the number of audit committees in a company, the smaller the errors in the financial statements will be. The increase in the number auditors of a company and the monitoring coverage, the company performance could be improved. This condition will improve the quality of financial reports (Lin et al., 2006).

DeZoort (2002) also asserted that to create an influential audit committee, the audit committee must at least have sufficient and adequate members to hold meetings and exchange opinions with others so that the assigned tasks were carried out correctly and adequately. The results of this study supported research conducted by Mutmainah and Wardhani (2013), which showed that the size of the audit committee had a significant effect on improving the quality of financial reports.

The Effect of Audit Committee Meetings on the Quality of Financial Statements

T value for audit committee meeting was 2.552 and t table value was 1.988, it means H4 is accepted and H0 is rejected. Likewise, the significant value was 0.012 where this number was smaller than α, namely 0.05, so it can be concluded that the audit committee meeting had a significant effect on the quality of financial statements with company size, company age, leverage and ROA as control variables.

The results of the above research indicated that there was a significant relationship between the number of audit committee meetings and the quality of financial reports. An audit committee that meets regularly will be a better supervisor in overseeing the financial reporting process so that it has an impact on the quality of financial reports. Company audit committees that make mistakes in financial reporting have fewer meeting frequencies than audit committees that do not make mistakes in financial reporting (Beasley et al., 2004).

Tiras (2004) also argued that an audit committee that held regular meetings or meetings, it will have a positive effect on the quality of the company's financial statements. The higher the intensity of the meetings held by the audit committee, the better the quality of monitoring and this will improve the quality of the company's financial reports. This explanation is in line with research conducted by Mutmainah and Wardhani (2013), which showed that the number of audit committee meetings had a significant effect on the quality of financial reports.

CONCLUSION, LIMITATION AND SUGGESTION

Conclusion

1. The expertise of the audit committee had a significant effect on the quality of financial reports. This result means that the better the expertise of an audit committee will have an impact on improving the quality of financial reports.
2. The audit committee charter had a significant effect on the quality of financial reports. This result indicates that the clearer the audit committee charter listed in a company will have an impact on improving the quality of financial reports.
3. The total of audit committees had a significant effect on the quality of financial reports. The greater of the total of audit committees in a company, thus, the errors in the financial statements will be smaller, or in other words, the quality of financial reports tends to increase.
4. Audit committee meetings affected the quality of financial reports. This result implies that the greater the total of audit committee meetings held, it will improve the quality of financial reports.

Limitation

This study has some limitations, both in sampling and in the methodology used. These limitations consisted of:

1. This study was limited to manufacturing companies with an observation period of 2018.
2. This study merely used the variable of audit committee expertise, audit committee charter, a total of audit committees and audit committee meetings and it also used variables of company size, company age, leverage and ROA as control variables. Meanwhile, may other variables affect the quality of financial reports such as managerial ownership, Corporate Social Responsibility (CSR).

Suggestion

Based on the results of research and discussion, the researcher provides suggestions for further researchers, namely:

1. For further research, it is suggested to add the research period than this study. Also, the use of an extended research sample covers the other firms than manufacturing firms. The vulnerability of research time and the size of the research sample may show significant changes related to factors that affect the quality of financial reports in a company.
2. The following research is expected to add other independent variables that can affect the quality of financial reports in a company. These variables are, such as managerial ownership, Corporate Social Responsibility (CSR).

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