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The Effectiveness of Audit Committee toward Financial Reporting's Quality (Non-Financial Issuers Listed in Indonesia Stock Exchange)

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Abstract
Corporate governance mechanism is a chain mechanism that direct and control a company with the purpose of the company's operations in line with the stakeholders' interest. Audit committee is an essential pillar of corporate governance in establishing integrity and quality financial reporting. The research aimed to testify the impact of audit committee toward financial reporting's quality in non-financial issuers listed in Indonesia Stock Exchange. The findings of the research indicated that the audit committee had significant impact on financial reporting's quality:
Keywords: Audit Committee, Financial Reporting's Quality

1. Introduction

A number of financial report scandal that had risen in several past years had risen concerns in financial reporting's quality. Levitt (1998) stated that the restatement of financial report or financial case caused explicit recognition on the imprudence and the misstatement of stating financial repot materially.

The number of financial manipulation cases which affected several companies proofed the concerns of financial reporting's quality and the failure of corporate governance. Not only the internal party of the company, but also the external party had to be responsible for the rise of financial manipulation cases (Abbott et al, 2004).

The audit committee was a basic mechanism of corporate governance, whether it was for public company or private company. Consistent and effective practice of corporate governance principles could prevent financial manipulation (earning management). It also caused financial report did not describe fundamental performance (Chtourou et al, 2001). The corporate governance mechanism affected financial information's quality (Klai and Omri, 2011).

Several research findings indicated that audit committee affect financial reporting's quality (Abbott et al, 2004; Felo et al, 2003; Klein, 2002). Abbott et al (2004) asserted that audit committee's independency and activities correlated negatively and significantly with the restatement of financial report. The findings also revealed that audit committee with a member who had skills in accounting and finance correlated negatively and significantly with the restatement of financial report. Nevertheless, audit committee with a member who had skills in accounting and finance was more likely understood audit internal program and its results.

A similar findings that supported by Felo et al (2003) said that the size and the percentage of audit committee's member who were skilled in accounting and management affected financial reporting positively. The findings revealed that the composition of audit committee with accounting and management skills for more than one would be beneficial to the investors. It was possible if the composition of audit committee was bigger. Then, the audit committee with every sources they had would spend more time and effort to ensure the information in the financial report was more accurate and misstatement free material.

In order to enhance the audit committee's effectiveness, the audit committee was required to have skills in accounting, independent and strong commitment in performing the job effectively. The findings revealed that 67% of the correspondents expressed that the audit committee's function assured accounting policy and the quality of financial reporting's monitoring. The audit committee's Independence correlated negatively with abnormal accrual. The findings indicated that the more independent the audit committee was, it would decrease the abnormal accrual (Klein, 2012).

Based on previous elaboration, it could be concluded that the audit committee was part of corporate governance and it was the factor that affected the quality of financial reporting. The correlation could be well elaborated whether theoretically or based on previous researches.

2. Literature Review

Hema (2012) asserted that corporate governance was a chain of processes, patter, policy, law and foundations that affected how the company was directed, given and managed. The financial reporting united the people involved in corporate governance such as management including board of directors, auditors, information distributors, analysts and stakeholders. It was the bridge that connected the company with external parties and it would be a measurement to determine the company's performance and outcome. According to Sloan (2001), the financial information was independent and accurate main source and it was about the communication of the managers' work performance. The relevancy made the financial reporting as the main attraction to affect the management. In other words, the integrity of financial reporting depended on corporate governance.

Board of directors were responsible in monitoring the company and the financial reporting process (Yatim, Kent and Clarckson, 2006). The stakeholders and other investors would observe the reporting in order to determine profit on their investments and making decisions. Essentially, when the corporate governance failed, it would make the company to report bankruptcy where most of it were manipulated by their financial report.

Beasley (2001) stated that board of commissioners designated the responsibility of monitoring financial reporting process. The audit committee was part of sub-committee of board of commissioners were responsible in monitoring financial reporting and reviewing the work would where the results would be used by board of commissioners in making decisions. The review would be dependent on factors such as composition and board of commissioners' size (Zaman, 2001).

The audit committee were responsible in assisting the commissioners in order to enhance the quality of financial reporting and the effectiveness of audit and external audit. The member of audit committee should be at least 3 persons appointed and dismissed by the commissioners, while independent commissioners were appointed to be the head of audit committee. Fama and Jansen (1983) affirmed that board of commissioners through the audit committee was the highest internal control mechanism that was responsible in monitoring the management.

The experience of audit committee in accountancy is really important to have an adequate understanding of monitoring duty. Moreover, previous research also suggests that the audit committee should improve the monitoring skill to improve the quality of financial report (Dezoort, 1998; Defond et al, 2005). Audit committee that possesses financial skill relates to the improvement of financial reporting (Abbott et al, 2003; Carcello et al, 2002) and decrease economic opportunism (Xie et al , 2003).

The size of audit committee is one important characteristic that contributes to the effectiveness. Abbott et al (2004), Vafeas (2005) and Xie et al (2003) state that the size of an ideal audit committee is about 3 to 4 members. Yang and Krishnan (2005) found out that the quarter profit management decreases in companies that have a large size of audit committee members. It shows that adequate numbers of audit committee member can increase the efficiency of monitoring function in financial reporting integrity.

Previous research shows that companies with a high frequency of committee meeting cause the financial report to decrease (Abbott et al, 2004), and also financial manipulation (Abbott et al, 2000; Beasley et al, 2000) and profit management (Xie et al., 2003). Audit committee that regulates the meeting can conduct an effective monitoring. The more often they meet, the more efficient they carry out their responsibility in monitoring. Furthermore, Raghunandan et al (2001) shows that audit committee consists of an independent director, who has at least one member with accountancy background or finance, has a bigger possibility to privately have a meeting with internal chief auditor, to review the result of internal audit, and to review the interaction of management and internal audit.

3. Research Method

The target population of the research is a Non Finance Company that is listed in Jakarta Stock Exchange (JSE). The total number of population is 451 Non-Finance Issuers listed in the JSE. The method used is Probability sampling. Thus, the samples of the study are 82 companies.

The dependent variable of the research is the quality of financial report. The proxy employed in the research is discretionary accrual that uses a modified Jones model.

The Independent Variable of the research is the audit committee that covers skills, the size of the committee, and the frequency of the activity and meetings. The proxy in this research is used as the base of the measurement of committee's skill and competency measured using the percentage of committee members with accountancy and finance skills. The size of audit committee is measured by seeing the percentage of audit committee possessed by a company. Furthermore, in order to be able to determine the frequency of committee meeting or activity can be seen by the percentage of meeting conducted by audit committee.

The Control Variable in the research is the existence of an independent council possessed by commissioner council. Council's skill or competency is measured by considering the percentage of council members with accountancy and finance skill. The size of the council is measured by considering the percentage of commissioner council members that belong to the company. The frequency of meetings can be seen from the percentage of meetings conducted by commissioner council. The commissioner council directly monitors the audit committee and determines the degree of independency and the skill of audit committee. Moreover, the council also agrees with the audit committee charter, the meeting frequency of council affects the audit committee and the responsibility of the committee. The council also has the role in approving the finance report arranged by the management that can influence the quality of the finance report (Beasley dan Salterio 2001, Klein 2002, Peasnell et al 2004).

The size of the company is proxied by the logarithm of natural asset, Profitability is proxied with ROA, leverage is proxied with the total ratio of responsibility toward the total asset that can affect the level of absolute discretionary accrual (Johnson et al, 2002).

The purpose of the finance audit is to give a certainty concerning the integrity of finance report prepared by the management. The uncertainty concerning the relevancy and the obstacles of the finance report of a company are very important in drawing a business decision (Mayangsari, 2003). Thus, in order to control the potential effect of the audit quality towards the characteristic of audit committee and the quality of finance report, the control variable is the quality of auditor which is proxied by dummy (1 = big 4 and 0 = vice versa).

4. The Results of The Research

The results of the audit committee towards the quality of reporting without control variable show that there is no significant influence. It shows that without the existence of independent council, council's skill and competency, the frequency of commissioner council, the size of the company, leverage, profitability and the audit quality as a control variable, audit committee does not influence the quality of finance reporting even though the committee has carried out the duties and responsibilities as regulated by the Government and the company.

The Audit Committee significantly influences the quality of finance report after the presence of control variable is taken into account. Thus, it can be summarized that the audit committee statistically has a significant influence towards the quality of finance report.

The results of the research are relevant. The results support the theory that states committee has an important role in improving the quality of finance reporting (Elder et al 2010: 114; Antonio Alijiyo and Subato Zaini 2004:98). The audit committee is arranged by the commissioner council and has the responsibility to assist the council with the duties and the functions. An effective audit committee will be beneficial in actualizing the clarity of quality finance reporting, an obedience of regulation, and an adequate internal control.

Moreover, audit committee is an important part of a company reporting. The main responsibility of the audit committee is to monitor the integrity of company's finance report and to control the procedure carried out by the management to protect the interest of the stakeholders (PWC 2003: 4).

5. Conclusion

The Audit Committee significantly influences the quality of finance report after the presence of control variable is taken into account. The audit committee is arranged by the commissioner council and has the responsibility to assist the council with the duties and the functions. An effective audit committee will be beneficial in actualizing the clarity of quality finance reporting, an obedience of regulation, and an adequate internal control.

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