



## Audit Committee Quality and Financial Reporting Quality: A Study of Selected Indian Companies

Kanukuntla Shankaraiah<sup>a</sup>, Seyed Masoud Sajjadian Amiri<sup>b</sup>

<sup>a,b</sup>Department of Commerce, Osmania University, India

\*Corresponding author: kanukuntlas@yahoo.com<sup>a</sup>

<https://doi.org/10.24815/jdab.v4i1.6653>

### INFORMATION ARTICLE

### ABSTRACT

Article history:

Received date: 16.December 2016

Received in revised form: 1 January 2017

Accepted: 5 January 2017

Available online: 10 March 2017

Keywords:

audit committee, financial reporting, quality, performance, discretionary accruals.

*This study examines audit committee quality and its relationship with financial reporting quality. The population of this study consists of the companies listed in Bombay Stock Exchange (BSE) between years 2002 and 2012. Using Godden sample size formula, 133 companies are selected randomly for the study. It is found that in most of the equity based listed companies at BSE under study have complied with the legal formalities, for instance, appointment of independent directors, number of meetings, size of the audit committee, legal qualifications and financial qualifications of the directors, as they were required for the listing at a stock exchange in India. Further, the analysis and tests state that board size, audit committee meetings and its size have relationship with the financial reporting practices, but the CEO tenure and hold, board independence, net income, proportion of independent directors on board, legal qualifications and financial qualifications of the directors and overlap of audit committee members on compensation committee, have no influence on the financial reporting practices. Thus, it may be inferred that the companies may improve the financial reporting quality, by managing the board size, audit committee meetings and size, as these characteristics have significant relationship with financial reporting quality.*

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### Introduction

Tang, Chen, and Lin, C. (2008) define financial reporting quality as the extent to which the financial statements provide true and fair view of the underlying performance and financial position. However, Jonas and Blanchet (2000) provide a commonly accepted definition, as quality financial reporting is full and transparent financial information that is not designed to obfuscate or mislead users. In the words of Watkins, Hillison and Morecroft (2004) financial

reporting quality refers to how well financial information of a company reflects the true economic circumstances of the company.

From the above expressions, it may be understood that financial reporting is an efficient tool for management to communicate the performance of the company to stakeholders, as they base their resource allocation decisions on financial information, thus, the financial reporting quality is a prerequisite for efficient capital markets. The following two general perspectives,

described by Jonas and Blanchet (2000) are widely used to assess financial reporting quality: (1) The first perspective relies on the needs of users and emphasizes that the quality of financial reporting is determined on the basis of the usefulness of the financial information to its users; (2) The second perspective focuses on the necessity of financial reporting quality for shareholder and investor protection.

In other words, the first perspective known as the user needs perspective is mainly concerned with the provision of relevant information to users for making decisions, whereas, the second perspective known as, shareholder/investor protection perspective aims at ensuring that the transparent and competent information provided to users is sufficient for their needs.

The utility of financial reports and their quality is further examined by Schipper and Vincent (2003) as the financial reporting quality is very important, and necessity to users to move decision as they need reliable financial information to base their resource allocation decisions. Specifically, auditors, management, audit committees, and boards of directors, have an interest in high quality financial reports to reduce the cost of capital and attract potential investors, for which they follow rules and regulations developed by the regulators and standard setters by promulgating necessary rules that aim for the effectiveness of capital markets.

Thus, the concept of financial reporting quality is broad and significant as it states the quality or useful financial information, disclosure practices and non-financial information to help in decision making, where the role of audit committee members assumes a greater significance in ensuring the financial reporting quality.

In this context, an attempt is made to establish the relationship conceptually between financial reporting quality and audit committee quality characteristics; to examine how the top management discharged their financial reporting

responsibilities to ensure the financial reporting quality.

Evaluating financial reporting quality is a part of the corporate oversight responsibilities of Audit Committees and one of the primary functions of audit committees is to monitor the financial reporting system of the firm, and contribute to corporate control, hence, the audit committees are expected to improve the financial reporting quality of a company.

Realizing the importance of the audit committee in ensuring the financial reporting quality, India began to think in terms of Audit Committees, and has been gaining popularity since 1980. In 1991, the economic reforms placed a great importance on the role of the audit committee, and in 1992, the stock market scam and liberalization of the economy led to the introduction of audit committee requirements. In 1998, constitution of audit committees was recommended by the Confederation of Indian Industries (CII) in its Code of Corporate Governance, which is the first and unique instance of an industry association taking the lead in prescribing audit committee standards for listed companies.

The Reserve Bank of India, in 1999, made it mandatory for all listed banks to establish audit committees as a sub-committee of Board of Directors constituted with non-executive directors, which were to be a liaison between the internal and external auditors and the board of directors. Furthermore, the Companies Act – Amendment (2000, Section 29A) provided for the formation and functioning of audit committees and contains a provision that every public company having paid-up capital of Rs. 5,00,00,000 or more must establish an Audit Committee. Similar requirements for audit committees are prescribed under clause 49 of the Listing Agreement issued by Securities and Exchange Board of India (SEBI), which required all listed companies must have a qualified and an independent Audit Committee, generally consisting of non-executive

directors. This clause was amended in 2004. The non-executive director requirement was removed and replaced with specification that the audit committees should have a minimum of three members with two-thirds of them being independent, and made it mandatory that all companies listed on the stock exchanges had to establish audit committees in their companies. Sarkar and Sarkar (2010), in their study, found that a majority of companies have adhered to this regulation and have constituted audit committees with the minimum size of three, as required under the regulations.

It is stipulated by Section 292A of Companies Act, 1956, that an Audit Committee should have discussions with the auditors periodically about internal control systems, ensure compliance of internal control systems, and scrutinize the scope of audit including the observations of auditors and review of the half yearly and annual financial statements before submission to the Board and that an Audit Committee shall have authority to investigate into anything in relation to such matters and shall have full access to information contained in records of the company.

Clause 49 of the Listing Agreement empowers the Audit Committee to investigate any activity within its terms of reference, seek information from any employee, obtains outside advice and secure attendance of outsiders, if necessary. Within its purview lies the responsibility to recommend the appointment and removal of external auditor, fix audit fees, approve payment for other services, review with the management the annual financial statements before submission to the Board, review the adequacy of internal control system, oversight of the financial reporting process of the company, disclosure of financial information to ensure that financial statements are correct, sufficient and credible; review the adequacy of internal audit function; review the financial and risk management policies of the company; review the functioning of whistle

blower policy and look into reasons for substantial defaults.

In summary, through the intervention of premier industrial association the Confederation of Indian Industries (CII), the Reserve Bank of India (RBI) and statutory and regulatory bodies like The Company Act and Listing Agreement (SEBI), India has developed a strong and empowered culture of Audit Committees in companies that perform their functions credibly.

The next section, literature review, describes state of art and previous studies' result as well as proposed hypotheses. Following that, research method section provides detailed research design and data analysis method. The research findings are discussed in the next section before research conclusion.

### **Literature Review**

In the post Sarbanes-Oxley (SOX) era, monitoring the financial reporting quality of a company, is recognized as a central concern of the of audit committees for the smooth functioning of capital markets, and became as the primary focus of corporate governance reform. Early accounting focused on research whether the existence of an audit committee improved financial reporting quality of firms and the general finding was that there is a positive association between the presence of an audit committee and the financial reporting quality of the firm. In this context, Wild (1996) found too, that the earnings response coefficients for companies with audit committees were higher after the appointment of the audit committee. Therefore, the focus of recent research has been specifically on the characteristics of audit committees and their association with proxies of financial reporting quality of the firm. More particular, independence and financial expertise are two major attributes of the audit committee were focused much in research literature [see for example Klein (2002) and DeFond, Hann and Hu (2005)]. A strong proponent of independence, Securities and Exchange Commission (1999)

argue that audit committees consisting of independent directors would lead to higher financial reporting quality, because they would have reduced conflicts of interest and lessened incentive to sacrifice objectivity. Consistent with this argument, the research concluded by Klein (2002), Abbott, Parker and Peters (2002), Bedard, Chtourou and Courteau (2004), Persons (2004) and Archambeault, DeZoort and Hermanson (2008), show that audit committee independence reduce earnings management, or the likelihood of financial reporting restatement and financial reporting fraud.

Krishnan (2005) stated that independent audit committees are significantly less likely to be associated with the incidence of internal control problems over financial reporting. Whereas, Beasley, Carcello, Hermanson and Neal (2009), concluded that the previous quantitative studies found that higher quality financial reporting and auditing is associated with more independent, expert and diligent audit committees. To sum up, Empirical evidence that the independence of audit committees enhance the quality of financial reporting has been revealed by many studies.

The Blue Ribbon Committee (1999) had advised that, considering the complexities of financial reporting at least a subset of audit committees should have financial reporting expertise, as Xie, Davidson and DaDalt (2003) documented that the performance of an audit committee is enhanced when audit committees have members with financial expertise.

The research has consistently found that it is specifically accounting financial expertise of the Audit Committee that yields monitoring benefits. One recent study, Carcello, Hollingsworth, Klein and Neal (2010), used post-SOX data to show that the positive association between accounting financial expertise and financial reporting quality (discretionary accruals) holds true only for firms with weak corporate governance systems, suggesting that, in the post-SOX era, audit

committee accounting expertise substitutes for other corporate governance mechanisms.

Therefore, the appointment of an accounting expert could only improve financial reporting quality when there are complimentary governance provisions (Carcello, Hollingsworth, Klein and Neal, 2008). On the other hand, firms with strong corporate governance may exert stronger control over the firm's financial reporting decisions, irrespective of the activities of the audit committee, and thus reduce the impact of audit committee financial expertise on the financial reporting quality of the firm (Beasley, Carcello, Hermanson and Lapidés, 2000).

Audit Committees play a very prominent role today in overseeing and monitoring the participation of the management and the independent auditor in the financial reporting process. Some of studies have in later period also shown that audit committees recruit members with significant accounting expertise and that they are involved in substantive financial reporting and oversight practices, assessing the subjective judgments of the management, meeting more frequently, and more often disagreeing with the accounting and reporting decisions of the management.

If an audit committee does not possess accounting expertise, and the lack of accounting expertise results in inadequate financial monitoring, appointing an accounting expert introduces a monitor who is intimately familiar with the financial reporting process, and the new accounting skills allow the audit committee to more effectively monitor the reporting decisions of the managers, then improvements in financial reporting quality would be largest for firms that appointed their first accounting expert. DeFond, Hann, and Hu (2005), provided evidence that accounting skills enhanced the ability of the audit committee to oversee high-quality financial reporting.

Some studies mentioned that audit Committee size (DeZoort and Salterio, 2001) and number of

its meetings (Menon and Williams, 1994) are the other dimensions of audit committees that have been found to be associated with financial reporting outcomes. As the audit committee characteristics have relationship with financial reporting quality, the committees may have a role in reducing in financial statements fraud.

The relationship between audit committees and financial statements fraud has been extensively studied and analyzed. Dechow, Sloan and Sweeney (1996) examined the companies that were required to accounting enforcement actions by the Securities and Exchange Commission for breach of Generally Accepted Accounting Principles and found that companies which were manipulating their earnings were less likely to have an audit committee. This is supported by McMullen (1996), who examined the five potential consequences of audit committees and the occurrence of errors, irregularities and illegal acts relating to financial reporting, and concluded that the companies that had Audit Committees displayed more reliable financial reporting.

Abbott, Park and Parker (2000) found that firms with audit committees constituted with independent directors, and met at least twice a year, were less likely to be fraudulent or misleading financial reporting. Further, the findings of Song and Windram (2004) suggested that the financial literacy of audit committees and their activity level contributed to greater probability of companies complying with financial reporting standards.

The above review of literature may reveal that the studies were conducted by taking up one issue at a time and in a different environment. No study is provided on the analysis of effectiveness of select audit committee qualities on financial reporting quality in Indian context, hence, the present study is taken up to fill up the gap, with the following research methodology expressed in terms of objectives, sample design, tools and limitations, whereas, hypotheses and models

adopted for the study are presented under the test of hypothesis:

Audit committees have attracted considerable attention from researchers due to the recent high profile financial reporting scandals, as the audit committee's play crucial role in the financial reporting processes of firms and hold more responsibility in evaluating financial reporting quality. In this context, a null hypothesis is set as below to test the relationship between audit committee quality and financial reporting quality:

H<sub>0</sub><sub>1</sub>: There is no relationship between audit committee quality and financial reporting quality.

### **Research Method**

The objective of this study is to examine the relationship between audit committee quality and financial reporting quality and measuring the effect of audit committee characteristics quality on corporate governance quality. From 15916 companies listed at Bombay Stock Exchange as on 8.11.2012, 3879 companies are considered based on equity and listing, out of which 133 companies are selected randomly and information relating to financial year 2002-03 to 2011-12 are considered for this study. This study uses the formula given by Godden (2004) to justify the size of sample, as the study uses descriptive statistics dealing with probability and the population is finite. In this study, as public limited companies having a paid-up capital of at least Rs.5,00,00,000, shall constitute a Committee of the Board known as Audit Committee (As required by section 292A of the Companies Act.1956), only listed companies which have Audit Committees are considered.

The data, related to the select characteristics and terms used in the models for analysis are collected from the annual reports of the select companies and notes and statements given in them. The period of the study is recent 10 years, i.e. from 2002-'03 to 2011-'12.

The study uses Pearson Correlation Coefficient, Regression analysis to establish the relationship between the variables. T-test and ANOVA are used to test the effect of the independent variable on the dependent variable and to test the stated hypotheses. Statistical Software-SPSS is used for the purpose of

processing data to arrive at relevant measures of analysis.

To test the above hypothesis the following model developed by Chandar, Chang, Zhenget al (2012), to examine the relationship between boards of directors' quality and financial reporting quality, is used as a basis:

$$\ln(\text{ABS\_PMDA})_{it} = \beta_0 + \beta_1 \text{OVERLAP}_{it\_P} + \beta_2 \text{BD\_IND}_{it} + \beta_3 \text{BDSIZE}_{it} + \beta_4 \text{CEO\_TENURE}_{it} + \beta_5 \text{CEO\_HOLD}_{it} + \beta_6 \text{ABS\_NI}_{it} + \beta_7 \text{L-ASSETS}_{it} + \beta_8 \ln(\text{ASSETS})_{it} + \epsilon_{i,t}$$

**Where,**

**ABS\_PMDA**, the dependent variable, is the natural log of the absolute value of abnormal accrual measured by the Performance Matched Modified Jones model (2005) (Kothari, Andrew and Wasley, 2005).

**OVERLAP\_P** is measured as the proportion of audit committee members who also sit on the compensation committee.

**BD\_IND** measures board independence and is defined as the proportion of independent board directors.

**BD\_SIZE** is the number of board directors.

**CEO\_TENURE** is measured as the number of years the current Chief Executive Officer (CEO) has been in his or her position.

**CEO\_HOLD** is the proportion of common equity owned by the CEO.

**ABS\_NI** is the absolute value of the change in net income between previous year and current year divided by last year's assets.

**L-ASSETS** is financial leverage defined as the long-term debt divided by last year's assets.

**ln(ASSETS)** represents firm size measured as the natural log of total assets.

$\epsilon_{i,t}$  is Error term in year  $t$  for firm  $i$ .

$\beta_0$  is a constant

$\beta_1$  is the slope (also called the regression coefficient)

**Where,**

**PMDA** (Performance Matched Discretionary Accruals), an indicator of financial reporting quality, is determined by modified Kothari – Jones Model as stated below:

$$\text{PMDA}_{i,t} = \text{TA}_{i,t} / \text{A}_{i,t-1} - \text{NDA}_{i,t} / \text{A}_{i,t-1}$$

**Here,**

$\text{TA}_{i,t} / \text{A}_{i,t-1}$  is determined by using modified Jones model as,

$$\text{TA}_{i,t} / \text{A}_{i,t-1} = \beta_0 + \beta_1 [1 / \text{A}_{i,t-1}] + \beta_2 [\text{REV}_{it} - \text{REC}_{it} / \text{A}_{i,t-1}] + \beta_3 [\text{PPE}_{it} / \text{A}_{i,t-1}] + \epsilon_{i,t}$$

**Where,**

$\text{TA}_{i,t}$  - Total accruals in year  $t$  for firm  $i$  (measured by operating profit after tax – cash flow from operations);

$\text{A}_{i,t-1}$  - Total assets in year  $t - 1$  for firm  $i$ ;

$\text{REV}_{it}$  - Revenues in year  $t$  less revenues in year  $t - 1$  for firm  $i$ ;

$\text{REC}_{it}$  - Net receivables in year  $t$  less net receivables in year  $t - 1$  for firm  $i$ ;

$\text{PPE}_{it}$  - Gross property, plant and equipment in year  $t$  for firm  $i$ ;

$\epsilon_{i,t}$  - Error term in year  $t$  for firm  $i$ . **and**,  
 $NDA_{it} / A_{it-1}$  is ascertained by using the following Performance-Matching Model of

$$NDA_{it} / A_{it-1} = \beta_0 [1/A_{it-1}] + \beta_1 [REV_{it} - REC_{it} / A_{it-1}] + \beta_2 [PPE_{it} / A_{it-1}] + \beta_3 ROA_{it-1} + \epsilon_{i,t}$$

**Where**,  
 $ROA_{it}$  is (income before extraordinary items for year  $t / A_{it-1}$ ) \* 100.

As stated earlier, in order to meet the objectives of the present study, the above Performance Matched Jones Modified Model (ABS\_ PMDA), is extended by adding the terms

modified Jones models, developed by Kothari, Leone, and Wasley<sup>5</sup>.

representing the select audit committee characteristics such as, ACIND, ACLEGEX, ACACCEX, ACMEET, ACSIZE, as a result of which, the following equation is emerged and used to test the above stated hypothesis:

$$\ln(ABS\_PMDA)_{it} = \beta_0 + \beta_1 OVERLAP\_P_{it} + \beta_2 BD\_IND_{it} + \beta_3 BDSIZE_{it} + \beta_4 CEO\_TENURE_{it} + \beta_5 CEO\_HOLD_{it} + \beta_6 ACIND_{it} + \beta_7 ACLEGEX_{it} + \beta_8 ACACCEX_{it} + \beta_9 ACMEET_{it} + \beta_{10} ACSIZE_{it} + \beta_{11} ABS\_NI_{it} + \beta_{12} L-ASSETS_{it} + \beta_{13} \ln(ASSETS)_{it} + \epsilon_{i,t}$$

Where, the notation of some terms such as, ABS\_ PMDA, OVERLAP\_ P, BD\_ IND, BD\_ SIZE, CEO\_ TENURE, CEO\_ HOLD, ABS\_ NI, L- ASSETS,  $\ln(ASSETS)$  and  $\epsilon_{i,t}$ , is given already in the context of model given up Nandini et al.

Whereas, the notation of other terms is as follows:

**ACIND** is proportion of independent directors on audit committee.

**ACLEGEX** is proportion of directors on audit committee with legal qualifications.

**ACACCEX** is proportion of directors on audit committee with accounting qualifications.

**ACMEET** is number of audit committee meeting for the year.

**ACSIZE** is number of audit committee members.

With the help of above equation, mean, standard deviation and correlation measures were computed and presented in table-1 and 2 respectively, and followed by the analysis.

**Table-1**  
**Mean and Standard Deviation of Directors Board and Audit Committee Quality and Financial Reporting quality**

No.	Variables	N	Mean	Std. Deviation
1	InABS_ PMDA	1330	0.764	0.560
2	OVERLAP_ P	1330	0.439	0.766
3	BD_ IND	1330	0.560	1.516
4	BDSIZE	1330	8.26	3.148
5	CEOTENURE	1330	6.83	2.542
6	CEO_ HOLD	1330	6.28	9.335
7	ACIND	1330	0.795	0.202
8	ACLEGEX	1330	0.286	0.059
9	ACACCEX	1330	0.601	0.076
10	ACMEET	1330	4.55	1.435
11	ACSIZE	1330	3.73	0.956
12	ABS_ NI	1330	3.765	67.874

No.	Variables	N	Mean	Std. Deviation
13	L_ASSETS	1330	0.092	0.244
14	ASSETS	1330	3.338	0.980
15	Valid N	1330		

Source: Data extracted from Annual reports

The following may be inferred from the above table:

- i) The financial reporting quality measured in terms of the mean value of Performance Matched Discretionary Accrual (ABS\_PMDA) is 0.76 million, and the Standard Deviation is 0.56 million, may reveal that all companies having an Audit Committee reflect a similar Performance Matched Discretionary Accruals.
- ii) The mean value of proportion of audit committee members who also sit on the compensation committee (OVERLAP\_P) is equal to 44 percent with standard deviation equal to 76 percent. A higher deviation that shows a significant dispersion from the mean, may explain that a remarkable number of firms do not have an overlap of Audit Committee Members on Compensation Committee members. This may be due to the fact that members of Compensation Committee are not always drawn from members of the Audit Committee.
- iii) The average value of proportion of independent board directors in the total board of directors (BD\_IND) is equal to 0.56 percent with standard deviation equal to 1.5 percent. The low Standard Deviation reveals that the proportion of Independent Members on the Board of all the firms under study is very similar.
- iv) The mean value of board size (BDSIZE) is 8.2 members and Standard Deviation is 3.1 members. The moderate Standard Deviation reveals that there is a fair percentage of dispersal from the mean in the value of board size among the firms under study. The reason for this may be the firms under study have a wide range of members in their Board.
- v) The mean value of number of years the current CEO in position (CEO\_TENUR) is 6.8 years with standard deviation of 2.5 years, showing that there is a negligible deviation from the mean, and that there is a reasonable range in the tenures of the CEOs of the firms under study.
- vi) The mean of proportion of common equity owned by CEO (CEO\_HOLD) is equal to 60 percent with standard deviation equal to 9.33 percent. The high standard deviation shows that the proportion of common equity owned by the CEOs differ significantly. In other words, the equity ownership varied from firm to firm during the period of study.
- vii) The independence of audit committee (ACIND) represented by the mean value of proportion of independent directors on audit committee (80%) and a standard deviation (20%), revealed that the audit committees of the firms under study have adhered to the requirement of Clause 49 of Listing Agreement (SEBI) 2005, which stipulates “all listed companies should have an Audit Committee, consisting of minimum three directors as members, of which two-third shall be independent”
- viii) The average of proportion of directors on audit committee with legal qualifications (ACLEGEX) value is (29%), while standard deviation equal to (6%). The Clause 49 of Listing Agreement (SEBI) 2005, stipulates that “the company secretary of the firm must also be the Secretary of the Audit Committee”, which brings into the Audit Committee the necessary legal input that is

required by the standard formula for Earnings Quality demands that the legal qualification of the Audit Committee members be taken as a variable in the computation of Earnings Quality. Hence, it may be concluded that the most of the companies in India have at least one audit committee member with legal knowledge and there is variation from a company to company in this regards.

- ix) The mean value of proportion of directors on audit committee with accounting qualification (ACACCEX) is 60% and standard deviation is 8%, revealing that there is a low dispersal from the mean, which may explain that the majority of the Audit Committees of the firms under study have the required number of members with financial and accounting qualification, as specified by the Companies (Amendment) Act (2000) and Clause 49 of Listing Agreement (SEBI) 2005 which states that *“a minimum of three members, all being nonexecutive directors, with the majority of them being independent directors, with at least one director having financial and accounting knowledge.”*
- x) The mean value of audit committee meetings is around 5 times and Standard Deviation is 1.4 times. The low Standard Deviation reveal that the Audit Committees Meet (ACMEET) regularly as stipulated by Section 292A of Companies Act 1956, and Clause 49 of Listing Agreement (SEBI) 2005, which lay down that *“the Audit Committee should meet at least four times in a year and not more than four months shall elapse between two meetings.”*
- xi) The mean value of audit committee size is 3.7 members and Standard Deviation is 0.95 members, showing that the dispersion from the mean is low and that the most of the Audit Committees of the firms under study adhered to the size of the Committee

(ACSIZE), stipulated by clause 49 of Listing Agreement (SEBI) 2005, and Section 292A of the Companies Act 1956, both of which require that *“the audit committee shall consist of not less than three directors /members”*.

- xii) The mean value of absolute value of the change in net income (ABS\_ NI) is 3.76 million and standard deviation is 67.87 million. The high Standard Deviation shows that there has been more or less a uniform change in the net income of the firms under study.
- xiii) The mean value of long-term debt divided by last year's assets (L-ASSETS) is equal to 0.09 million with standard deviation equal to 0.24 million. The reasonably high Standard Deviation reveals that there is a significant difference in the mean value of L-ASSETS of the firms under study, indicating that there could be remarkable variation in either the amount of long-term debts of firms or in their previous year's assets.
- xiv) On the whole, it may be concluded that the most of the equity based listed companies at BSE under study revealed the varied facts related to compensation committee, independency of the directors, the size of the board of directors, tenure and equity owned by CEO and net income. The reason for the longer tenure in the Board and committees might be the members want to stick to the organizations as they saw them growing. Whereas, the constitution of the audit committees in Indian companies are based on the requirement of the various statutes, hence the variability is very less from their respective means.

After knowing the means and variability of the terms of Performance Matched Jones Modified Model, an attempt is made to measure the relationship between the terms and the values are presented in table-2. A close observation of the

table may reveal the following relationships between the characteristics of audit committee quality and directors' board quality, and financial reporting quality, expressed in terms of Performance Matched Discretionary Accruals (AB\_PMDA):

- i) Financial reporting quality expressed in terms of Performance Matched Discretionary Accruals (ABS\_PMDA) are positively and significantly correlated with number of board directors (BD\_SIZE), audit committee with independent members (ACIND) and total assets (ASSETS). This may indicate that PMDA increases with an increase in the BD\_SIZE, ACIND and total assets of company.
- ii) OVERLAP\_P is positively and significantly correlated with independency of the audit committee (ACIND). This may indicate that OVERLAP\_P increase resulted in an increase in ACIND.
- iii) BD\_IND is positively and significantly correlated with number of independent members in audit committee members (ACIND). This may indicate that BD\_IND increases with an increase in the number of independent members of Audit Committees of companies, revealing that the companies' preferred independent members on their board of directors and audit committees.
- iv) Number of Board Directors (BD\_SIZE) is negatively and significantly correlated with CEO\_TENURE and equity owned by the CEO (CEO\_HOLD), showing that with an increase of the tenure of the CEO and an increase in equity owned by the CEO, the number of board members of the company in the Audit Committee decreases. Whereas, the number of board of directors (BD\_SIZE) is positively and statistically correlated with ACIND, ACMEET and ACSIZE. This may indicate that an increase of board members

may lead to an increase in the ACIND, ACMEET and ACSIZE of the company.

The number of board directors (BD\_SIZE) is negatively and significantly correlated with ACLEGEX and ACACCEX, showing that with an increase of the ACLEGEX and ACACCEX, the number of board members of the company decreases or vice versa, which may indicate that the qualifications of audit committee members affected the size of board of director negatively. Further, the number of board directors (BD\_SIZE) and total assets (ASSETS) are positively and significantly correlated, indicating that an increase of board members in the Audit Committee increases the total assets of the company.

CEO\_TENURE and CEO\_HOLD are positively and significantly correlated. This indicates that with an increase in the CEO tenure, there is an increase in the CEO holding in the company. Further, the study of relationship between CEO\_TENURE and audit committee characteristics may reveal that the CEO\_TENURE has positively and significantly correlated with ACLEGEX and ACACCEX. This indicates that an increase in the CEO\_TENURE resulted in an increase in the ACLEGEX and ACACCEX of the company. Whereas, CEO\_TENURE and ACSIZE are negatively and significantly



No.		PMDA	OVER LAP_P	BD_IND	BD-SIZE	CEO_ TENURE	CEO_ HOLD	ACIND	ACLEGEX	ACACCEX	ACMEET	ACSIZE	ABS_ NI	L_ ASSETS	ASSETS	
	<b>Sig. (2-tailed)</b>	0.079	0.747	0.480	0.000	0.017	0.000	0.000		0.000	0.001	0.000	0.048	0.072	0.000	
	<b>N</b>	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	
<b>9</b>	<b>ACACCE</b>	<b>Pearson</b>	-0.005	-0.018	0.020	-0.171**	0.086**	0.053	0.026	0.450**	1	-0.086**	-0.402**	0.024	0.026	-0.227**
	<b>X</b>	<b>Correlation</b>														
	<b>Sig. (2-tailed)</b>	0.845	0.515	0.473	0.000	0.002	0.054	0.345	0.000		0.002	0.000	0.376	0.345	0.000	
	<b>N</b>	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	
<b>10</b>	<b>ACMEET</b>	<b>Pearson</b>	0.014	0.027	0.009	0.259**	-0.017	-0.082**	0.056*	-0.087**	-0.086**	1	0.129**	-0.002	-0.085**	0.412**
		<b>Correlation</b>														
	<b>Sig. (2-tailed)</b>	0.616	0.332	0.746	0.000	0.539	0.003	0.041	0.001	0.002		0.000	0.948	0.002	0.000	
	<b>N</b>	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	
<b>11</b>	<b>ACSIZE</b>	<b>Pearson</b>	0.025	-0.019	-0.021	0.389**	-0.165**	-0.130**	-0.214**	-0.776**	-0.402**	0.129**	1	-0.043	-0.031	0.282**
		<b>Correlation</b>														
	<b>Sig. (2-tailed)</b>	0.366	0.483	0.436	0.000	0.000	0.000	0.000	0.000	0.000	0.000		0.121	0.266	0.000	
	<b>N</b>	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	
<b>12</b>	<b>ABS_ NI</b>	<b>Pearson</b>	-0.021	0.001	-0.002	-0.043	0.035	-0.023	-0.008	0.054*	0.024	-0.002	-0.043	1	0.001	-0.075**
		<b>Correlation</b>														
	<b>Sig. (2-tailed)</b>	0.440	0.973	0.933	0.114	0.196	0.405	0.766	0.048	0.376	0.948	0.121		0.980	0.006	
	<b>N</b>	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	
<b>13</b>	<b>L_ASSET</b>	<b>Pearson</b>	0.052	0.015	0.006	0.005	-0.089**	0.017	-0.055*	0.049	0.026	-0.085**	-0.031	0.001	1	-0.090**
	<b>S</b>	<b>Correlation</b>														
	<b>Sig. (2-tailed)</b>	0.060	0.593	0.819	0.867	0.001	0.542	0.044	0.072	0.345	0.002	0.266	0.980		0.001	
	<b>N</b>	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	
<b>14</b>	<b>ASSETS</b>	<b>Pearson</b>	0.179**	0.028	-0.027	0.580**	-0.198**	-0.171**	0.173**	-0.259**	-0.227**	0.412**	0.282**	-0.075**	-0.090**	1
		<b>Correlation</b>														
	<b>Sig. (2-tailed)</b>	0.000	0.309	0.320	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.006	0.001		
	<b>N</b>	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	1330	

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).

correlated, this may indicate that the ACSIZE of the company is decreased when the CEO\_TENURE is increased.

CEO\_TENURE is negatively and significantly correlated with L\_ASSETS, i.e long-term debts divided by last year's assets and total assets. This indicates that the leverage and total assets of the company decreased when the CEO\_TENURE increased.

- i) CEO\_HOLD is negatively and significantly correlated with ACIND, ACMEET, ACSIZE, indicating that ACIND, ACMEET and ACSIZE of the company decreased when the equity owned by CEO increased. Whereas, CEO\_HOLD is positively and significantly correlated with ACLEGEX and ACACCEX. This may indicate that an increase in the CEO tenure increases the ACLEGEX and ACACCEX in the company. Further, CEO\_HOLD and ASSETS are negatively and significantly correlated, indicating that the total assets of the company decreased when the equity owned by CEO increased.
- ii) ACIND is positively and significantly correlated with ACLEGEX and ACMEET and ASSETS. This indicates that an increase in the ACIND resulted in an increase in the ACLEGEX, ACMEET and ASSETS of the select companies. ACIND is negatively and significantly correlated with ACSIZE and L\_ASSETS, indicating that the ACSIZE and L\_ASSETS of the companies are decreased when the ACIND increased.
- iii) ACLEGEX is positively and significantly correlated with ACACCEX and ABS\_NI, revealing that with an increase in the ACLEGEX, there is an increase in the ACACCEX and ABS\_NI of the select companies. ACLEGEX is negatively and significantly correlated with ACMEET and ACSIZE and ASSETS, showing that the ACMEET and ACSIZE and ASSETS of the

select companies are decreased when the ACLEGEX increased.

- iv) ACACCEX is negatively and significantly correlated with ACMEET and ACSIZE and ASSETS. This shows that with an increase of the ACMEET and ACSIZE and ASSETS, the ACACCEX of the company decreases.
- v) ACMEET is positively and significantly correlated with ACSIZE and ASSETS, revealing that with an increase in the ACMEET, there is an increase in the ACSIZE and ASSETS in the company. ACMEET and L\_ASSETS are negatively and significantly correlated, showing that with an increase of the L\_ASSETS, the ACMEET of the company decreases.
- vi) ACSIZE and ASSETS are positively and significantly correlated. This indicates that with an increase in the ACSIZE, there is an increase in the ASSETS in the company.
- vii) ABS\_NI and ASSETS are negatively and significantly correlated, which implies that as the net income of the company rises, the total assets of the company decreases.
- viii) L-ASSETS with ASSETS are negatively and significantly correlated, from which it may be inferred that the decrease in long-term debts of a company, increases its ASSETS.

In brief, it may be concluded from the above stated findings of the present study that the discretionary accruals increases with the size of the board of directors and the assets for the reason that the choices increase with an increase in the size of the board and assets' volume. The long-term stay by the CEO in the company or the long-term holding of the equity has a negative impact on the discretionary accruals. The board size, leverage with assets base are positively and significantly related. An interesting fact may be noticed from the study that, Board size and assets base, and CEO tenure and the equity holding of the CEO are going hand in hand. This may be due to the expansion of the size of the company and an

increase in the board size with a preference to stay for a long time.

After analyzing the relationships, ANOVA is used to test the presumption that board of directors

and audit committee quality has no relationship with financial reporting quality and the values are presented in the following table-3:

**Table-3:**

**ANOVA table for Directors Board and Audit Committee Quality and Financial Reporting Quality**

Model	Sum of Squares (SS)	DF (V)	Mean Square (MS)	F	Sig.
Regression	27.376	13	2.106	7.107	0.000
Residual	389.929	1316	0.296		
Total	417.305	1329			

*Source: Data extracted from Annual reports*

In the above table, the F-ratio for the regression model is computed by taking a ratio of Mean Square (MS) Regression to Mean Square Residual, and which is equal to 7.107 (2.106/0.296). The test of significance reveals that the probability of obtaining F-stat as the one or more extremes from F distribution on 13 and 1316 degrees of freedom is less than 5% level of significance. Hence, there may be no difference in mean values of board of directors and audit committee quality characteristics and financial

reporting quality measures, thus this study rejects the null hypothesis, and conclude that the alternative hypothesis may be accepted, which means, there is a relationship between the characteristics of the board of directors and audit committees and financial reporting quality. Further, the impact of characteristics of directors of board and audit committee on the financial reporting quality is measured by t-test. The values of which are presented in table-4:

**Table-4:**

**Coefficients table for Directors Board and Audit Committee Quality and Financial Reporting Quality**

Model	Unstandardized Coefficients			t	Sig.
	B	Std. Error			
(Constant)	0.507	0.257		1.970	0.049
OVERLAP_P	0.008	0.020		0.397	0.691
BD_IND	0.005	0.010		0.466	0.641
BDSIZE	0.033	0.006		5.319	0.000
CEOTENURE	0.005	0.006		0.825	0.410
CEO_HOLD	0.000	0.002		-0.218	0.827
ACIND	0.033	0.079		0.416	0.678
ACLEGEX	-0.482	0.414		-1.163	0.245
ACACCEX	0.227	0.221		1.026	0.305
ACMEET	-0.029	0.012		-2.480	0.013
ACSIZE	-0.055	0.026		-2.080	0.038
ABS_NI	0.000	0.000		-0.243	0.808
L_ASSETS	0.132	0.062		2.128	0.034
ASSETS	0.074	0.021		3.529	0.000

*Source: Data extracted from Annual reports*

Table-4 indicates that except, CONSTANT, BDSIZE, ACMEET, ACSIZE, L-ASSETS and ASSETS, the null hypotheses for all other variables, such as, OVERLAP\_P, BD\_IND, CEO\_TENURE, CEO\_HOLD, ACIND, ACLEGEX, ACACCEX and ABS\_NI are accepted. In other words, for the CONSTANT, BDSIZE, ACMEET, ACSIZE, L-ASSETS and ASSETS, H<sub>0</sub> is rejected, from which it may be concluded that there is a significant difference between boards of directors and audit committee characteristics, such as, CONSTANT, BDSIZE, ACMEET and ACSIZE.

### Conclusions

From the above findings, it may be concluded that board size, audit committee meetings and its size, have relationship with the financial reporting practices, but the CEO tenure and hold, board's independence, net income, ACIND, ACLEGEX, ACACCEX and OVERLAP of audit committee members on compensation committee, have no influence on the financial reporting practices. Thus, it may be inferred that the companies may improve the financial reporting quality, by managing the board size, audit committee meetings and size, as these characteristics have significant relationship with financial reporting quality.

Moreover, this study has the limitations as, i) The study is limited to 133 equity based companies listed at Bombay Stock Exchange (BSE) and selected on the basis of Bill Godden principle, hence, the results may not represent of the entire industry or the economy; ii) The study is based on secondary data only and confined to analyze the same for establishing the relationship to understand the impact of select factors on audit committee quality; iii) The study used the models developed by the various authors, academicians, and researchers, after modifying them according to the need of the study, thus, sometimes the process of modifications may not truly represent the desired phenomenon; iv) There may be various

characteristics that determine the audit committee quality, but the study considered only a few audit committee quality characteristics, such as, independency, size, accounting and legal qualifications of members and number of audit committee meetings.

Considering the above limitations, it may suggest to identify other important characteristics of audit committee quality and consider for future studies.

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