

**THE EFFECT OF AUDIT COMMITTEE AND EXTERNAL  
AUDITOR CHARACTERISTICS ON FINANCIAL REPORTING  
QUALITY**



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**THE EFFECT OF AUDIT COMMITTEE AND EXTERNAL AUDITOR  
CHARACTERISTICS ON FINANCIAL REPORTING QUALITY**

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## ABSTRAK

Kajian ini adalah untuk mengenalpasti hubungan di antara ciri-ciri jawatankuasa audit dan ciri-ciri juruaudit luar (pembolehubah bebas) dan kualiti pelaporan kewangan (pembolehubah bersandar). Kajian lepas yang berkaitan dengan kualiti pelaporan kewangan mempunyai skop yang terhad dengan latar belakang Malaysia. Pembaharuan penyelidikan ini adalah ia menyumbang kepada dua dimensi ciri-ciri audit yang berbeza iaitu ciri-ciri jawatankuasa audit dan ciri-ciri juruaudit luar yang dikaji dalam skema yang sama. Kajian ini telah menggunakan sampel daripada Bursa Malaysia, tentunya 100 syarikat tersenarai teratas mengikut saham Bursa Malaysia.

Analisis laporan tahunan telah membuktikan bahawa jawatankuasa audit (berdikari, kepakaran, kerajinan) mempunyai keupayaan ramalan kepada kualiti pelaporan kewangan. Walaupun keputusan menunjukkan pemimpin industri didapati signifikan ke atas kualiti pelaporan kewangan tetapi pada sudut lain, firma audit yang besar tidak signifikan ke atas kualiti pelaporan kewangan. Kajian ini telah menambahkan pemahaman mengenai amalan jawatankuasa audit dan prosedur literatur perakaunan dalam konteks di Malaysia. Kajian ini tidak boleh dibuat kesimpulan umum kerana kajian mengambil 100 syarikat tersenarai teratas dari Malaysia. Keputusan kajian ini mungkin berubah jika kajian akan datang mengambil koleksi sampel yang berbeza.

**Kata kunci:** Jawatankuasa Audit, Juruaudit Luar, Kualiti Laporan Kewangan



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## ABSTRACT

This study aims to examine the relationship between audit committee characteristics and external auditors' characteristics (independent variables) and financial reporting quality (dependent variable). Past studies related to the financial reporting quality has limited scope with regard to Malaysian background. The novelty of this research, therefore, is that it accounts for two different dimensions of audits characteristics i.e. audit committee characteristics and external auditors' characteristics that are examined in the same schema. The study used the sample firms from the Bursa Malaysia, explicitly top 100 performing firms according to the Bursa Malaysia stock exchange.

The analysis of annual reports has proven that audit committee (independence, expertise, and diligence) has the prediction capability to financial reporting quality. Although results indicate that industry leader has significant impact on financial reporting quality, but on other side, large audit firms do not have any significant effect on financial reporting quality. This study adds the knowledge of audit committee practices and procedures in accounting literature regarding Malaysian context. The results of this study cannot be generalized because study used top 100 performing firms from Malaysia. The results of this study might be changed if future researches use different set of sample firms.

**Keywords:** Audit Committee, External Auditor, Financial Reporting Quality



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## TABLE OF CONTENT

<b>PERMISSION TO USE.....</b>	<b>iii</b>
<b>ABSTRAK .....</b>	<b>v</b>
<b>ABSTRACT .....</b>	<b>iv</b>
<b>ACKNOWLEDGEMENT .....</b>	<b>v</b>
<b>TABLE OF CONTENT .....</b>	<b>vii</b>
<b>LIST OF TABLES .....</b>	<b>x</b>
<b>LIST OF FIGURES .....</b>	<b>xi</b>
<b>LIST OF ABBREVIATION.....</b>	<b>xii</b>
<b>APENDIX .....</b>	<b>xiii</b>

### CHAPTER ONE

<b>INTRODUCTION.....</b>	<b>1</b>
1.1 Background of Study .....	2
1.2 Problem Statement .....	5
1.3 Research Questions .....	7
1.4 Research objectives .....	8
1.5 Significance of Study.....	8
1.5.1 Theoretical.....	8
1.5.2 Practical .....	9
1.6 Scope of the Study .....	9
1.7 Organization of the Study .....	9

### CHAPTER TWO

<b>LITERATURE REVIEW.....</b>	<b>11</b>
2.1 Financial Reporting Quality .....	11
2.1.1 Financial Reporting Quality and Audit Committee Characteristics.....	12
2.1.2 Financial Reporting Quality and External Audit Characteristics .....	13
2.1.3 Empirical Studies of Financial Reporting Quality .....	14
2.2 Audit Committee Characteristics .....	16
2.2.1 Audit Committee Independence .....	16
2.2.2 Audit Committee Expertise .....	22
2.2.3 Audit Committee Diligence.....	26
2.3 External Auditor Characteristics .....	28
2.3.1 Large Audit firms .....	28
2.3.2 Industry Leader.....	32

2.4 Underpinning Theories.....	34
2.4.1 Stakeholder Theory .....	34
2.4.2 Signaling Theory .....	35
2.4.3 Agency Theory .....	38
2.5 Summary of the Chapter .....	39

### **CHAPTER THREE**

<b>HYPOTHESIS DEVELOPMENT AND METHODOLOGY.....</b>	<b>40</b>
3.1 Introduction .....	40
3.2 Research Framework.....	41
3.3 Hypothesis Development .....	44
3.3.1 Audit Committee Independence and Financial Reporting Quality .....	44
3.3.2 Audit Committee Expertise and Financial Reporting Quality .....	45
3.3.3 Audit Committee Diligence and Financial Reporting Quality .....	46
3.3.4 Large Audit Firm and Financial Reporting Quality .....	46
3.3.5 Industry Leader and Financial Reporting Quality .....	47
3.4 Data Collection.....	48
3.5 Data Collection Procedures.....	49
3.6 Model Specification and Ordinary Least Square Regressions.....	49
3.7 Measurement of the Variables .....	50
3.7.1 Dependent Variable.....	50
3.7.2 Independent Variables .....	51
3.7.3 Unit of Analysis.....	52
3.7.4 Statistical Technique .....	52
3.7.5 Correlation of Variables .....	53
3.7.6 Regression of Variables.....	54
3.8 Summary for the Chapter .....	54

### **CHAPTER FOUR**

<b>FINDINGS AND DISCUSSION .....</b>	<b>55</b>
4.1 Introduction .....	55
4.2 Descriptive Analysis .....	55
4.3 Correlation Analysis .....	60
4.4 Regression Analysis.....	61
4.5 Summary of the Chapter .....	67



## **CHAPTER FIVE**

<b>CONCLUSION AND RECOMMENDATIONS .....</b>	<b>68</b>
5.1 Introduction .....	68
5.2 Discussion of the Results .....	68
5.3 Limitations and Recommendations for Future Research .....	71
5.4 Conclusion .....	73
<b>References.....</b>	<b>74</b>



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## LIST OF TABLES

Table 4.1	Descriptive Statistics	56
Table 4.2	Correlation Matrix	60
Table 4.3	Estimates of Auxiliary Regression Estimating NDAC	61
Table 4.4	Estimates of Regression Estimating FRQ	64



## LIST OF FIGURES

Figure 3.1      Framework of the study

43



## LIST OF ABBREVIATION

MCCG	Malaysian Code of Corporate Governance
IFRS	International Financial Reporting Standard
FRQ	Financial Reporting quality
ACI	Audit Committee Independence
ACE	Audit Committee Expertise
ACD	Audit Committee Diligence
EALAF	External Auditor Large Audit Firm
EAIL	External Auditor Industry Leader
TAC	Total Accrual
REV	Revenue
REC	Receivable
PPE	Property, Plant and Equipment
ROA	Return on Assets
DAC	Discretionary accrual
NDAC	Non - Discretionary accrual

## APENDIX

List of Companies

88



# CHAPTER ONE

## INTRODUCTION

It is generally believed that fundamental pillar of capital markets is financial reporting quality as efficient resource allocation is determined by such information. When the true performance of a firm is neither disclosed in the annual reports nor reflected in the reported earnings then economy, different companies, individual employees and investors face huge losses (Pergola & Verreault, 2009). Similarly, the evidences of Schipper and Vincent (2003) claim that stakeholders are very much concerned in financial reporting quality disclosed in annual reports as this information highly influence their decision making, specifically information related to investments and contracting.

It is generally argued that information about low and poor financial reporting quality leads to unintended transfer of wealth. The most important role that corporate governance system plays closely monitor financial reporting and earnings quality of a firm (Cohen, Krishnamoorthy, & Wright, 2004). However, significant relation between poor financial reporting quality and different mechanisms of corporate governance is revealed by past studies that particularly discuss hot issues like manipulation, earnings management, flaws in internal control system and financial statement frauds (Beasley, Carcello, Hermanson, & Lapides, 2000; Beasley, 1996; Carcello & Neal, 2000; Dechow & Skinner, 2000; Klein, 2002; Krishnan, 2001). Four major stakeholders watch over corporate governance of a firm which includes external auditors, internal audit, governing board, including audit committee,

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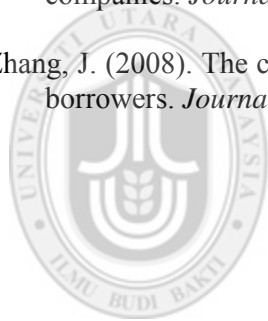
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