



Effects of Audit Quality on the Relationship Between Audit Committee Accounting Expertise and Forward-Looking Disclosures

Mohammad Omid Akhgar

Assistant Professor, Accounting Department, University of Kurdistan, Sanandaj, Iran
mo.akhgar@uok.ac.ir

Peyman Amini

Assistant Professor, Accounting Department, University of Kurdistan, Sanandaj, Iran
(Corresponding Author)
p.amini@uok.ac.ir

Koorosh Morovati

M.A in Accounting, Accounting Department, University of Kurdistan, Sanandaj, Iran
koorosh.morovati@gmail.com

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Abstract

The most important and valuable financial information that disclosed on time can be effective for the users and decision makers. The forward-looking information disclosed is a kind of information that can affect users' decisions. Forward-looking information can reduce the information gap between firms and investors by improving the future anticipation of earnings and investment decisions.

Different factors such as audit committee and the audit quality, can affect the forward-looking information disclosures. The purpose of this study is to investigate the relationship between audit committee accounting expertise and forward-looking information disclosure with the emphasis on the role of audit quality of accepted firms in Tehran Exchange Stock. For this purpose, 114 firms selected as statistical sample by using the systematic sampling among firms accepted in the TSE during 2011-2017. In general 794 firm-year observations were considered to be analyzed. An OLS regression and panel data method is considered for studying the relationship between variables and testing the hypotheses. The results show that there is a positive and significant relationship between audit committee accounting expertise and forward-looking information. Also, the effect of audit quality on the relationship between audit committee accounting expertise and forward-looking information is significant too.

Keywords: Audit committee expertise, Audit quality, Forward-looking information.

1. Introduction

Financial reporting and disclosure are important devices for management in order to have an effective transfer of data to other people. In present literature there are many hypothesis and theories in relation to forward-looking information disclosure and economic consequences of forward-looking information disclosure and its positive effect are implicated. According to Boston (1997), forward-looking information disclosure can have a good rule in reducing the capital expense and increasing the value of company. According to signal theory, firms are in competition to accessing the limited wealth. If a company are well-known and disclose many data about its actives and has a good name in the aspect of financial reporting, it will have more ability in wealth attracting because it will attract investor's trust. The reliable and on time reports can help users to evaluate the future perspective of firms.

Preparing financial reports according to the manager's reporting decision or in other word, according to manager's voluntary and non-voluntary motivation are important areas in literature that is related to information disclosure. Hereof, experimental research about voluntary disclosure have special importance; because it shows the chance and possibility of understanding the role of accounting data in evaluating and financing of companies. Also because of factors such as estimation, allocation and judgment in using the accounting methods, the manager has an opportunity to made decisions about time of recognition and measurement of revenues and expenses. Due to this lack of information, directors can manage the earnings and because of that there will be different between reported earnings (managed earnings) and real performance result of firms (taymori and kazemi, 2017).

Information disclosure by firms is one of the important and valuable sources for making sound decision by investors, creditors and other users. Based on present literature in Iran about information disclosure, the investors, shareholders and analysts pay attention to firms information disclosure that become

mandatory by accounting standards, supervisor and policy maker institutions such as Securities and Exchange Organization, and the voluntary forward-looking information disclosure by management is not more considered (rahmani and bashirymanesh, 2014).

The voluntary disclosure in the most of accepted firms on valid universal securities and exchange organization had been noticed and include other aspects like financial information, future perspective, nonfinancial information and etc. Previous researches in the recent years indicate that classical financial reporting framework doesn't have the ability to show company's activities completely and it doesn't have the ability to response correctly. The forward-looking information disclosure show gap reduction between entity and investors and one of the results of this forward-looking information disclosure is to improve the prediction of firms' future revenues and investors' decision making (Abed and Bravo, 2018).

In order to manage the firms effectively, it is necessary to consider governance mechanisms like independent member in board of directors, audit committee and the internal audit unit. Because of the recent financial bankruptcy of some firms like WorldCom and Enron in U.S and the financial crisis of Europe like the Parmalat in Italia and BBVE in Spain, the quality and the ability of financial reporting and the auditor profession has been suspicion and the rule of audit committee in the financial reporting process has been noticed by standard setting body (mohaamdzadeh kamaly and jafarzadeh, 2018).

The board of directors and its committees are relevant corporate governance mechanism in the oversight of managerial actions (Fama and Jensen, 1983) and board members have an effect on the information disclosed in annual reports (Li et al., 2008).

In recent years, academics and standard setters have called for the improvement of the configuration of the audit committee. In the USA, the independence of audit committees is required for listed companies. The US corporate governance standards establish that the audit committee must have at least one financial

expert. Yet the EU standards have chosen a narrower definition of expertise, focusing on accounting and/or auditing expertise. (Chan et al., 2013; Karamanou and Vafeas, 2005; Wang and Hussainey, 2013). In Iran, existence of audit committee is required for listed companies but, expertise of audit committee members is not mentioned.

Accounting expertise of audit committee members may be necessary for the experts to better perform their monitoring roles because the functions performed by audit committee members require having a thorough knowledge of the accounting standards, practices and procedures (Abed and Bravo, 2018).

The evidence of this study contributes to the corporate governance literature by shedding light on the role of directors' characteristics, such as accounting expertise, and audit quality in the disclosure process. This paper is the first to examine the association between the accounting expertise of audit committee members and forward looking information disclosure and the effect of audit quality on this relationship.

The paper is organized as follows. First, the literature review is described in Section 2. The research methodology that includes hypothesis development, statistical sample and research variables are provided in Section 3. Section 4 discusses the results of the empirical analysis and conclusion is provided in Section 5.

2. Literature Review

Abed and Bravo (2018) investigate the relationship between accounting expertise of the audit committee and forward-looking information disclosure of US companies. The results show that the accounting expertise of audit committee members is associated with forward-looking disclosure practices, particularly with information of a financial and strategic nature.

Se Tin and Murwaningsari (2018) investigate the effect of the audit committee on the relation of the ability of managers on the profit quality. The studying sample include 53 producing firms during the 2014 to 2016 have showed that the ability of manager have a

position and meaningful effect on the profit quality and also the existence of this accounting committee increases the influence of the ability of management on the profit quality.

Alqatamin (2018) studied the effectiveness of the audit committee and the company's operation during the 2014 to 2016. The studied sample include 165 accepted firms in the Security and Exchange Stock of Jordan. The result of research showed that the size of audit committee, independence and gender variety the positive connection with company's operation whereas there isn't a meaningful relation between the experience and the number of session with the company's operation.

Alfarihi (2017) have studied the connection between the dispensation of the company and voluntary forward-looking information. The results indicate that mutual presidency the size of directorate and the dichotomy of duties have a negative relation with the voluntary forward-looking information, whereas the governmental ownership, has a positive relation with the voluntary forward-looking information athwart the unbound managers proportion, the family members in the directorate, the existence of accounting committee and the presence of the governor family in directorate, have a non-meaningful effect on the voluntary forward-looking information process.

El-diftar and the teammates (2017) have studied the connection among the natural ownership, the voluntary forward-looking information and the transparency of the company. The experimented results have shown that the bank ownership and foreign ownership have a positive and meaningful effects on the voluntary forward-looking information and transparency. Among the four properties that have been studies just the size of firms have a positive effect on the voluntary forward-looking information.

Ahmadi and Bauri (2017) have studied the influence of some accounting quality properties (the auditor credit and the profession in audit industry) on the voluntary forward-looking information. With analyzing the panel data through the a sample of 29

accepted firms in the Security and Exchange Stock of Tunisia during the 2009 to 2011 the result posit that the profession in audit and auditor credit improve the voluntary forward-looking information.

Salehi and Shirazi (2010) in their researches indicates that the accounting committee can be encouraging factor for preparing the financial exporting data with high quality

Eazi et al. (2017) in a research studied the relation between the financial behavior of manger on the cognition psychology and the quality of the accounting data forward-looking information with the organizational equation process and the regression equation. The result have indicated that financial behavior of the mangers influenced the quality of forward-looking information of the accounting data.

Rezazade et al. (2018) have expressed the properties of audit committee and the renewed offer of the financial statement that whatever the audit committee expertise be more the renewed offer of the financial statement will be less.

Naqdi and kurdlor (2017) in a research that deal with the influence of the properties of company on the amount of optional forward-looking information of data in the TSE companies posit that just the size of company has a meaningful relation with the level of the optional forward-looking information like profit-making data. the other variables like the age of company, liquidity and the size of the company had not a meaningful connections.

Salehi et al. (2017) examined the influence of the existence of audit committee and the delay of independent auditors report. They found that the amount of the financial expertise audit committee have a negative relation with the delayed auditor reports.

Sadidi et al. (2014) in a survey studied the effective features on the effective factors on the level of the future perspective in the firms that are the members of Security and Exchange Stock of Iran and wrap up that there is a meaningful connection among the size of company, ratio of debt, the size of accounting company and the level of profit of the company with the forward-looking information.

3. Research Method

3.1. Hypotheses Development

In this study, based on literature review and theoretical basis that provided in previous section, we develop 3 hypotheses as follow:

- 1) There is a significant relationship between the audit committee expertise and forward-looking information disclosure.
- 2) Audit quality has a significant effect on the relationship between the audit committee expertise and disclose forward-looking information disclosure.

3.2. Sampling Method

Statistical population in this research includes all firms listed on the Tehran Stock Exchange (TSE) for period from 2011-2018. Systematic elimination method is used for sampling. Hence, firms must have following criteria to be considered as sample:

- Each company must have enough data through years 2011 to 2018, meaning it must be active in Tehran Stock Exchange through this period.
- Each company must be traded at least 9 months per year.
- Financial year of firms must ends in Esfand (end of Iranian fiscal year).
- Companies must not be part of financial firms (including banks), because this industry is regulated and is likely to have a fundamentally different cash flow and accrual processes.
- Financial period of firms must not be changed.

Eventually, after applying these criteria, there are 114 firms in our sample and the final sample size is 794 firm-years.

Financial and accounting data needed to estimate models are obtained from TSE reports on CDs and web.

3.2. Research Models and Variables

In our research, variables are classified into independent variable (audit committee expertise), dependent variable (Forward-looking information

disclosure), moderator variable (audit quality) and control variables (board independency, firm size, financial leverage, and ROA).

In order to testing first hypothesis, we use the following multiple regression:

$$C_{index_{it}} = \alpha + \beta_1 audit\ committee_exp_{it} + \beta_2 Board\ independent_{i,t} + \beta_3 Size_{i,t} + \beta_4 Financial\ leverage_{i,t} + \beta_5 ROA_{i,t} + \varepsilon_{i,t}$$

For testing second hypothesis, the following multiple regression is used:

$$C_{index_{it}} = \alpha + \beta_1 audit\ committee_exp_{it} + \beta_2 audit\ quality_{it} + \beta_3 audit\ committee_exp_{it} * audit\ quality_{it} + \beta_4 Board\ independent_{i,t} + \beta_5 Size_{i,t} + \beta_6 Financial\ leverage_{i,t} + \beta_7 ROA_{i,t} + \varepsilon_{i,t}$$

Where:

C_index_{it} is proxy for forward-looking information disclosure. According to Abed and Bravo (2018) we measure forward-looking information disclosure by using 19 indices such as product share and market share, description of activities, innovation and production, impact of production on results, environmental actions, investment in R&D, human resources, investment in capacity, quality controls and commercial policies, company market analysis, discussion about corporate strategy, investment by segment or geographical location, risk exposure, dividends distribution, intellectual capital, profitable ratios, cash-flow and earnings, financial structure and costs distribution, shares and market capitalization. For each firm-year observation, c_index is measured by dividing the number of disclosed indices by total indices (19).

$audit\ committee_exp_{it}$ is a dummy variable that is used for measuring the audit committee expertise. If in firm's audit committee there is at least one expert in the field of financial accounting, auditor or financial manager it equals one, otherwise it will be zero (Bedard and others, 2004).

$audit\ quality_{it}$ is a dummy variable that take value 1 if the financial statements audit by the Audit

Organization or Mofidrahbar Audit Firm (one of the members of Iranian Association of Certified Public Accountants), or otherwise zero (Nownahal naher et al., 2013; Zalaghi et al., 2019).

$Board\ independent_{i,t}$ is measured as percentage of members on the board who are considered to be independent directors. (Barako et al, 2006; Lime et al., 2007; Abed and Bravo, 2018).

$Size_{i,t}$ represent the size of company and measured as natural logarithm of firm's total assets (Wong and Hosaini, 2003).

$Financial\ leverage_{i,t}$ is companies' leverage and measured as ratio of total liabilities to total owners' equity (Abed and Bravo, 2018; Jonson and Macling, 1976).

$ROA_{i,t}$ is returns on assets and used to measure profitability (Abed and Bravo, 2018).

4. Results

4.1. Descriptive Statistics

Information related to descriptive statistics of variables is shown in table (1) and (2). In table (1) descriptive statistics of relative variables is summarized. As shown in this table, the maximum and minimum values of forward-looking information disclosure (dependent variable) are 0.83 and 0.55 respectively.

In table (2) descriptive statistics of dummy variables (audit committee expertise and audit quality) is shown. As shown in this table, in 507 observations, there is at least one expertise member in their audit committee and in 224 observations, financial statements are audited by the Audit Organization or Mofidrahbar Audit Firm.

Table (1): descriptive statistics of relative variables

Variable	Observation	mean	median	maximum	minimum	Std-Dev
Forward-looking information disclosure	794	0.662	0.662	0.833	0.555	0.787
Board independent	794	0.245	0.400	0.800	0	0.476
Firm size	794	6.064	6.023	8.177	4.415	1.457
ROA	794	11.791	10.127	62.678	-40.386	0.875
Financial Leverage	794	1.552	1.279	25.827	-37.313	0.144

Table (2): descriptive statistics of dummy variables

Variable	Observations	Frequency
Audit committee expertise	794	507
Audit quality	794	224

4.2. Hypotheses Testing

First Hypothesis

In the first hypothesis, the relationship between accounting expertise of audit committee and forward-looking information disclosure is investigated. The results of estimation of regression model related to this hypothesis are shown in table (3).

As shown in table (3) *F*-statistic of model is 92612.65 and significant. This issue shows that this model is significant in general. Adjusted R^2 of this model is 0.999 and means that all variables of model together explain 99% of variation in forward-looking information disclosure. Variance inflation factor (VIF)

for all variables are less than 10 and this means that there is no collinear between variables.

T-statistic of independent variable is 6.331 and it is statistically significant. This shows that there is significant relationship between audit committee expertise and forward-looking information disclosure. The coefficient of independent variable is positive so it could conclude that there is positive and significant relationship between audit committee expertise and forward-looking information disclosure. This result shows that the first hypothesis is confirmed.

Results of testing first hypothesis show that only one control variable (board independent) has a significant relationship with forward-looking information disclosure.

Table (3): results of testing first hypothesis

Variable	Coef.	T-Stat.	Prob.	VIF
C	0.661	3936.220	0.000	-
Audit committee expertise	0.001	6.331	0.000	2.851
Board Independent	-0.001	-6.327	0.000	2.845
Firm Size	-2.761	-0.486	0.626	1.006
ROA	1.361	1.739	0.082	1.016
Financial leverage	-1.320	-0.531	0.595	1.016
R ²	0.998			
Adjusted R ²	0.999			
F-statistic(prob)	92612.65 (0.000)			
Durbin-Watson	2.039			
$C_index_{it} = \alpha + \beta_1 audit\ committee_exp_{it} + \beta_2 Board\ independent_{it} + \beta_3 Size_{it} + \beta_4 Financial\ leverage_{it} + \beta_5 ROA_{it} + \varepsilon_{it}.$				

Second Hypothesis

In the second hypothesis, the effect of audit quality on the relationship between accounting expertise of audit committee and forward-looking information disclosure is investigated. The results of estimation of regression model related to this hypothesis are shown in table (4).

As shown in table (4), *F*-statistic of model is 167351.9 and *p*-value is 0.000. This issue shows that this model is significant in general. Adjusted R^2 of this model indicate that all variables of model together explain 99% of variation in forward-looking information disclosure. Variance inflation factor (VIF) for all variables are less than 10 and this means that there is no collinear between variables.

In this model, coefficient of concern variable (Audit committee*Audit quality) is positive and significant. With regard to coefficient of audit committee expertise that it is positive and significant, it could conclude that audit quality has significant effect on the relationship between accounting expertise of audit committee and forward-looking information disclosure. So, results of estimation of this model indicate that second hypothesis is confirmed.

In this model, only board independent, as a control variable, has a significant relationship with forward-looking information disclosure too.

Table (4): Results of testing second hypothesis

Variable	Coef.	T-Stat.	Prob.	VIF
c	0.661	3916.328	0.000	-
Audit committee expertise	0.003	8.708	0.000	3.056
Audit quality	0.001	-2.458	0.014	1.568
Audit committee*Audit quality	0.001	8.843	0.000	1.962
Independent board	-0.001	-8.785	0.000	2.875
Firm size	8.910	0.204	0.837	1.008
ROA	1.070	1.819	0.063	10.19
Financial leverage	-9.180	-0.297	0.766	1.16
R ²	0.998			
Adjusted R ²	0.999			
F-statistic(prob)	167351.9(0.0000)			
Durbin-Watson	2.050			
$C_index_{it} = \alpha + \beta_1 audit_committee_exp_{it} + \beta_2 audit_quality_{it} + \beta_3 audit_committee_exp_{it} * audit_quality_{it} + \beta_4 Board_independent_{it} + \beta_5 Size_{it} + \beta_6 Financial_leverage_{it} + \beta_7 ROA_{it} + \varepsilon_{it}$				

5. Conclusion

Forward-looking information disclosure can make the decision making process better and also has important role on it. In Iran there is no compulsion about forward looking information disclosure and it is voluntary disclosure. So, mechanisms such as audit committee and accounting expertise of audit committee could affect this type of disclosure. In the other hand, compulsory auditing of firms' financial statements propounds this issue that what is the role of audit quality in voluntary disclosure.

Based on this problem, in this study the relationship between accounting expertise of audit committee and forward-looking information disclosure and the effect of audit quality on this relationship is investigated. For this purpose, two hypotheses is developed.

In first hypothesis the relationship between accounting expertise of audit committee and forward-looking information disclosure is investigated. The results of testing this hypothesis show that there is positive and significant relationship between accounting expertise of audit committee and forward-

looking information disclosure. This result indicates that accounting expertise of audit committee member can increase the disclosure of forward-looking information. In other word, accounting expertise in the audit committee will improve financial reporting and disclosure. The results of testing first hypothesis is consistent with Abad and Barve (2018), Se Ting and Moraning (2018), CHiand and Lin (2012), Nasirzadeh et al. (2018), Rezazadeh et al. (2016) and Chen and Hope (2011).

In second hypothesis the effect of audit quality on the relationship between accounting expertise of audit committee and forward-looking information disclosure is investigate. The results show that audit quality can affect the positive and significant relationship between accounting expertise of audit committee and forward-looking information disclosure. This means that in the firms with high audit quality, the relationship between accounting expertise of audit committee member and disclosure of forward-looking information is stronger. In other word, quality of audit process can improve the relationship between accounting expertise in the audit committee and financial reporting and disclosure. The results of testing second hypothesis is consistent with Ahmadi and Bouri (2017), Lee. P and Taylor (2006), Poorhaidari and Badri (2013), Saemipoor et al. (2014) Liu and Tiras (2014).

The evidence documented in this study contributes to the academic debate about benefits of being financial expert in audit committee. Also, stakeholders and creditors may therefore pay more attention to the firms that have financial expert in audit committee and those that financial statements audited by the Audit Organization or Mofidrahbar Audit Firm. The main limitation of the empirical study is that the level of forward-looking information in annual reports is measured with a disclosure index. The findings of this research create opportunities for future research, such as research on this study topic by analyzing different institutional contexts or use additional measures for the disclosure of forward-looking information for example, focusing on the good news versus bad news.

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