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THE INFLUENCE OF AUDIT COMMITTEE COMPOSITION, AUTHORITY, RESOURCES, AND DILIGENCE TOWARD FINANCIAL REPORTING QUALITY

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Abstract: *This study examines the influence of audit committee composition, authority, resources, and diligence toward financial reporting quality. This study uses explanatory research method and amultivariate regression test to conductthe statistic testing. Data are collected directly from companies and authoritative bodies, i.e., annual report, audit committee charter, and other publications. The result indicates a positive influence of the audit committee diligence on the financial reporting quality. This is revealedthat audit committee meeting and audit committee voluntary disclosure are considered to improve the quality of financial reporting.*

Keywords: *Audit Committee, Composition, Authority, Resources, Diligence, Financial Reporting Quality*

1. INTRODUCTION

There are several definitions about financial reporting. For example, Drake and Fabozzi (2012) define financial reporting as an aggregate presentation of historical and current financial information about a company, whereas Wild *et al*. (2009) refer to itas a means to communicate for the benefit of decision making in investment, credit, and other business field. Financial reporting will report financial information about how a company is performing (Drake and Dingler, 2001). Financial reporting is a means to an end which its ultimate outcome is to improve the decision making (Williams *et al*., 2010). Financial reporting is considered as a lens to see the whole business (Williams *et al*., 2010).

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Financial reporting in Indonesia still has many problems to be solved. First of all, there are several listed companies' annual financial reports with qualified or even disclaimer opinion, consequently they get a warning from Indonesia Stock Exchange (Hoesen, 2014). Another problem is that the many peculiar transactions indicated in financial performance reported by listed companies, so that an investigation audit is conducted for it (Johanes Soetikno, 2014).

The delayed annual and interim financial report delivery to the authoritative body is yet another problem that makes several companies' trading is suspended in the stock exchange as the form of sanction (Ito Warsito, 2012 and Toelle, 2012). Besides, there are many findings in Financial Transaction Reports and Analysis Center/Pusat Pelaporan dan Analisis Transaksi Keuangan (PPATK) related with peculiar financial reporting in some corporations and partnerships (Yunus Husein, 2011).

This low financial reporting quality isprobablydue to the ineffectiveness of the audit committee. This is shown in some phenomena. Based on Bapepam-LK research in 2012, it was discovered that 395 out of 458 listed public companies (93. 60%) already disclosed their audit committee members, but 27 companies only had 1-2 person(s) in their audit committee members, which violatedthe Bapepam-LK rule No. IX. I. 5 about Audit Committee Establishment and Working Guidance. As a result, these 27 companies were sentenced (Etty Retno Wulandari, 2012).

Meanwhile, based on data from 2012annual report, there were only 30% of audit committee members had accounting background (education or experience), 30% had nonaccounting background, and the remaining had no clear background (Ucu Rufiadah, 2013).

Another problem relates tothe audit committee independence. There are many audit committee members who had a special relation with the company and it is contraryto the ideal condition that they must have no relation with stockholders, board of commisioner, and board of director (Allison Marunduri, 2013).

The poor function of audit committee is supposed to drive the low quality of financial reporting. This study examines the influence of audit committee (composition, authority, resources, and diligence) toward the financial reporting quality.

2. LITERATURE REVIEW

2.1. Audit Commitee

Ghillyer (2012) states that audit committeeis an operating committee staffed by members of the board of directors plus independent or outside directors. Audit

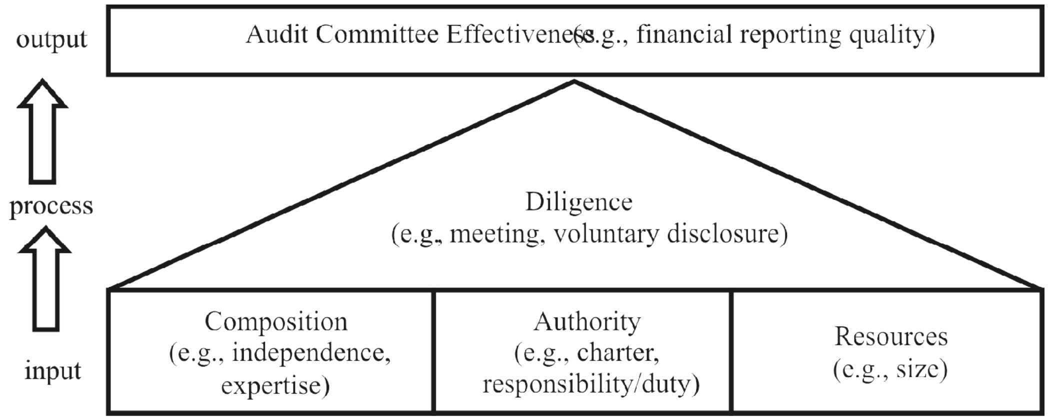

Figure 1: Components of an Effort to Achieve Audit Committee Effectiveness

Source: Adapted from DeZoort *et al.* (2002)

committee has a responsibility tomonitor the financial policies and procedures of the organization-specifically the accounting policies, internal controls, and the hiring of external auditors (Ghillyer, 2012).

Audit committee isone of several operating committees established by the board of commisioners and to some extent guided by the full range of broad responsibilities (Moeller and Witt, 1999). It consists of only outside directors-giving it independence from management and should be composed of a special qualified group of outside directors who understand, monitor, coordinate, and interpret the internal control and related financial activities for the entire board. (Moeller and Witt, 1999).

According to Arens *et al.* (2014) this audit committee is a selected number of members of company's board of directors whose responsibilities include helping auditors remain independent of management. Although there is no worldwide concensus on the composition of audit committees, the best practice is that the committee is made up of three to six members (Ali, 2014).

Briotta (2010) defines audit committee as a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of financial statements of the issuer. Briotta (2010) explains that if no such committee exists with respect to an issuer, the entire board of commisioners of the issuer will function as audit committee.

DeZoort *et al.* (2002) reveal there are four componentsofan effort to achieve audit committee effectiveness:

1. *Composition:* expertise, independence, integrity, objectivity.
2. *Authority:* responsibilities, influence (derived from full board of directors, federal law, and exchange listing requirements).
3. *Resources:* adequate number of members; access to management, external auditors, and internal auditors.
4. *Diligence:* incentive, motivation, perseverance.

Audit committee composition, authority, and resources are the basic inputs needed to achieve its effectiveness (DeZoort *et al*., 2002). These foundation inputs go into the diligence which is the primary process factor needed to achieve effectiveness (DeZoort *et al*., 2002). This framework is used in this study as follows:

2.2. Audit Committee Composition

Audit committee composition refers to the requirement of "right people" as audit committee members with two main facets: independence and competencies (Bedard and Gendron, 2009). Usually, there is a requirement that audit committee must be composed of at least three independent, financially literate directors, one of whom must have accounting or related financial-management expertise (DeZoort *et al*., 2002). The ultimate objective of such requirement is to enable the audit commmittees to make judgments that are in the best interests of shareholders (*i.e.*, independence is required so as to promote objectivity on the part of audit committee members) (DeZoort *et al*., 2002). It is also as an effort to restore investor's confidence in the wake of various financial reporting scandals (Owens-Jackson *et al*., 2009).

Committee members must have no relationship to the company that may interfere with the exercise of their independence from management and the company (Vera-Munoz, 2005). In addition, the audit committee must include at least one member with financial expertise, designated as the financial expert (Vera-Munoz, 2005). Thus, audit committee must have the "right people" as members with member qualifications such as independence and expertise (Bedard and Gendron, 2009).

2.3. Audit Committee Authority

Audit committee authority is a function of the audit committee responsibilities and influence (DeZoort *et al*., 2002) on management and auditors (Van der Nest, 2008). It is derived from the full board of commisioners, law, and exchange listing requirements (DeZoort *et al*., 2002). Authority refers to formal responsibilities where audit committee is made accountable and endowed with the authority to intervene (Bedard and Gendron, 2009). These audit committee responsibilities are generally stated in a formal charter (the audit committee charter), which provide legitimate capacity to intervene (Bedard and Gendron, 2009).

The audit committee charter has become an increasingly important document for helping audit committee members to focus on their specific responsibilities and for helping stakeholders to assess the role and responsibilities of audit committee (DeZoort *et al*., 2002). Audit committee authority (influence) also depends on the audit committee's relationships with management, external and internal auditors, and the board as a whole (DeZoort *et al*., 2002). However, it is important to be realized that all mandatory responsibilities documented in audit committee charter always have the risk exposure of becoming ritualistic (Bedard and Gendron, 2009).

2.4. Audit Committee Resources

Because of the comprehensive responsibilities scope and the complex nature of the accounting and financial mattes reviewed, the audit committee needs significant resources, *e.g.*, number of commisioners involved on the committee, monetary resources to hire consultants for advice, and informational resources (Bedard and Gendron, 2009). The audit committee must have adequate resources to do its job (DeZoort *et al*., 2002). Adequate number of committee members is needed to generate substantive discussion and to consider emerging issues, as well as access to management, external auditors, internal auditors, the full board, and legal counsel (DeZoort *et al*., 2002).

Recent regulations (Bapepam-LK, 2012) stipulatethat audit committee of a company should comprise of at least three members. This minimal threshold is seen as ensuring appropriate monitoring through diversity of expertise (Bedard and Gendron, 2009). The benefits of additional members must be weighed against the incremental costs of poorer communication, coordination, involvement and decision-making associated with larger groups (Bedard and Gendron, 2009). The objective is to have an audit committee not so large as to become unwidely, but sufficiently large to ensure appropriate monitoring (Bedard and Gendron, 2009).

2.5. Audit Committee Diligence

Diligence refers to the willingness of committee members to work together as needed to prepare, ask questions, and pursue answers when dealing with management, external auditors, internal auditors, and other relevant constituents (DeZoort *et al*., 2002). The audit committee member's will to act is the most important component of an effort to achieve an effective audit committee

(DeZoort *et al*., 2002). Expertise, independence, authority, and resources as the input components, will not result in effectiveness unless the audit committee conducts the mechanisms by which all inputs are translated into organizational outcomes (Bedard and Gendron, 2009). Audit committee must be diligent in working to serve the best interests of stakeholders (DeZoort *et al*., 2002).

Diligence is considered a process factor which is required for an effective audit committee (Lary and Taylor, 2012). Diligence is the desire of audit committee members' to carry out their monitoring roles and include factors such as the number of board meetings and the behavior of individual which include preparation before meetings, attentiveness and participation, and post-meeting follow-up, but the factor that is publicly observable is the number of board meeting (Lary and Taylor, 2012).

Diligence can be observed fromsix proxies, *i.e.*, agenda, meetings, questioning, relationships, power and leadership (Bedard and Gendron, 2009). The number of meetings held is an observable proxy to the degree of effort the audit committee exerts in overseeing financial reporting (He *et al*., 2009). Every important activity should be disclosed to signal that the audit committee works well. Thus, another important proxy to audit committee dilligence is audit committee voluntary disclosure.

2.6. Financial Reporting Quality

Stice and Stice (2012) state that the purpose of financial reporting is to aid interested parties in evaluating a company's past performance and in forecasting its future performance. The information about past events is intended to improve future operations and forecasts on future cash flows (Stice and Stice, 2012).

According to Jonas and Blanchet (2000) there are two approaches related to financial reporting quality, as follows:

1. *Users need approach:* This approach tend to focus on valuation-related issues (Jonas and Blanchet, 2000). Under the user need category, the quality of financial reporting is determined in relation to the usefulness of the financial information to the user (broadly defined as investors and creditors) of that information (Jonas and Blanchet, 2000).
2. *Shareholders/investors protection approach:* This approach tends to focus more on corporate governance and stewardship-related issues (Jonas and Blanchet, 2000). Under the shareholder protection category, the quality of financial reporting is defined primarily in relation to providing shareholders with full and transparent financial information that is not designed to obfuscate or mislead users (Jonas and Blanchet, 2000).

The objectives of each approach are not necessarily mutually exclusive, in many respects, they reinforce each other (Jonas and Blanchet, 2000).

Cohen *et al*. (2004: 91) explain that the notion of financial reporting quality remains a vague concept. Financial reporting is another term for financial accounting (Anthony *et al*, 2011: 4). In financial accounting quality, there are five quality approaches, *i.e.*,1) GAAP quality, 2) audit quality, 3) GAAP application quality, 4) transaction quality, and 5) disclosure quality (Penman, 2007). This study uses the last approach by operationalizing qualitative characteristics both fundamental and enhancing qualities (van Beest*et al.,* 2009).

The fundamental qualitative characteristics (*i.e.* relevance and faithful representation) are most important and determine the content of financial reporting information (van Beest *et al*., 2009). The enhancing qualitative characteristics (*i.e.* understandability, comparability, verifiability, and timeliness) can improve decision usefulness when the fundamental qualitative which include characteristics are established (van Beest *et al*., 2009).

In order to achieve a high quality of financial reporting, the acceptable accounting methods, the amount and types of information to disclose, and the format in which to present it are chosen depend on which alternative provides the most useful information for decision-making purposes (decision-usefulness) (Kieso *et al*., 2014). Regardless of the classification, each qualitative characteristic contributes to the decision-usefulness of financial reporting information (Kieso *et al*., 2014). Characteristics that make information useful are relevance, reliability, completeness, timeliness, understandability, and verifiability (Azmi Fitriati and Sri Mulyani, 2015).

Mackenzie *et al*. (2012) state that qualitative characteristics consist of fundamental and enhancing characteristics, where fundamental qualitiesen compass relevance and faithful representation, while enhancing qualities encompass comparability, verifiability, timeliness, andunderstandability. Beyersdoff *et al*. (2013) also explain that fundamental and enhancing qualities are the most valuable information for capital providers. The qualities that make accounting information useful have been designated its "qualitative characteristics" (Carmichael *et al*., 2007). These characteristics are the attributes that make information useful to users (Gaffikin, 2008). Subramanyam and Wild (2009) call these characteristics as desirable qualities of accounting information. Information with criteria such as relevant, reliable, complete, timelines, understandable, verifiable, and accessible is classified as a high quality infomation (Sri Mulyani, 2009). The usefulness of this high quality information depends on the user (Sri Mulyani, 2009).

2.7. The Influence of Audit Committee Composition, Authority, Resources, and Diligence Toward Financial Reporting Quality

One form of audit committee effectiveness is a high quality of financial reporting. The audit committee has a significant impact in reducing the likelihood of fraud and restatements, so that there must be frequent communication between the auditor, the audit committee, and the board (Cohen *et al*., 2007). Communications between the audit committee and the auditor must include discussions of areas susceptible to earnings management (Cohen *et al*., 2007). The auditor and the audit committee should discuss factors that are not included in the financial statements that might drive managers to make aggresive accounting choices, such as analyst forecast data (Cohen *et al*., 2007). Thus, audit committee (composition, authority, resources, and diligence) will influence the financial reporting quality.

The firstpotential factor that can affect the financial reporting qualityis the audit committee composition (Beasley and Salterio, 2001). Composition of the audit committee has been the focus of many governance reform efforts (Beasley and Salterio, 2001). Audit committees with independent members appear to be more active, more involved in audit committee functions and less likely to be involved in actions that impinge on the quality of financial reporting (van der Nest, 2008). Aggresive earnings management is negatively associated with financial and governance expertise of audit committee members and with independence of the committee (Owens-Jackson *et al*., 2009). Independent audit committee members and audit committee financial experts are positively related to factors expected to improve the financial reporting process (Felo and Solieri, 2009). Thus, the first hypothesis is formulated as follows:

H_1: Audit committee composition has a positive effect on financial reporting quality.

The second factor potentially affecting the financial reporting quality is audit committee authority. Audit committeeauthority can be grouped into three categories:

1. oversight of external communications,
2. monitoring of the internal control system, and
3. oversight of the external auditor (Bedard and Gendron, 2009).

While the requirements of laws and regulations have traditionally emphasized the oversight of financial reporting and external auditing, recent regulatory reforms have extended audit committee authority to internal control systems and expanded its oversight responsibilities regarding external communications and external auditing (Bedard and Gendron, 2009). There are five key authority areasidentified, namely financial reporting, risk management, governance, internal control and the evaluation of the audit process (Bedard *et al*. 2004; van der Nest, 2008). The main audit committee authority is to oversightthe financial reporting. Thus, the second hypothesis is formulated as follows:

H_2: Audit committee authority has a positive effect on financial reporting quality.

The third factor is the audit committee resources. One of observable resouces of audit committee is the audit committee size. There are mixed findings in various studies relating to the impact of audit committee size on financial reporting quality, where out of 27 studies, only six find a positive association, five a negative one, and the sixteen other no significant association (Bedard and Gendron, 2009). However, audit committee was considered as a significant variable in explaining the likelihood of quarterly earnings management (Yang and Krishnan, 2005), of earnings restatement (Lin *et al.,* 2006), and of qualified audit opinion in annual report (Pucheta-Martinez and Fuentes, 2007). A limited number of audit committees indicates an essentially dysfunctional committee (van der Nest, 2008). Thus, the third hypothesis is formulated as follows:

H_3: Audit committee resources has a positive effect on financial reporting quality.

The last factor is the audit committee diligence which can be shown in audit committee meeting and voluntary disclosure. Several studies have examined the relationship between audit committee meetings and financial reporting quality. Farber (2005) found that fraud firms had less frequent audit committee meetings than non-fraud firms in a year preceding the fraud is revealed; but in three years after, fraud firms conducted audit committee meetings more frequent than non-fraud firms. With regard to restatement (one of the proxies for low reporting quality), Abbott *et al*. (2004) found that firms with audit committee meetings at least four times a year were less likely to have prior period financial statement restatement. Thus, the fourth hypothesis is formulated as follows:

H_4: Audit committee diligence has a positive effect on financial reporting quality.

3. METHOD

The research object at the center of attention in this study is audit committee (composition, authority, resources, diligence) and financial reporting quality. The research method is explanatory method, which is done to obtain a description, picture or depicting systematically, factual information aboutthe nature of and the relationship between variables studied (Sekaran and Bougie, 2013). The main reason of using this method is to find empirical facts about audit committee (composition, authority, resources, diligence) as factors that can cause a particular phenomenon related to the low quality of financial reporting.

3.1. Sample and Data Collection

Population is the entire group of people, events, or things that the researcher desires to investigate (Sekaran and Bougie, 2013). The population of this study is comprised of 511 listed corporationin Indonesia Stock Exchange for 2014.

Sampling is the process of selecting items from the population so that sample characteristics can be generalized to population (Sekaran and Bougie, 2013). Sampling consists of decision in design choice and sample size (Sekaran and Bougie, 2013: 398).

Sampling technique designused in this research is probability sampling-simple random sampling. The sample is chosen randomly without any group level concerns and every item has the same probability to be chosen (Sekaran and Bougie, 2013).

The minimum sample size is 84, calculated based on Slovin equation as follows (Husein Umar, 2003) :

$$n = \frac{N}{1 + Ne^2}$$

Where

n = sampel size

N = population size

E = tolerable error term (10%)

87 companies is already chosen for the actual sample in this research. Data are collected directly from 87 companies and also from the authoritative bodies (Indonesia Stock Exchange and Financial Service Authority). In order to maintain the data validity, the measurement is conducted by three raters and only the same result of measurement is used.

3.2. Varaible Operationalization

Measurement for every variable is conducted based on the variable operationalization as follows:

3.3. Data Analysis

The purpose of this study is to examine whether audit committee (composition, authority, resource, and diligence) have an influence on financial reporting quality. The independent variable audit committee (composition, authority, resource, and

Table 1
Variable, Proxy, and Measurement

Variables (Code)	*Proxies (Measurement)*	*Scale*	*Item*
Audit Committee Composition (ACC) (DeZoort *et al*., 2002; Bedard & Gendron, 2009; van der Nest, 2008; Felo & Solieri, 2009; Owens-Jackson *et al*., 2009; Beasley & Salterio, 2001; Ali, 2014; Vera-Munoz, 2005)	Audit committee independence Percentage of independent audit committee member (Bedard & Gendron, 2009; He *et al*., 2009; Bedard *et al*., 2004; Abbott *et al*., 2000; Carcello *et al*., 2002; Kusnadi *et al*., 2014; Sun *et al*., 2012; Hamdan *et al*., 2013; Habbash *et al*., 2013; Miettinen, 2008; Lary & Taylor, 2012; Kang *et al*., 2011; Chan & Sun, 2010; Lin *et al*., 2006; Rahman & Ali, 2006; Abbott *et al*., 2003; Aanu *et al*., 2014; Carcello *et al*., 2010)	Ratio	1
	Audit committee expertise Percentage of audit committee member with finance/accounting education/experience (Nelson & Devi, 2013; Krishnamoorthy *et al*., 2002; Bedard & Gendron, 2009; He *et al*., 2009; Bedard *et al*., 2004; DeZoort & Salterio, 2001; Krishnan *et al*., 2011; Sharma & Iselin, 2012; Carcello *et al*., 2002; Chan & Sun, 2010; Krishnan & Lee, 2009; Lin *et al*., 2006; Rahman & Ali, 2006; Carcello *et al*., 2006; Abbott *et al*., 2003; Cohen *et al*., 2013; Aanu *et al*., 2014; Carcello *et al*., 2010; Kang *et al*., 2011; Lary & Taylor, 2012; Morrow & Pastor, 2007; Miettinen, 2008; Habbash *et al*., 2013; Hamdan *et al*., 2013; Kusnadi *et al*., 2014; Sun *et al*., 2012; Salleh & Steward, 2011)	Ratio	2
Audit Committee Authority (ACA) (DeZoort *et al*., 2002; Bedard & Gendron, 2009; van der Nest, 2008)	Audit committee charter Explanation that the company has anaudit committee charter. Further explanation in audit committee charter 1. Duties, responsibility and authority 2. Composition, structure, and requirement of member 3. Working procedure 4. Meeting policy 5. Activity reporting system 6. Provision about whistleblowing related with financial reporting 7. Working period (Section 1 point *f* RuleNo. IX.1.5 Appendix of the Bapepam LK Decree No. Kep-643/BL/2012 about Audit Committee Establishment and Working Guidance)	Ratio	3-10

	Audit committee charter index$_j$ = $\left(\sum_{i=1}^{n} a_i\right)/M$ Where: *j* = company *j* a_i = audit committee charter indicatori M = expectedmaximum score (Bedard & Gendron, 2009; Bedard *et al*., 2004; Carcello *et al*., 2002; Rezaee *et al*., 2003; Morrow & Pastor, 2007)		
	Audit committee responsibility/duty Further explanation about audit committee responsibility/duty 1. Reviewing financial information published by the company for public or the authority 2. Reviewing compliance on regulation 3. Giving independent opinion in a dissenting opinion 4. Giving recommendation to the Board of Commisioner about appointment of public accountant 5. Reviewing audit process of internal audit and its follow up on findings 6. Reviewing risk management (only if the company does not have a risk management function below the board of commisioner) 7. Reviewing whistleblowing related with company accounting process and financial reporting 8. Reviewing and giving recommendation about potential interest conclict 9. Maintaining the confidentiality of company document, data, dan information (Section 5 Rule No. IX.1.5 Appendix of the Bapepam LK Decree No. Kep-643/BL/2012 about Audit Committee Establishment and Working Guidance) Audit committee duty index = $\left(\sum_{i=1}^{n} a_i\right)/M$ Where: *j* = company *j* a_i = audit committee duty indicator *i* *M* = expectedmaximum score (Bedard & Gendron, 2009; Bedard *et al*., 2004; Rezaee *et al*., 2003; Kamel & Elkhatib, 2013)	Ratio	11–19
Audit Committee Resources(ACR) (DeZoort *et al*., 2002;	Audit committee size Audit committee size compared to three minimum member (Section 2 Point a Rule No. IX.1.5	Ratio	20

Bedard & Gendron, 2009; van der Nest, 2008)	Appendix of the Bapepam LK Decree No. Kep-643 /BL/2012 about Audit Committee Establishment and Working Guidance)(Bedard & Gendron, 2009; Bedard *et al*., 2004; He *et al*., 2009; Carcello *et al*., 2002; Turley & Zaman, 2007; Lin *et al*., 2006; Aanu *et al*., 2014; Carcello *et al*., 2010; Kang *et al*., 2011; Miettinen, 2008; Habbash *et al*., 2013; Hamdan*et al*., 2013)		
Audit Committee Diligence (ACD) (DeZoort *et al*., 2002; Bedard & Gendron, 2009; van der Nest, 2008; He *et al*., 2009; Turley & Zaman, 2007; Cohen *et al*., 2007; Lary & Taylor, 2012)	Audit committee meeting 1. Number of audit committee meeting compared to fourth times as minimum number annually (one times for three month) (Section 7 point a Rule No. IX.1.5 Appendix of the Bapepam LK Decree No. Kep-643/BL/2012 about Audit Committee Establishment and Working Guidance) (Bedard & Gendron, 2009; Ali, 2014; He *et al*., 2009; Bedard *et al*., 2004; Carcello *et al*., 2002; Turley & Zaman, 2007; Lin *et al*., 2006; Raghunandan & Rama, 2007; Abbott *et al*., 2003; Vera-Munoz, 2005; Aanu *et al*., 2014; Carcello *et al*., 2010; Kang *et al*., 2011; Lary & Taylor, 2012; Miettinen, 2008; Habbash *et al*., 2013; Hamdan *et al*., 2013) 2. Average of presentation percentage in audit committee meeting in a year (Bedard & Gendron, 2009; Carcello *et al*., 2002)	Ratio	21–22
	Audit committee voluntary disclosure Concise report about real activity related with duty and responsibility of audit committee 1. Reviewing financial information published by the company for public or the authority 2. Reviewing compliance on regulation 3. Giving independent opinion in a dissenting opinion 4. Giving recommendation to the Board of Commisioner about appointment of public accountant 5. Reviewing audit process of internal audit and its follow up on findings 6. Reviewing risk management (only if the company does not have a risk management function below the board of commisioner) 7. Reviewing whistleblowing related with company accounting process and financial reporting 8. Reviewing and giving recommendation about potential interest conclict	Ratio	23–31

	9. Maintaining the confidentiality of company document, data, dan information Audit committee disclosure index$_j$ = $\left(\sum_{i=1}^{n} d_i\right)/M$ Where: j = company j d_i = audit committee disclosure indicator i M = expected maximum score (Bedard & Gendron, 2009; Turley & Zaman, 2007; Rezaee *et al*., 2003)		
Financial Reporting Quality (FRQ) (Kieso *et al*., 2014; Mackenzie *et al*., 2012; Beyersdoff *et al*. 2013)	Relevant (Braam & van Beest, 2013; van Beest*et al*., 2009; Kieso *et al*., 2014; Mackenzie *et al*., 2012; Beyersdoff *et al*, 2013; Carmichael *et al*., 2007; Gaffikin, 2008; Stice & Stice, 2012; Subramanyam & Wild, 2009; Gibson, 2011; Sri Mulyani, 2009) 1. To what extent does the company use fair value instead of historical cost? 2. To what extent does the presence of non-financial information in terms of business opportunities and risks complement the financial information? 3. To what extent does the risk section provide good insights into the risk profile of the company? 4. To what extent does the annual report contain forward-looking information? 5. To what extent does the annual report contain information on CSR? 6. To what extent does the annual report contain a proper disclosure of the extraordinary gains and losses? 7. To what extent does the annual report contain information regarding personnel policies? 8. To what extent does the annual report contain information concerning divisions? 9. To what extent does the annual report contain an analysis concerning cash flows? 10. To what extent are the intangible assets disclosed? 11. To what extent are the “off-balance” activities disclosed? 12. To what extent is the financial structure disclosed? 13. To what extent does the annual report contain information concerning the companies’ going concern? Braam & van Beest (2013)	Ordinal	1–13

	Representation Faithfulness (Braam & van Beest, 2013; van Beest*et al.*, 2009; Kieso *et al*., 2014; Mackenzie *et al*., 2012; Beyersdoff *et al*, 2013; Carmichael *et al*., 2007; Subramanyam & Wild, 2009; Sri Mulyani, 2009) 14. Which type of auditors' report is included in the annual report? 15. To what extent does the company provide information on corporate governance? 16. To what extent does the annual report contain disclosure concerning the "comply or explain" application? 17. To what extent does the annual report contain disclosure related to both positive and negative contingencies? 18. To what extent does the annual report contain information concerning bonuses of the board of directors? Braam & van Beest (2013)	Ordinal	14–18
	Comparability (Braam & van Beest, 2013; van Beest*et al.*, 2009; Kieso *et al*., 2014; Mackenzie *et al*., 2012; Carmichael *et al*., 2007; Gibson, 2011) 19. To what extent are changes in accounting policies disclosed? 20. To what extent are changes in accounting estimates disclosed? 21. To what extent does the annual report contain information concerning comparison and effects of accounting policy changes? 22. To what extent does the company present financial index numbers and ratios in the annual report? 23. To what extent does the annual report contain information concerning companies' shares? 24. To what extent does the annual report contain benchmark information concerning competitors? Braam & van Beest (2013)	Ordinal	19–24
	Verifiability (Braam & van Beest, 2013; van Beest*et al.*, 2009; Kieso *et al*., 2014; Mackenzie *et al*., 2012; Beyersdoff *et al*, 2013; Carmichael *et al*., 2007; Subramanyam & Wild, 2009; Gibson, 2011; Sri Mulyani, 2009) 25. To what extent are valid arguments provided to support the decision for certain assumptions and estimates in annual report?	Ordinal	25–26

	26. To what extent does the company base its choice for certain accounting principles on valid arguments? Braam & van Beest (2013)		
	Timeliness (Braam & van Beest, 2013; van Beest*et al.*, 2009; Kieso *et al.*, 2014; Mackenzie *et al.*, 2012; Beyersdoff *et al*, 2013; Stice & Stice, 2012; Subramanyam & Wild, 2009; Sri Mulyani, 2009) 27. How many days did it take for the auditor to sign the auditors' report after book-year end? Braam & van Beest (2013)	Ordinal	27
	Understandability (Braam & van Beest, 2013; van Beest*et al.*, 2009; Kieso *et al.*, 2014; Mackenzie *et al.*, 2012; Beyersdoff *et al*, 2013; Gaffikin, 2008; Stice & Stice, 2012; Sri Mulyani, 2009) 28. To what extent is the annual report presented in a well organized manner? 29. To what extent does the presence of graphs and tables clarify the presented information? 30. To what extent does the annual report contain technical jargon in the perception of the researcher? 31. What is the size of the glossary? 32. To what extent does the annual report contain information concerning mission and strategy? 33. To what extent is the annual report understandable in the perception of the researcher? Braam & van Beest (2013)	Ordinal	28–33

diligence) is measured in a ratio scale. The dependent variable financial reporting quality is measured in an ordinal scale. So it needs to be upgraded to an interval scaleusing the method of succesive inverval (MSI). The following cross-sectional regression model with an ordinary least squares (OLS) technique is used to test the influence of audit committee (composition, authority, resource, and diligence) toward financial reporting quality.

$$FRQ = \alpha + \beta_1 ACC + \beta_2 ACA + \beta_3 ACR + \beta_4 ACD + e$$

The proxy and measurement of each variable is defined in the variable operationalization (Table 1). STATA 12.0 is used as ananalysis tool to develop the cross-sectional regression model. A robust option is already used for estimating the standard errors and passing the classic assumption test.

4. RESULT AND DISCUSSION

The multivariate regression analysis gives the following result:

Table 2
Result of Multivariate Regression for Estimating *FRQ*
***n* = 87**

Item	*Parameter*	*Estimate*	*Standard Error*	$p > \|t\|$
Constanta	α	0. 8009943	0. 1097661	0. 000 ***
ACC	β_1	0. 0344876	0. 0735716	0. 640
ACA	β_2	0. 0390168	0. 0519445	0. 455
ACR	β_3	0. 061153	0. 0821545	0. 459
ACD	β_4	0. 1276893	0. 0258902	0. 000 ***
R-Square		0. 4020		
Probability F		0. 0000***		

As shown in Table 2, the F-statistic of the model is significant (p < 0,00001) indicating that a subset of the independent variables does explain the variation in Financial Reporting Quality (FRQ). The value of R^2 is 0. 4020 indicating that about 40 per cent of the Financial Reporting Qualityvariance can be explained by independent variables in the model.

Audit committee diligence (ACD) is a significant variable which influence financial reporting quality (at 1 per cent level). The result suggests the audit committee diligence is more likely to increase the financial reporting quality of the company. It supports that the audit committee meeting is important process to be considered for enhancing the financial reporting quality. Audit committee meeting can be held in both face-to-face meeting and teleconference meeting, so every participant can discuss anything planned in the agenda (Bedard and Gendron, 2009). A private meeting with the external and internal auditor, without management being present, is very suggested to find a fact objectively, *e.g.,* their relation with the management and management's competencies (Bedard and Gendron, 2009).

Formal and informal process is proven very important for the audit committee to conduct its duty and responsibility (Turley and Zaman, 2007). Audit committee voluntary disclosure is an important means to signal that every process, both formal and informal,is done well. The reports of the audit committee can lend more credibility to audit financial statements by affirming that:

1. financial statements present fairly in conformity with GAAP;
2. financial statements fairly reflect the company's financial condutions and performance;

3. the financial audit are thorough; and
4. there were no conflicts of interest that could possibly impair the auditors' independence (Rezaee *et al*., 2003)

The regression result also indicates that audit committee composition (ACC), authority (ACA), and resources (ACR) are not significant in influencing FRQ. On the other hand, the positive coefficient of audit committee composition, authority, and resources is consistent with the prediction in the literature which implies that input factors in an effort toachieve audit committeeeffectiveness has a positive association with financial reporting quality. This result may be explained by the fact that information about audit committee composition, authority, and resources reported by the company in annual report and website is not in the same format so it is not comparable for the content analysis. Besides, the input factors among the company is indifferent each other, with very little variance. Every company reports their ideal desirable inputsof audit committee to the public.

5. CONCLUSION

This study provides empirical evidence on the important role of audit committee, as one of the corporate governance mechanism, in ensuring the financial reporting quality. The finding shows that the audit committee diligence may increase the quality of financial reporting. In Indonesia, audit committee diligence is proven as a significant factor that can influence financial reporting quality. Thus, companies should perhaps evaluate how to further improve audit committee diligence in order to enhance the quality of financial reporting.

There are some limitations in this study that should be considered when interpreting the results. First, with regard to the design of this study, the data are collected from externally available information (annual report and website). There is a possibility that audit committee component and financial reporting quality presented in the annual report and website does not reflect the actual practices. Further research is suggested to use other measurements by in depth interview to depict this true fact from the company. Second limitation is the window period. This research is a crosssection research that uses data from 2014 annual report and information published in website in 2015. Thus, further research may perform a longitudinal analysis to capture more complex factors that influence financial reporting quality. Another limitation is the measurement developed in this research. Probably, there are other aspects of audit committee and financial reporting quality that have not been addressed by this study. Then, further research can explore other alternative measurements for audit committee and financial reporting quality.

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………, Bapepam LK RuleNo. IX. 1.5 Appendix of the Bapepam LK Decree No. Kep-643/BL/2012 about Audit Committee Establishment and Working Guidance.

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