

**The Impact of the Audit Committee  
Effectiveness and Audit Quality on Financial  
Reporting Quality of listed company in Stocks  
Exchange of Thailand**

Malai Kamolsakulchai  
College of Innovation Management,  
Rajamangala University of Technology Rattanakosin,  
Nakornpathom, Thailand

— *Review of* —  
**Integrative  
Business &  
Economics**  
— *Research* —

**ABSTRACT**

This study aims to investigate the relationship between the audit committee effectiveness and audit quality on financial reporting quality. Panel data were collected from the Form 56-1 and financial statements of listed companies, including three industry groups, in Stock Exchange of Thailand from 2008 to 2012; and data was analyzed using Panel Fixed Effects Model. The results show that the audit committee effectiveness had a significantly positive relationship with financial reporting quality. As the size of audit committee increased, financial reporting quality was improved. However, this study reveals that a decreased quality of financial reporting may be a result from arisen discretionary accruals. Audit quality was found to be positively associated with financial reporting quality significantly, determined from unqualified audit opinion. This indicates that financial reporting was prepared according to generally accepted accounting standards. Moreover, size of board of directors, financial risk, return on assets and growth had a positive relationship with financial reporting quality, as administrators are motivated to create a good operation performance, thus creates credibility to investors and shareholders.

Keywords: audit committee effectiveness, audit quality, financial reporting, Thai listed companies

**1. INTRODUCTION**

Discretion of the executive is a part of financial reporting that can be manipulated according to their requirements in order to achieve their goal of operation, by the use of earnings management. There are studies showing that discretionary accrual is a proxy of earnings management and indicative of financial reporting (Dechow & Sloan, 1995; Healy, 1995; DeAngelo, 1986). However, administrators or the authority intend to modify performance to comply with their needs by any means, such as earnings or accounting manipulation that can be managed through optional accounting standards. Adjustment on accounting policy to reflect business would affect users' decision on financial statements that requires a high quality financial reporting. Audit committees are responsible for considering hiring and examining the performance of auditors, and considering impacts of audit quality on the relationship between audit committee effectiveness and financial reporting quality (Cohen, 2004).

This present study is, therefore, investigates the association between the audit committee effectiveness and audit quality that affects financial reporting quality of listed companies in Stock Exchange of Thailand (SET); in order that shareholders and stakeholders would be aware of financial reporting quality which could reduce earnings management. Also, this could indicate a good corporate governance, transparency and creditability.

## **2. THEROTICAL FRAMEWORK, REVIEW AND HYPOTHESES**

### **2.1 Theoretical framework**

One of the main objectives of corporate governance is to ensure a good quality of company's financial reporting. Previous studies have focused on the role of board of committee on operating audit committee and external auditor to observe the effectiveness of the audit committee, supervise and oversee financial reports. This partly depends upon the constitution of the board of directors and the audit committee of each firm that are factors of a good quality profit account (Bradbury, 2004; Vafeas, 2005). Study of Ball (2008) states that financial reports are also economically important. Therefore, administrators are the agent, which is responsible for preparing financial statements to report financial position and the achievement to shareholders, also known as the principal in the agency theory. The management division holds more information over shareholders in which asymmetric information is generated between them. (Jensen & Mecking, 1976; Healy & Palepu, 2001). Shareholders will ensure financial reporting prepared by administrators to affirm the accuracy of the prepared report. In general, the management division uses services provided by professional external auditors in order to conduct the audit and comment on financial reports, as well as to verify whether or not the report is prepared in compliance with generally accepted accounting standards. Auditor's opinion on financial reports can assure users. According to theories, auditors will perform to benefit shareholders and to reduce agency problems between the agent and the principal. It is possible that administrators would hire auditors who serve high quality standards. Therefore, the agency theory is a prediction that agency problems will become severe, so that administrators have a demand of high quality financial reporting for shareholders, creditors and other investors (Francis & Wilson, 1988; DeFond, 1992; Kalbers, 1998).

The link between earnings management and optional accounting procedures is an opportunity for administrators to manage earnings, in case of administrators having an incentive to use discretionary accrual through choosing an accounting policy that increases profits in the current accounting period. This is dependent on how effective the operation is. Therefore, financial statement is employed as a tool for measuring performance of management. However, it is not implied that the management division always has motivation to increase earnings. Never the less, if earnings of any year is lower than the intended level for bonus payments, the management division tends to reduce earnings in that year by recognizing losses as far as possible; as the management division is aware of a chance for not getting a bonus is very high. This purging behavior is called Take an Earning Bath. This activity would help to increase profits of the next year resulting in bonus being paid as desired (The Bonus Plan Hypothesis) (Watts & Zimmerman, 1978; Watts & Zimmerman, 1979).

### **2.2 Literature review and hypotheses**

### **2.2.1 Audit committee effectiveness**

An audit committee is a subcommittee of the board of directors which is responsible for operating company's financial reporting. Responsibilities of the audit committee include financial reporting (including internal controls), auditing and supervising other proceedings, *e.g.*, facilitating communication between the board and the external auditor (Wolnize, 1995; DeZoort, 1997). Studies also found that audit committee effectiveness is the ability to implement its responsibilities as stated above (Kalbers & Fogarty, 1993; DeZoort, 2002).

Previous research has measured the audit committee effectiveness by the following variables;

#### ***Audit committee size***

From previous studies, it has been shown that the size of an audit committee measured as a figure has a positive effect on the audit committee effectiveness. This is because the number of the audit committee members of sufficient size is better than a small committee size (DeZoort, 2002; Cummings, 1974). However, it is likely that audit committee effectiveness may be experiencing problems if the committee becomes too large. As a large committee may generate more losses, process and workload distribution is immoderate. Therefore, the previous studies have shown that the right size of the audit committee will provide a high quality of monitoring financial reporting.

#### ***Audit committee meeting frequency***

Studies of Kalbers (1993) and DeZoort (2002) show that the number of committee meetings has an effect on audit committee effectiveness. It is expected to increase the frequency of committee meetings (Menon, 1994; Abbott, 2000; DeZoort, 2002; Lee & Mande, 2005; Stewart, 2007). To become more effective, committee members ought to be willing to devote more of their time for auditing (Kalbers, 1993; Lee, 2004). Previous studies also found that the frequency of meetings of audit committees is associated with increased quality of earnings (Xie, 2003; Vafeas, 2005). However, researches from Australia found that no significant evidence of association between the frequency of meetings and earnings management (Davidson, 2003).

#### ***Audit committee expertise***

Audit committee expertise is referred to the audit committee members who have the knowledge and experiences in accounting and financial reporting, internal controls and auditing (such as SOX 2002). Experts are expected to have a greater directing on financial reporting quality over non-expert auditors, including a better understanding of risks and on auditor's opinions. The above notion is supported by evidence in previous studies. For example, studies of DeZoort (1998), DeZoort & Salterio (2001) and Bédard (2004) found that audit committee members with accounting and financial expertise provide more support on auditing output and to reduce problems on auditor's disagreement, as well as to confine earnings management. These findings contradict the research by Peasnell (2005) as no correlation between audit subcommittee properties and earnings management was not found, as the following hypothesis has been developed:

H1: Audit committee effectiveness is positively associated with financial reporting quality.

### 2.2.2 Audit quality

Literature review of DeAngelo (1981) defines audit quality as a chance or a probability of auditors to identify and report significant errors. A study found that a good quality auditing is correlated with earnings management in which there is less manipulation on numeral report (Becker, 1998). Variables that have been studied in the past on audit quality are as follows.

#### *Audit fees*

Studies have found that auditor's opinion is referred as a measure of auditor independence because auditors must be independent enough to report the truths to the public. It has been shown that audit fee is negatively correlated with the possibility of financial statement manipulation. This means that a higher audit fee results in a better audit quality (Hoitas, 2007; Stanley & Dezoort, 2007). However, the rate of audit fees is dependent on how many hours spent on the audit (Goodwin & Munro, 2004).

#### *Audit firm size*

Audit firm size is highly associated with a greater level of disclosure. Audit firm's authority is designated to push clients to disclose more information in their annual reports (Watts and Zimmerman, 1986; Francis, 2004). Currently, the integration of four internationally renowned audit companies, also known as Big 4 comprising of Pricewaterhouse Coopers (PwC), Deloitte Touche Tohmatsu (DTT), Ernst & Young (EY) and KPMG, may have an impact on small-sized audit firms; in which merging is a mechanism to prevent earnings management (DeAngelo, 1981; Al-Ajmi, 2009). However, studies of Jeong & Rho (2004) found that different sizes of audit firms do not significantly affect the audit quality.

#### *Auditor report*

Previous researches investigating conducting roles of the Securities and Exchange Commission (SEC) have shown that a higher quality audit improves the quality of financial reporting and reduces risks from auditor report on financial misstatements (Blue Ribbon Committee (BRC), 1999; Australian Stock Exchange (ASX) Corporate Governance Council, 2003). This may be because an unqualified audit opinion is used to address hypothesis in most researches, but emphasis is not taken into consideration. Nevertheless, as by the present inspection procedures of SEC on financial statements, although a company was audited with an unqualified audit opinion but emphasis is included, the company will be closely monitored or reviewed in particularly. These studies led to the hypothesis as follows:

H 2: Audit quality is positively associated with the quality of financial reporting.

### 2.2.3 Board of Directors

A principle of corporate governance of listed companies is that the board of directors is responsible for overseeing the management to achieve the objectives of shareholders, and is representative of shareholders (the Stock Exchange of Thailand, 2006). Variables used in the study are as follows.

#### *Board size (BSIZE)*

Studies of Ezat & EL-Masry (2008) and Beasley (2000) found that the high number of board members results in users receiving information more quickly, and improving performance efficiency. Instead, Jensen (1986) asserted that a high number

of board members causes a lower operating efficiency and related problems, as members assume that the company will be audited by involved participants but there is no such act (free-riders).

***Board independent (BIND)***

The high number of independent directors results in more contribution monitoring and management (Ezat & EL- Masry, 2008).

***Board meeting frequency (BMEET)***

The number of meetings of the board of directors is used as a measure of commitment in operation, as being a representative of shareholders. Directors that meet regularly improve understanding and can identify problems more quickly, thus operation is improved (Hashim&Rahman, 2010).

H 3: Board of directors is positively associated with financial reporting quality.

**2.2.4 Control variables**

Ratios of leverage, shareholders and firm size are control variables to avoid errors in this study. These variables are as follows.

***Leverage***

Financial risk is measured in a form of the ratio of total debts to total assets. A study has shown that companies with a high ratio of financing structure are likely to fail to comply with the repayment agreement (DeFond & Jambalvo, 1994). Earnings management is operated through discretionary accruals by manipulating earnings. This is consistent with Chen & Church (1992) which states that high financial risk will create a greater level discretionary accrual. This means that a company with high financial risk results in a low earnings quality.

***Return on Assets (ROA)***

ROA is a ratio that measures the ability of an enterprise to generate profits from assets. If ROA is higher compared to the average ROA of an industry or a sector, the company has a highly efficient use of assets.

***Growth***

Study of Smith and Watts (1992) found that administrators of companies of high growth tend to carry out earnings management through discretionary accruals. This is due to increased earnings will increase the value of firm. This indicates that a higher assets growth results in increased accruals, which is in turn increasing in earnings management (Johnson & Lys, 1990; Smith &Watts, 1992).

***Quick ratio***

Quick ratio is calculated from the current assets deduced by inventories, then divided by the current liabilities.

***Firm size***

Firm size has been considered to be a control variable due to several reasons such as political costs, which occur in a large enterprise facing with political processes, that may have a greater effect on business compared to a small one (Watts & Zimmerman, 1986). Thus it is more likely to manage earnings, compared to a small business, to avoid pressure. The reason that earnings management of a large business tends to be lower than a small business is because of a larger capital. A sufficient amount of personnel that can clearly be appointed for operations and a decent internal control will help to amend the data. Total assets is used as a measure of firm size

calculated from the natural log of total assets to reduce scale difference of variables (Xie, 2003; Yang & Krishnan, 2005).

H 4: Control variables are positively associated with financial reporting quality.

### 3. METHODOLOGY

#### 3.1 Data collection and Samples

Data of listed companies in SET that have similarities in the population were collected and categorized into 3 industry groups. The information is a data collection of five years (2008-2012) of the Form 56-1 annual reports from the website of SEC, and financial statements were obtained from SETSMART.

#### 3.2 Model Specification and variables

Measurement of financial reporting quality (FRQ) is measured from earnings management of a firm with changes in discretionary accruals. It can be calculated from the equation model developed in the Modified Jones (1995). Dechow (1996), Teoh (1993), Ching (2002) and Klein (2002) measured earnings management as follows.

**Step 1** Total accruals (TA) was calculated from the difference between net profit and cash flow operations on cash flow statement; it can be expressed by the following equation:

$$TA_{it} = NI_{it} - CFO_{it} \quad (1)$$

where:

$$\begin{aligned} TA_{it} &= \text{Total accruals} \\ NI_{it} &= \text{Net profit} \\ CFO_{it} &= \text{Cash flow from operations} \end{aligned}$$

**Step 2** Total accruals was used in the model of Jones (1991) creating a least squares regression model of total accruals to estimate the linear regression coefficients according to the following equation:

$$TA_{it}/A_{it-1} = \alpha_1 (1/A_{it-1}) + \alpha_2 [(\Delta REV_{it})/A_{it-1}] + \alpha_3 (PPE_{it}/A_{it-1}) + \varepsilon_{it} \quad (2)$$

where:

$$\begin{aligned} TA_{it} &= \text{Total accruals of firm } i \text{ at the end of time } t \\ \Delta REV_{it} &= \text{Revenue of firm } i \text{ at time } t \text{ deduced by income of firm } i \text{ at time } t-1 \\ PPE_{it} &= \text{Property Plant and Equipment of firm } i \text{ at time } t \\ A_{it-1} &= \text{Total assets of firm } i \text{ at the end of time } t-1 \\ \alpha_1 \alpha_2 \alpha_3 &= \text{Linear regression coefficients of the model} \\ \varepsilon_{it} &= \text{Approximation errors of total accruals} \end{aligned}$$

After the coefficients  $\hat{\alpha}_1 \hat{\alpha}_2 \hat{\alpha}_3$  were determined, they were then put into the Modified Jones (1995) to calculate non-discretionary accrual. The model is expressed as follows:

$$NDA_{it} = \hat{\alpha}_1 (1/A_{it-1}) + \hat{\alpha}_2 [(\Delta REV_{it} - \Delta REC_{it})/A_{it-1}] + \hat{\alpha}_3 (PPE_{it}/A_{it-1}) \quad (3)$$

where:

$NDA_{it}$  = Non-discretionary accruals at time  $t$  divided by total assets of firm  $i$  at time  $t-1$

$\Delta REC_{it}$  = Receivable of firm  $i$  at time  $t$  divided by receivable of firm  $i$  at time  $t-1$

Because administrators are likely to manage earnings as income from credit sales are higher than cash sales, so that the Modified Jones (1995) uses receivables from credit sales that are deducted from revenue before calculating  $NDA_{it}$ . Thus in this model, it was then divided by total assets of the previous year to reduce effects of heteroscedasticity.

**Step 3** When non-discretionary accrual was defined, it was deduced from total accruals. The remaining is the difference that is discretionary accrual, as expressed in the equation:

$$FRQ_{it} = (TA_{it}/A_{it-1}) - NDA_{it} \quad (4)$$

where:

$FRQ_{it}$  = Financial reporting quality measured through discretionary accrual

Although FRQ should conceptually be positive, the computed FRQ can actually be both positive and negative. To solve this problem, this study transforms FRQ by taking exponential function to adjust the value to be positive

$$EFRQ_{it} = \exp(FRQ_{it}) \quad (5)$$

Then, the model:

$$\begin{aligned} EFRQ_{it} = & \beta_0 + \beta_1 AC\_SIZE_{it} + \beta_2 AC\_MEETING_{it} + \beta_3 AC\_EXP_{it} \\ & + \beta_4 AUDITFEE_{it} + \beta_5 AUDITSIZE_{it} + \beta_6 AUDITREPORT_{it} \\ & + \beta_7 BSIZE_{it} + \beta_8 BIND_{it} + \beta_9 BMEET_{it} + \beta_{10} LEV_{it} + \beta_{11} ROA_{it} \\ & + \beta_{12} GROWTH_{it} + \beta_{13} QR_{it} + \beta_{14} FIRMSIZE_{it} + \beta_{15} GROUP_{it} + \varepsilon_{it} \end{aligned} \quad (6)$$

where

#### **Dependent variables**

$EFRQ_{it}$  = Financial reporting quality measured through exponential of discretionary accrual

#### **Independent variables**

Audit committee effectiveness:

$AC\_SIZE_{it}$  = Audit committee size

$AC\_MEETING_{it}$  = Ratio of number of audit committee meetings to total meetings

$AC\_EXP_{it}$  = Auditors with expertise in accounting and finance ratio

Audit Quality:

$AUDITFEE_{it}$  = Audit fees

$AUDITSIZE_{it}$  = Audit firm size, 1=Big 4 and 0=others

$AUDITREPORT_{it}$  = Auditor report, 1 = Clean report and 0 = others

#### **Control variables**

$BSIZE_{it}$  = Number of board members

$BIND_{it}$  = Board independence ratio

$BMEET_{it}$  = Frequency of board meetings

Copyright © 2015 Society of Interdisciplinary Business Research ([www.sibresearch.org](http://www.sibresearch.org))

ISSN: 2304-1013 (Online); 2304-1269 (CDROM)

$LEV_{it}$	= Leverage ratio
$ROA_{it}$	= Return on assets
$GROWTH_{it}$	= Rate of growth of assets
$QR_{it}$	= Quick ratio
$FIRMSIZE_{it}$	= Firm size measured from the natural log of assets
$GROUP_{it}$	= Industry group
$\varepsilon_{it}$	= Errors of the model

#### 4. RESULTS

Result estimation of each industry group analyzed using Panel fixed effects is shown in Table 1.

**Table 1:** Result estimation of each industry group analyzed using Panel fixed effects

VARIABLE	AGRO&FOOD	TECHNOLOGY	INDUSTRIALS
<b>Audit committee</b>			
<i>AC_SIZE</i>	0.1101 ***	0.0887 *	-0.0200
<i>AC_MEETING</i>	-0.0213	0.2622	0.0032
<i>AC-EXP</i>	0.0085	0.1067	0.1760
<b>Audit Quality</b>			
<i>AUDIT FEE</i>	-0.0614	0.0019	-0.0306
<i>AUDIT SIZE</i>	-0.0320	-0.0544	-0.2009
<i>AUDIT REPORT</i>	-0.2517 **	-0.1859	0.0283
<b>Control variable</b>			
<i>BSIZE</i>	0.0020 *	-0.0284	-0.0082
<i>BIND</i>	-0.0978	0.0919	-0.2195
<i>BMEET</i>	0.0086	0.1786	-0.0711
<i>LEV</i>	0.1706 ***	-0.0828	0.0341
<i>ROA</i>	0.0001	0.0042 ***	0.0067 ***
<i>GROWTH</i>	0.2960 ***	0.2950 ***	0.1520 ***
<i>QR</i>	0.0001	0.0028	-0.0010
<i>FIRM SIZE</i>	-0.0460	-0.0672	0.0308
<i>_cons</i>	1.9913 ***	1.7481 **	1.0213
Number	185	169	270
F-test	5.9575	10.0690	7.2667
R-squares	0.3854	0.5443	0.3440
Adjusted R-squares	0.1497	0.3513	0.0904



Fixed Effects F-test	2.0340	2.3449	1.0014
Correlation of Fixed Effects	-0.7610	-0.7548	-0.7222
Overall R-squares	0.0696	0.1743	0.1952
Within R-squares	0.3854	0.5443	0.3440
Between R-squares	0.0054	0.0279	0.1985

\*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$

The results in Table 1 show that audit committee effectiveness is significantly in a positive correlation with financial reporting quality. For Agro & Food industry and Technology groups, increased number of audit committee members resulted in increased level of discretionary accruals, thus causing a decreased quality of financial reporting. Whereas, there was no such relationship found in the industrial products group. By considering each variable, it was found that increased number of audit committee members resulted in improved monitoring of financial reporting, whereas the frequency of meeting and audit committee expertise in accounting or finance were found to have no correlation with financial reporting quality in all 3 groups.

The correlation result between audit quality and financial reporting quality was significantly positive. There was no correlation found between audit fees and audit firm size with financial reporting quality in all 3 industry groups. Besides, auditor's opinion was found positively associated with financial reporting significantly in Agro & Food industry, whereas there was no such correlation found in Technology and Industrials groups.

Board of directors had a significantly positive relationship with financial reporting quality, by which board size was determined as a variable, in Agro & Food industry; no similar correlation was seen in Technology and Industrials groups. Board independence and board meeting frequency were not found to be associated with financial reporting quality in all 3 industry groups.

There was a significantly positive relationship between leverage and financial reporting in Agro & Food group, but there was no such correlation found in Technology and industrials groups. For rate on assets in Technology and Industrials groups, there was a positive strong correlation between with financial reporting, whereas similar correlation in the Agro & Food industry was not detected. There are indications of a significant relationship between growth and financial reporting shown in all 3 groups of industries while no association was found using quick ratio and firm size as variables.

## 5. DISCUSSION AND CONCLUSION

From the study of the relationship between audit committee effectiveness and audit quality with financial reporting quality, it may be concluded as follows.

**Audit committee effectiveness** If there are more members of audit committee, the oversight on financial reporting is greater. While in this study found that a lower financial reporting quality may be consequence of increased level of discretionary accruals. This suggests that an adequate size of audit committee is better than a small-sized audit committee, which is consistent with the study of DeZoort (2002) and Cummings (1974). Conversely, effectiveness of audit committee may be problematic if it is too large by which it may generate more losses. Process and workload distribution

Copyright © 2015 Society of Interdisciplinary Business Research ([www.sibresearch.org](http://www.sibresearch.org))

ISSN: 2304-1013 (Online); 2304-1269 (CDROM)

could be immoderate. So that previous studies have addressed that an appropriate size or large-sized audit committees can enhance financial reporting quality. For the ratio of audit committee meeting to total meetings and audit committee members with expertise in accounting or financial, no relationship was found in 3 industry groups. This is consistent with studies of Davidson (2003), Vafeas (2005) and Peasnell (2004). It may be due to a low proportion of experts in accounting or finance, which complies with regulations of SET assigning that there must be at least one auditor who has expertise in accounting or finance. So when the proportion is higher, limitations of internal control or corruption issues including prevention of the client's benefits from management misconduct could be directed. Also, accounting procedures, financial reporting and suitable disclosure of information could be advised.

**Audit quality** It was shown that the correlation result between audit quality and financial reporting quality was positive, by which unqualified auditor report is considered. Unqualified auditor report is an indicative of auditors' confidence on financial statement that is prepared in accordance with generally accepted accounting standards and the audit is complied with audit standards. Conversely, audit report of Technology and Industrials groups was not related to financial reporting quality in this study. This is similar to Corporate Governance Council (2003). Studies have found that companies acquiring qualified auditor reports pay a higher audit fee than those receiving unqualified auditor reports. Companies with qualified auditor reports often face instability problems, going concern issues or issues that remain unsolved. Therefore, in this study, audit fee was not associated with financial reporting quality in all industry groups. This finding is in accordance with Goodwin and Munro (2004) showing that audit fees depend on how many hours spent on the audit. Similarly, audit firm size was not associated with financial reporting quality in all industry groups, which is in compliance with studies of Jeong & Rho (2004). These studies found that there is no significant difference whether auditors are from different audit firm sizes. Instead, other studies found that a high quality audit firm could reduce the level of discretionary accruals. This means that a company who is audited by a big audit firm (*e.g.* Big 4) would increase earnings quality, hence increased financial reporting quality. This study supports the notions in Watts & Zimmerman (1983) and Watts & Zimmerman (1986). Certified public accountants play a role in oversight on the audit including behavior of directors which may cause questionable issues. This is believed to ease the agency cost, and is an assurance to clients. The arisen costs will influence client's willingness to disclose more information in their annual financial reports. It is possible that audit firm size is associated with disclosure of information in the pronounced financial reports. So that auditors' mission is to benefit shareholders and to mitigate the agency problem between the principal (shareholders) the agent (administrators).

**Board of directors** It was found that board of directors was in a significantly positive relationship with financial reporting quality. The increased board size may result in users receiving information more quickly, hence improved effectiveness. This is in accordance with Beasley (2000) in which more board members can enhance performance efficiency, and diversity within the board will influence audit performances. There was no correlation found in Technology and Industrials groups, in which the increased number of board members may generate free-riders (Jensen, 1986). Board independence and board meeting frequency were not found to be associated with financial reporting quality in all industry groups. This is in compliance with Klein (2002) that the high proportion of independent board members may cause an extra

control on management (Ezat & EL-Masry, 2008). On the other hand, independent directors who joined the board may lack business expertise causing inefficiency in operations.

**Control variables** There was a significantly positive relationship between leverage and financial reporting quality in Agro & Food industry, which is similar to study of Chen & Church (1992) that high financial risk will create a greater level of discretionary accrual. This means when a company is in high financial risk it affects earnings quality. Thus the company will try to maintain leverage ratio by recognition or unrealized revenue in the current accounting period. When the firm had a better income it would not be suspicious to creditors (Debt Covenant Hypothesis), according to the positive accounting theory, thus a lower quality financial reporting. However, there was no such correlation found in Technology and Industrials groups, in which the result remains inconclusive. Return on assets in Technology and Industrials groups was in a positive strong correlation with financial reporting quality, whereas similar correlation in the Agro & Food industry was not detected. This ratio is a measure of ability to advantage on assets to build profits. The higher the profits, the more efficient use of assets.

There are indications of a significant relationship between growth and financial reporting quality shown in all 3 groups of industries. Directors are likely to manage earnings through discretionary accruals in a firm with high growth resulting in a greater firm value. This is in compliance with the agency theory that everyone in an organization all has incentives to act for personal gain (Jensen & Meckling, 1976). There was no association found between quick ratio and financial reporting quality in these 3 industry groups. Companies with high liability are expected to experience more risks and extra auditing is required (Antle, 2006). Similarly, firm size and financial reporting quality are not related in the samples. A large enterprise with political costs is more likely to face with political processes that may have a greater effect on business compared to a small one (Watts & Zimmerman, 1986).

In conclusion, audit committee effectiveness, audit quality, board size, ROA and growth had a significantly positive relationship with financial reporting quality. However, this study is a test of hypothesis finding association between financial reporting quality with audit effectiveness and audit quality subjected to 3 industry groups only, in which the information obtained from this study may not be generalized in other industry groups in Thailand. Further research could be done to address issues using other factors that may have an impact on financial reporting quality. In addition, other industry groups could be undertaken to extend the study.

#### ACKNOWLEDGMENT

This study has been successful with helps from various people for information, advice, suggestions and encouragement. The author would like to thank Assoc.Prof. Dr. Tatre Jantarakolica, Dr. Korbkul Jantarakolica, Dr. Tanomsak Suwanno and Miss Jutamas Wongkantarakorn who have supervised, devoted their times on all stages of this project and helped improve the research. Finally, I would like to thank Rajamangala University of Technology Rattanakosin for supporting the budgets for this study.

## REFERENCES

- [1] Abbott, L.& S. Parker (2000). Auditor selection and audit committee characteristics. *Auditing: A Journal of Practice & Theory* 19:2, 47-66.
- [2] Ajmi, Jasim Al. (2009). Audit firm, corporate governance, and audit quality :Evidence from Bahrain. *Advances in Accounting, in corporating Advances in Interna-tional Accounting*. Vol. 25., 64 - 74.
- [3] Amr Ezat, Ahmed El-Masry, (2008) "The impact of corporate governance on the timeliness of corporate internet reporting by Egyptian listed companies", *Managerial Finance*, Vol. 34 Iss: 12, 848 - 867
- [4] Antle, R., E. Gordon, G. Narayanamoorthy & L. Zhou (2006). The joint determination of audit fees, non-audit fees, and abnormal accruals. *Review of Quantitative Finance and Accounting* 27:3, 235-266.
- [5] Ball, R. (2008). What is the Actual Economic Role of Financial Reporting? Essay based on a presentation at the Panel on "Big" unanswered questions in accounting. *Annual Meeting of the American Accounting Association*, Chicago, August 2007.
- [6] Beasley, M.,J. Carcello, D. Hermanson& P. Lapidés (2000). Fraudulent financial reporting: Consideration of industry traits and corporate governance mechanisms. *Accounting Horizons* 14:4, 441-454.
- [7] Becker, C., M. DeFond, J. Jiambalvo & K.R. Subramanyam (1998). The effect of audit quality on earnings management. *Contemporary Accounting Research* 15:1, 1-24.
- [8] Bédard, J. & K. Johnstone (2004). Earnings manipulation risk, corporate governance risk, and auditors planning and pricing decisions.*The Accounting Review*, 79:2, 277-304, 28.
- [9] Blue Ribbon Committee (BRC).1999. Audit Committee Characteristics and
- [10] Restatements: A study of the Efficacy of Certain Blue Ribbon Committee Recommendations. New York, NY: New York Stock Exchange and National
- [11] Bradbury, Michael E., Yuen Teen Mak, and S.M. Tan. 2004. Board characteristics, audit committee characteristics and abnormal accruals. SSRN.com/abstract=
- [12] 535764
- [13] Chen, K. C. W., and Church,b. K. (1992). Default on Debt Obligations and theIssuance of Going-Concern.
- [14] Opinions. *Auditing: A Journal of Practice & Theory*11 (Fall), 30-49.
- [15] Cohen, J., G. Krishnamoorthy& A. Wright (2004).The corporate governance mosaic and financial reporting quality. *Journal of Accounting Literature* 23, 87-152.
- [16] DeAngelo, L. (1981). Auditor size and audit quality. *Journal of Accounting and Economics*. Vol. 3. No. 3. ,183 - 199.
- [17] DeAngelo, L.(1986). Accounting numbers as market valuation substitutes: A study of management buyouts of public stockholders. *The Accounting Review* 61:3, 400-420.

- [18] Dechow, R.G. Sloan, and A.P. Sweeney. 1995. Detecting earning management. *The Accounting Review* 70 (2) , 193-225.
- [19] Dechow, R.G. Sloan, and A.P.Sweeney. 1996. Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC. *Contemporary Accounting Research*, 13, 1-36.
- [20] Davidson W.N., Jiraporn P., Kim Y.S. and C. Nemeč (2004) Earnings management following dualitycreating successions: ethnostatistics, impression management, and agency theory, *The Academy of Management Journal*, 47(2), 267–75.
- [22] DeFond, M. (1992). The association between changes in client firm agency costs and auditor switching. *Auditing: A Journal of Practice & Theory* 11:1, 16-31.
- [23] DeFond, Mark L. and James Jiambalvo. 1994. Debt covenant violation and manipulation of accruals. *Journal of Accounting and Economics*, 17, 1-2 (January): 145–176.
- [24] DeZoort, F. T. (1997). An investigation of audit committees' oversight responsibilities. *Abacus* 33:2, 208-227.
- [25] DeZoort, F. T. (1998). An analysis of experience effects on audit committee members oversight judgments. *Accounting, Organizations and Society* 23:1, 1-22.
- [26] DeZoort F.T. and Steven E. Salterio. 2001. The effects of corporate governance experience and financial-reporting and audit knowledge on audit committee member judgments. *Auditing: A Journal of Practice and Theory*, 20, 2 (September): 31–47.
- [27] DeZoort, F. T., D. Hermanson, D. Archambeault & S. Reed (2002). Audit committee effectiveness: a synthesis of the empirical audit committee literature. *Journal of Accounting Literature* 21, 38-75.
- [28] Goodwin, J., and L. Munro, 2004, The impact of audit committee meeting frequency on the external audit: perceptions of Australian auditors, working paper (Queensland University of Technology, Brisbane, Qld).
- [29] Francis, J. (2004). What do we know about audit quality? *The British Accounting Review* 36:4, 345-368.
- [30] Healy, P. & K. Palepu (1995). The challenges of investor communication: The case of CUC International, Inc. *Journal of Financial Economics* 38: 2, 111-140.
- [31] Healy, P. & K. Palepu (2001). Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and Economics* 31:1-3, 405-440.
- [32] Hoitash, Rani, Markelevich, Ariel and Barragato, Charles A. (2007). Auditor fees and audit quality. *Managerial Auditing Journal*. Vol. 22. No. 8. pp.761 - 786.
- [33] Jensen, M. & W. Meckling (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics* 3:4, 305-360.
- [34] Jensen, Michael C. (1986). "The Takeover Controversy: Analysis and Evidence." [35] *Midland Corporate Finance Journal* 4, no. 2 (Summer): 6-32.
- [36] Jones, J (1991). Earnings management during important relief investigations. *Journal of Accounting Research* 29:2, 193-228.
- [37] Jeong, Seok Woo and Rho, Joonhwa. (2004). Big Six auditors and audit quality : The Korean evidence. *The International Journal of Accounting*. Vol. 39,175 - 196.

- [38] Kalbers, L. & T. Fogarty (1993). Audit committee effectiveness: An empirical investigation of the contribution of power. *Auditing: A Journal of Practice & Theory* 12:1, 24-49.
- [39] Kalbers, L. & T. Fogarty (1998). Organizational and economic explanations of audit committee oversight. *Journal of Managerial Issues* 10:2, 129-150.
- [40] Klein, A. (2002). Audit committee, board of director characteristics, and earnings management. *Journal of Accounting & Economics* 33:3, 375-400.
- [41] Lee, H., V. Mande & R. Ortman (2004). The effect of audit committee and board of director independence on auditor resignation. *Auditing: A Journal of Practice and Theory* 23:2, 131-146.
- [42] Menon, K. & J. Williams (1994). The use of audit committees for monitoring. *Journal of Accounting and Public Policy* 13:2, 121-139.
- [43] Peasnell, K.V., Pope, P. and Young, S. (1999). Characteristics of firms subject to adverse financial reporting review panel rulings. Paper Presented at the Financial Accounting and Auditing Research Conference, July 12-13, SOAS, University of London.
- [44] Peasnell, K. V., Pope P. & Young, S. (2005). Board monitoring and earnings management: Do outside directors influence abnormal accruals? *Journal of Business Finance & Accounting* 32:7/8, 1311-1346.
- [45] SET (Stock Exchange of Thailand). (1999). Best practice guidelines for the audit committee. Internet site: [http://www.set.or.th/en/regulations/corporate/download](http://www.set.or.th/en/regulations/corporate/download/bestace_upd.doc)
- [46] /bestace\_upd.doc.
- [47] Teoh, S. & T.J. Wong (1993). Perceived auditor quality and the earnings response coefficient. *The Accounting Review* 68:2, 346-366.
- [48] Vafeas, N. (2005). Audit committee, boards, and the quality of reported earnings. *Contemporary Accounting Research* 22:4, 1093-1122.
- [49] Watt, R.L. and J.L. Zimmerman. (1978). Towards a positive theory of the determination of accounting standards. *The Accounting Review*. (January), 112-134.
- [50] Watt, R.L. and J.L. Zimmerman. (1979). The demand for and supply of accounting theories: The market for excuses. *The Accounting Review*. (April), 273-305.
- [51] Watt, R.L. and J.L. Zimmerman. (1986). *Positive accounting theory*. Englewood Cliffs: Prentice Hall.
- [52] Wolnizer, P. W. (1995). Are audit committees red herrings? *Abacus* 31:1, 45-66.
- [53] Xie, B., W. Davidson & P. DaDalt (2003). Earnings management and corporate governance: The role of the board and the audit committee. *Journal of Corporate Finance* 9:3, 295-316.