Relationship between voluntary disclosure and audit committee independence, financial expertise and diligence

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Executive Summary

To confront with the increasingly corporate disclosure frauds that perplex investors' investment decision-making, the close attention has been paid to the study of voluntary disclosure. Enormous studies has evidenced that audit committee characteristic is crucial to the extent of voluntary disclosure. Three audit committee characteristics: independence, financial expertise and diligence have been widely researched as the most vital factors for voluntary disclosure. Hence, this paper aims to investigate the relationship between voluntary disclosure and audit committee independence, financial expertise and diligence based on literature review. By reviewing numbers of literature, our results indicate a positive relationship between voluntary disclosure and audit committee independence for the most studies; a multiple relationships with audit committee financial expertise and a consistent positive relationship with audit committee diligence. This paper also provide suggestions to directors and regulators to enhance voluntary disclosure from the perspective of audit committee characteristics based on these results above and current regulations.

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1. Introduction

1.1 Problem Description

> "Manufacturing giant Toshiba Corp.'s president and seven other directors were forced to resign when an investigation revealed in July that the firm had doctored the books and had padded its profits over the past seven years to the tune of hundreds of billions of yen (Nagata, 2015)"

Reported by The Japan Times, Toshiba, Japanese Multinational Corporation encounters its largest crisis over its 140-year-history (Nagata, 2015 and Pfanner & Fujikawa, 2015). The causes of this event are not limited to the strict profit target and company's culture (Chambers, 2015). The details of the Investigation Report (2015) indicates a weak corporate governance and a poor internal control within Toshiba Corporation. Especially, Toshiba Corp's audit committee did not function properly to recognize and discontinue the inappropriate accounting behaviors (Carpenter, 2015).

Corporate disclosure scandals have occurred over past decades, such as Enron (2001) and WorldCom (2002). These events have resulted in an increase in the attention from regulatory bodies, researchers and investors focusing on corporate disclosures and corporate governance (Akhtaruddin & Haron, 2010). Corporate disclosure can be divided to mandatory financial reporting and voluntary disclosure which are two important channels of communicating information between firms and outside parties (Balakrishnan, Li, & Yang, 2012). However in recent years, it is witnessed that there is a significant change in the extent of corporate disclosure.

The dissatisfaction of mandatory disclosures have encouraged companies to enhance voluntary disclosure (Boesso, G. & Kumar, K., 2005). In addition, there is a requirement that information that published by firms is more abundant and diversified reflected in the information about society, environment and strategy, etc. (Barros, Boubaker, & Hamrouni, 2013). Whereupon, there is an increasing demand for disclosing information on a voluntary basis (Schuster, & O'Connell, 2006). Particularly, in today's capital markets which provide more unforeseen investment opportunities, the tendency for investors is to be likely to obtain an abundance of disclosed information about various corporate activities (Schuster, & O'Connell, 2006). As more supplemented information is disclosed, investors can easier to realize the value and company' future performance, thereby to increase investors' willingness and to reduce the investment risk (Tian, & Chen, 2009). The Financial Accounting Standard Board (FASB, 2000) which describes "voluntary disclosure" as "information primarily outside of the financial statements that are not explicitly required by accounting rules or standards" state that such disclosure aims to mitigate information asymmetry between management and outside investors and hence lowers agency costs, clarify business strategy and improve the financial reporting transparency (Madi et al., 2014; Boesso, & Kumar, 2005). Voluntary disclosure, categorized into financial, non-financial and strategic information, is furthermore a significant channel in mitigating the information asymmetry between management and shareholders (Othmana et al., 2014). Additionally, voluntary disclosure has been received intense concern as a result of its contributions to increasing firm's value (Othmana et al., 2014; Peters et al., 2000), equity values (Healy & Palepu, 1993), market returns (El-Gazzar, & Fornaro, 2012), minority shareholder's rights (Jiang et al., 2011), and mitigating information asymmetry (Balakrishnan et al., 2012;

Madi et al., 2014), reducing agency costs (Madi et al., 2014).

Prior studies have stated that the voluntary disclosure can be affected by several corporate governance variables, such as ownership structure (Chen et al, 2008; Elmans, 2012), the directors' and supervisors' structures (Patelli, & Prencipe, 2007; Alvesa, Rodriguesb, & Canadasa) and corporate culture (Rouf, 2011; Alvesa et al., 2012). Apart from those factors, there is an increasing understanding that audit committee (AC or audit committee hereafter) is another key component which has received close attention. (Bédard, & Gendron, Y, 2009; Akhtaruddin & Haron, 2010). In the past decades, many regulatory bodies such as the Securities and Exchange Commission (SEC) and the Sarbanes-Oxley Act (SOA) require that the listed firms should establish an audit committee. The audit committee is widely considered as an integral part of a firm's overall corporate governance (Chapple et al., 2012), which is generally devoted to achieving corporate legal and ethical standards (Blue Ribbon Committee, 1999). Specifically, in the terms of corporate disclosure (DeZoort, 1997; Li et al., 2012; Liu, & Sun, 2010; Bédard, & Gendron, Y, 2009), internal management (Kalbers, & Fogarty, 1993; Krishnan, 2005) and external audit (He, et al., 2009; Aronmwan, & Abadua, 2013). With respect to financial reporting, the main duty of AC is to monitor financial reporting process that ensuring the firm's performance is ethically reported by management (Bédard, & Gendron, Y, 2009; Kusnadi et al, 2015). Especially, in the respect of voluntary disclosure, the AC's monitoring activities may prevent the possibility of opportunistic behavior of management (Allegrini, & Greco, 2011), since voluntary information is the product of management's decision which completely depends on managers (Healy, & Palepu 2001, Kowalewska, 2015). In such an intensive monitoring environment, managers will be unlikely to conceal information for private interests or other purposes, which might be an improvement of the voluntary disclosure (Allegrini, & Greco, 2011). The AC could also be considered as an arbiter between management and other parties since they may have different opinions on the extent of voluntary information (Klein, 2002). Additionally, AC might be able to examine compliance of legal issues and government regulations, as well as assessing the risk of exposed information of firm's activities and internal controls (Klein, 2006). As stated partly above, the level of corporate voluntary disclosure is influenced by many factors, among which an ethical and behavioral component (Rouf, 2011). The AC in turn is also influenced by ethical and behavioral components (Rouf, 2011). Based on this connection we would like to see the relationships between voluntary disclosure and the most vital three AC characteristics which are independence, financial expertise and diligence that are frequently cited and discussed (Abbott & Parker, 2000; Bédard, & Gendron, 2009).

1.2 Research question

In order to explore whether there is a relation between audit committee and voluntary disclosure, and what exactly factors included. The main question and sub-questions will be given below.

The main question could be: *"What is the influence of independence, financial expertise and diligence of the audit committee on the effectiveness on their monitoring the extent of voluntary disclosure according to the literature?"*

In order to answer the main question, this paper also formulate 2 sub-questions:

1. *What is the reason to expect a relationship between audit committee independence, financial expertise and diligence and the extent of voluntary disclosure?*
2. *What is the empirical evidence in the literature of the relationship between voluntary disclosure and audit committee independence, financial expertise and diligence?*

1.3 Methodology

1.3.1 Specification of research process

The research process of this paper is literature review by analyzing and summarizing information from previous research.

1.3.2 Literature review methodology

The research will analyze and summarize relevant information based on the following range of scientific sources to evaluate the relation between audit committee and voluntary disclosure. Sources used for the research for relevant information include:

- Articles from journals
- Thesis and dissertations
- Websites
- Reports
- Working Paper

1.3.3 Article search method

The paper includes articles from journals, which could provide information of high relevance.

These journals are the following:

- *Advances in Accounting*
- *Auditing: A Journal of Practice & Theory*
- *Asian Review of Accounting*
- *African Journal of Business Management*
- *A journal of accounting, finance and business studies*
- *An International Review*
- *Accounting Horizons*
- *Accounting, Auditing & Accountability Journal*
- *Contemporary Accounting Research*
- *European Accounting Review*
- *Global Review of Accounting and Finance*
- *International Journal of Auditing*
- *International research*
- *International Strategic*
- *International Journal of Economics and Finance*
- *International Journal of Disclosure and Governance*
- *Journal of Public Administration and Governance*
- *Journal of management and governance*
- *Journal of Accounting Research*

- *Journal of Practice and Theory*
- *Journal of International Accounting, Auditing and Taxation*
- *Journal of political Economy*
- *Journal of Accounting Literature*
- *Journal of Accounting and Public Policy*
- *Journal of Accounting and Economics*
- *Journal of Forensic & Investigative Accounting*
- *Journal of Economics and Finance*
- *Journal of Accounting Research*
- *Journal of Accounting and Public*
- *Journal of Accounting and Public Policy*
- *Journal of International Accounting Auditing and Taxation*
- *Journal of finance and economics*
- *Journal of Financial Economics*
- *Journal of Accountancy*
- *Journal of Management and Governance*
- *Management Review*
- *Managerial Auditing Journal*
- *Managerial Finance*
- *Management Accounting Quarterly Winter*
- *Procedia - Social and Behavioral Sciences*
- *Procedia Economics and Finance*

- *Review of Applied Management Studies*
- *Research Journal of Finance and Accounting*
- *The Journal of Applied Business Research*
- *The Accounting Review*
- *The British Accounting Review*

In order to search for relevant articles, the following key words are used in this paper: *audit committee, mandatory disclosure, voluntary disclosure, financial report, corporate governance, financial expertise, audit committee size, audit committee meeting.*

The paper uses the following search engines in order to identify relevant articles and materials:

- Google Scholar
- Science Direct
- Google
- Jstor
- Research gate

Selection criteria and procedures

Firstly, the articles are searched according to key words.

Secondly, the articles are selected by title, abstract and introduction.

Finally, these articles are selected by writing after 1990 which ensure that the content is up to date.

1.4 Research objective

This paper aims to integrate previous literatures and thus explain the relation between audit committee and voluntary disclosure through a literature review study. It will provide detailed information of each main AC characteristic which has impact on the voluntary disclosure.

The contribution of this paper is to mainly offer practical suggestions to board of directors and regulators, based on the result of the relationship between AC and voluntary disclosure. Firstly, as the composition of audit committee, board of directors could be inspired by reading this paper to obtain an understanding of the importance of voluntary disclosure and audit committee and their relationship. Board of directors could improve the AC's effectiveness based on advice that provided by this paper, thereby monitoring voluntary disclosure effectively. Secondly, this paper provides empirical evidence on the relation between AC and voluntary disclosure to regulatory bodies. Regulators may choose this paper as a theoretical basis to examine the effectiveness of extant regulations or to issue new standards.

1.5 Paper outline

This paper is consist of three chapters. In the first chapter, it introduced the background information, research motivation, research objective, research questions and methodology. In the second chapter, this paper provide the theoretical framework which describe the audit committee and voluntary disclosure and mainly demonstrate the relation between these two elements. Finally, in chapter three, the conclusions will be provided, which includes the answer to research questions, limitations and policies.

2. Theoretical Framework

2.1 Voluntary Disclosure

2.1.1 Definition of voluntary disclosure

Financial report includes two kinds of corporate disclosure which are mandatory reporting and voluntary disclosure. Mandatory reporting is consist of all the financial information that disclosed as a requirement by regulations and/or accounting standards. On the other hand, voluntary disclosure refers to freewill actions of corporations to reveal other information to users when there is no legal requirement (Albawwat, & Ali basah, 2015). In 2001, the Financial Accounting Standards Board (FASB) issues the Improving Business Reporting: Insights into Enhancing Voluntary Disclosure Steering Committee Report. It defines voluntary disclosure as:

> *"the information disclosed voluntarily by listed companies, but not the basic financial information that is required to be publicized by the widely acceptable accounting principles and the requirements of securities regulatory agencies."* *(Tian & Chen, 2009).*

Voluntary disclosure often includes corporate's strategy, competitiveness, environmental issues and forecasts, etc. (Li, & Zhao, 2011). As the extension of mandatory disclosure, it provides public with more complex view and perception of a company (Tian & Chen, 2009, Kolton et. al. 2001). Additionally, voluntary disclosure may contains information that recommended by various authoritative code, for instance the operating and financial review in the UK. (Shehata, 2014).

2.1.2 *Incentives for Voluntary disclosure*

One possible reason why firms voluntarily disclose information is the presence of information asymmetry caused by agency problem. (Tijssen, 2012). Agency problem is the interest conflict that inherent between management and shareholders (Boučková, 2015), and we will illustrate further later on. To overcome this issue, corporates will voluntarily disclose more information in order to eliminate the information gap and obtain the most optimum conditions when capital funding. Accordingly, voluntary disclosure is targeted to introduce and explain firms' potentials and future prospects to investors, hence to achieve a better communication among companies and outside parties (Tian & Chen, 2009). According to Healy and Palepu (2001), the major incentives that influence the managers to disclose information voluntarily mainly include capital markets transactions, corporate control contest, stock compensation, management talent signaling. These motivation can be considered as the benefits of a proper voluntary disclosure.

Capital markets transactions

The investors' perception towards corporates is essential to companies to issue debt or equity in stock transaction (Healy and Palepu, 2001). In consideration of a firm's managers who have more information compared with investors about the corporate's futures prospects. Myers and Majluf (1984) stated that corporates raising capitals will be more costly for current shareholders if this information asymmetry cannot be reduced. As a consequence, corporate managers who are willing to make capital market transactions will be motivated to voluntarily disclosure more information to mitigate the asymmetric information problem, hence decreasing the corporate's external financing cost. Moreover, (Healy and Palepu, 2001) suggested that information asymmetry can be reduced by increased voluntary disclosure and result in a decrease of cost of capital.

Corporate control contest

This refers to board of directors and investors are supposed to believe that managers are accountable for firm's stock performance. Thus, the probability of undervaluation of a firm is a motivation for management to extend voluntary disclosure, so that it can eliminate such possibility, especially when poor financial performance and stock price happening which may bring the risk of job loss. For instance, Weisbach (1988) stated that the poor stock performance is associated with CEO turnover. Consequently, managers enhance voluntary disclosure to keep corporate under control and to explain the reasons for the poor financial performance and to reduce the likelihood of undervaluation of the company's stocks (Healy & Palepu, 2001).

Stock compensation

Another incentive for management to work on voluntary disclosure is to reward managers by stock compensation (Healy & Palepu, 2001). This can be explained by two reasons. First reasons is when managers who act in the interest of shareholders will try to conduct higher quality voluntary disclosure in order to cut contract costs related to stock compensation for new employees (Graham et al., 2005). Second, managers will have incentives to disclose private information to meet the insider trading requirements and to avoid any underestimation (Healy & Palepu, 2001).

Increased analyst coverage

Analysts tracking and expressing their views on a corporate will lead to more investment activity than a corporate without such analyst coverage. Since private management information is not compulsory by mandatory disclosure, thus increased voluntary information will increase information amounts available to analysts. Hence, the cost of information acquisition by analysts can be reduced (Graham et al., 2005).

Management talent signaling

Investors tend to consider managers who are able to predict economic condition changes in the future and quickly respond to those changes as competent managers. Accordingly, such managers are inclined to reveal their talent by voluntarily disclosing more information to attract more investors (Graham et al., 2005). The investors' perception and confidence in managers' talent will turn into firm's market value.

2.2 Audit committee

2.2.1 The background of audit committee

The audit committee is considered as one of the main corporate governance mechanisms to restraint corporate managers' behavior (Bédard, & Gendron, Y, 2006). The audit committee has been defined by Sarbanes-Oxley Act (SOX):

> *" The term 'audit committee' means 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 the financial statements of the issuer; and if no such committee exists with respect to an issuer, the entire board of directors of the issuer."

The development of corporate audit committee has experienced a long incremental progress. In 1940s, the SEC has recommended that: *"outside members of the board of directors nominate the outside auditors and, in turn, the shareholders elect the public accounting firm"* (Braiotta, 2004). In July 1967, the Executive Committee of the American Institute of Certified Public Accountants recommended that listed firms establish an audit committee with outside board of directors, because *"the auditors should communicate with the audit committee whenever any significant question having material bearing on the company's financial statements has not been satisfactorily resolved at the management level."* (AICPA, 1967). During the 1970s, audit committee in the United States has been paid a close attention due to the demand for greater corporate accountability and higher quality of financial reporting. In 1972, in response to these demands, the SEC issued Accounting Series Release No. 123, "Standing Audit Committees Composed of Outside Directors," which stated:

…endorses the establishment by all publicly held companies of audit committees composed of outside directors and urges the business and financial communities and all shareholders of such publicly held companies to lend their full and continuing support to the effective implementation of the above cited recommendations in order to assist in affording the greatest possible protection to investors who rely upon such financial statements.

1974, the SEC issued Accounting Series Release No. 165, "Notice of Amendments to Require

Increased Disclosure of Relationships Between Registrants and Their Independent Public Accountants," which stated:

> *Disclosure is required of the existence and composition of the audit committee of the board of directors. The Commission has already expressed its judgment that audit committees made up of outside directors have significant benefits for the company and its shareholders (ASR 123). This disclosure will make stockholders aware of the existence and composition of the committee. If no audit or similar committee exists, the disclosure of that fact is expected to highlight its absence.*

It is worth noting that this release not only made an AC to be compulsory, but also emphasized the importance of selection of AC members. Later, the New York Stock Exchange (NYSE) made the first official mandatory recognition of the need for an audit committee in 1978, which stated:

> *Each domestic company with common stock listed on the Exchange, as a condition of listing and continued listing of its securities on the Exchange, shall establish no later than June 30, 1978, and maintain thereafter an Audit Committee, composed solely of directors independent of management and free from any relationship that, in the opinion of its Board of Directors, would interfere with the exercise of independent judgment as a committee member. Directors who are affiliates of the company or its subsidiaries would not be qualified for Audit Committee membership*

After aforementioned events, in 1980s and 1990s, there are many countries are required to establish audit committee by legislative acts, such as Canada, Australia and the United

Kingdom. For instance, in 1992, The Committee on the Financial Aspects of Corporate Governance in the United Kingdom issued a report which includes a Code of Best Practice. The Committee recommended that the boards of all listed companies listed in the United Kingdom establish and maintain audit committees. The code stated, in part:

> *There should be a minimum of three members. Membership should be confined to the nonexecutive directors of the company and a majority of the nonexecutives serving on the committee should be independent.*

Through those events, the motivations of the presence of audit committees in capital markets has become widespread in the corporate governance area. Overall, over the past decades, the establishment and development of audit committee have witnessed an evolutionary process. Also the role and responsibilities of audit committee has been revealed by a large amount standards and regulations.

2.2.2 The role of audit committee in voluntary disclosure

In order to illustrate the role of AC in voluntary disclosure, the main conflict between management and shareholders shall be primarily explained by agency theory. The agency theory is a well-established theory of understanding firms over past several decades.

> *"An agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent."*

Defined by Jensen & Meckling (1976). Agency theory originates from the assumption that there is a contractual relationship within two parties which are the agent and principals who have inconsistent interests. The principals is supposed to provide capital and bear the risks, while the agent is expected to operate company, make decisions and take the risk too (Boučková,2015). The agency relationship confronts a serious problem in dealing with the agent's behavior which is inconsistent with the interest of the principal. Jensen & Meckling (1976) stated that it is reasonably to believe that the agent might not always act in accordance with the principals' best interests.

One of the main issue of agency relationship is information asymmetry which arises when agent is able to access more information than the principals. Such problem can be considered as a form of market failure, which leads to an inefficient resources allocation (Boučková, 2015). Information asymmetry could lead to several problems of agency relationship which are the moral hazard and unfavorable selection (Boučková, 2015). On the one hand, the existence of information asymmetry may leads to moral hazard, in which one of the parties creates the unbalance of information due to their personal benefits (Boučková, 2015). Principals have limited opportunities to oversee the actions of agents, and can only evaluate management performance by firm's final results. In this case, the agents may try to default their duties due to the principals may not be able to monitor and detect their behaviors. On the other hand, information asymmetry may also bring about an adverse selection. Principals cannot evaluate the effectiveness of agent's work due to the lack of information. Particularly, the principals are unable to verify the actual capacity of an agent if an agent exaggerates his ability. This may lead to an unfavorable selection of an agent who is actually not the appropriate person for a certain position (Islam et al., 2010).

These inconsistent interests can be reduced by implementing incentives in order to align the interest of the agent with the principal and/or by monitoring the actions of the agent to limit the possibilities of shirking (Demsetz and Lehn, 1985). Nevertheless, in order to achieve these solutions and make the agent acts in accordance with principals, three kinds of costs will be made (Jensen & Meckling, 1976). Firstly, monitoring costs which are used for supervising whether the agent does indeed act in line with the best interest of the principal (Jensen & Meckling, 1976). The second type of expenditure is called bonding costs (Jensen & Meckling, 1976). These are expenses to guarantee that the agent will not act in disfavor of the principals and in case he does, to ensure compensation for those actions. The final type of agency cost is called residual loss and is occurred because of the ever remaining difference in decisions taken by the agent and the decisions that would be optimal for the principal (Jensen & Meckling, 1976).

There are also some solutions to the agency problem. Firstly, establishing a compensation agreement which could help reducing agency problem in the way of making the agent's interests in accordance with principals' interests (Healy & Palepu, 2001). The next solution to mitigate agency problem is the directors who are on behalf of shareholders to oversee and control management (Healy & Palepu, 2001). In addition, information intermediaries which has been discussed above. Finally, laws and regulations are other means of reducing the agency problem. It is required that agent should disclose relevant information (Shehata, 2004). However, the presence of regulations cannot guarantee a full disclosure because of the existence of interest contradiction (Al-Razeen & Karbhari, 2004). The regulation are attempted to ensure the minimum level on the extent of information which used for shareholder's decision-makings (Al-Razeen & Karbhari, 2004). Thus, voluntary disclosure can be considered as another way to mitigate agency problem. The management voluntarily expose more relevant information that enables principals to evaluate whether agent act in the best interest of principals (Healy & Palepu, 2001). Voluntary disclosure also helps in monitoring the performance of contractual agreements (Healy & Palepu, 2001), reducing agency costs (Healy & Palepu, 2001), and convincing the outside users that management are acting in a most appropriate way (Watson et al., 2002).

In order to mitigate agency problem by enhancing such voluntary disclosure, the audit committee can play an important role (Bédard, & Gendron, Y, 2009; Akhtaruddin & Haron, 2010). The evidence also suggested that audit committee is a most commonly studied variable as the main determinants of voluntary disclosure. In the modern enterprise management system, a corporate governance mechanism to insure corporates' implementation of voluntary disclosure is audit committee, which plays a crucial role in monitoring disclosure practices, hence helps to control agency problems between managers and outside parties (Madi et al., 2014; Liu, & Sun, 2010). Ho and Wong (2001) and Yuen, et al. (2009) argued that the existence of an AC significantly increase the reliability and relevance of corporate voluntary disclosure. McMullen (1996) suggested that when AC exists, the firm is likely to have errors, defects and any form of inaccuracies. In particular, AC meets top financial managers and auditors to review disclosure process (He et al., 2009) and discuss the financial statement, thereby acting as an assurance to the public by providing reliable information (Al-Baidhani, 2014). Moreover, AC is keeping professional skepticism to challenge the management, internal auditors and external auditors to ensure that they act in accordance with the firm's best interest (He et al., 2009). Furthermore, in a competitive corporate environment, information of the AC characteristics are useful for all the users to assess and detect any criteria related to a reliable financial statement (Hamid et al., 2014). Thereupon, Klein (2002) stated that AC is considered as an "ultimate monitor" in the financial reporting system. In regards to agency theory which indicates that AC is a means of reducing agency costs and enhancing disclosure quality (Dhaliwal et al., 2010; Chung et al., 2004). Klein (2002) claim that the legal differences of opinion may consist between management and outside parties in corporate disclosure. These differences lead to a negotiation in final corporate disclosure (Klein, 2002). Nelson et al. (2000) also using survey data and evidenced that many financial figures can be negotiated. Therefore, previous research suggested that the role of AC can be seen as an arbiter between management and outsiders in order to express judgments on diverse views, hence to ultimately report a balanced and reliable financial statement. Moreover, many research explicitly found that AC has positive influence on the extent of voluntary disclosure (Ho, & Wong, 2001; Barako et al. 2006; Arcay and Vazquez, 2005). Similarly, Samaha et al., (2015) have done an over-all meta-analysis results, it shows a significant association between AC and voluntary disclosure.

2.3 Audit committee effectiveness

Audit committee effectiveness has been defined by DeZoort et al. (2002):

> *An effective audit committee has qualified members with the authority and resources to protect stakeholder interests by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts.*

This definition emphasized the ultimate goal of audit committee and the approaches in which the AC achieves this goal (DeZoort et al., 2002). AC effectiveness is one of most essential theme in corporate governance since the 1990s. Prior studies stated that an effective AC provide a large number of benefits, such as better financial reporting and less corporate fraud (Abbott et al., 2000). Over last few decades, a numerous publications were issued by regulatory bodies and accounting firms have provided guidelines and standards to improve AC effectiveness (e.g., BRC, 1999; KPMG, 1999). A large number of these guidelines have been made legally compulsory, for instance, the Sarbanes-Oxley Act (2002). Accounting academic field has also made efforts in the requirement for AC effectiveness. For instance, prior research like DeZoort et al., (2002) and Bédard, & Gendron (2009) have tried to identify influential factors of AC effectiveness. DeZoort et al., (2002) categorized AC effectiveness into AC independence and AC financial expertise as the basic input to achieve AC effectiveness. Upon this foundation of inputs, DeZoort et al., (2002) set the primary process factor named AC diligence. Overall, AC that has proper independent members with financial expertise who act and to put effort in order to effectively functioning (DeZoort et al., 2002).

2.4 Audit committee independence

2.4.1 Definition of Audit committee independence

The audit committee independence is perceived as an essential quality to AC members (Bédard, & Gendron, 2009). It has been widely claimed as one of the key characteristics associated with AC effectiveness. The importance of audit committee independence has been emphasized in a large number of publications. The Blue Ribbon Committee' first recommendation proposed the composition of AC that AC members to be independent from management (BRC, 1999). The ultimate goal of such recommendations is to ensure AC making decisions that are in accordance with the best interests of shareholders. AC member's independence is defined by BRC (1999) as:

> *The absence of relationship with the company that may interfere with the exercise of their independence from management and the company.*

Prior research on AC independence can be classified into two dimensions: degree of AC member's independence and the proportion of independent members sitting on the AC. Independence of individual AC members is identified into three material relationships in regulatory literatures: employment relationship, personal relationship, and business relationship. Employment relationships consists of AC members are currently employed by the corporate or have been employed by the corporate in the last three years (BRC, 1999).There is an argument regarding to whether or not a director is independent when they also employed as a director of subsidiary company. Secondly, personal relationships with management team may harm AC members' objectiveness, such as family relationship and friendship. Although family relationships can be controlled by regulations, the social relationships between AC members and management are too hard to regulate. Finally, as for business relationships, regulations suggest that any form of advisory or compensatory fee that received from the corporate or its subsidiary bodies are considered as a material relationship (SEC, 2003d). In the past regulations, independence is perceived as an absence of employment relationship only, currently it is emphasized the absence of all three types of relationships.

The second aspect of independence is the proportion of independent members. There is an argument of the perfect proportion. Some judicial districts require a great majority of AC members to be independent, while others require that to have all members independent is compulsory (Bédard, & Gendron, 2009). Currently, the trend among regulatory bodies are likely to require all AC members to be independent (e.g., SOX, 2002). Independent directors are thought to have a critical role in mitigating agency problem, since independent directors can reduce the risk of collusion with the management (Patelli, & Prencipe, 2007). In particular, an AC is considered to be independent when Non-Executive Directors (NEDs) are dominated, since management members could impair the effectiveness of AC by influencing decision-making of the AC (Salloum et al., 2014). Abbott, Park, & Parker, (2000) have also stated that an AC consists solely of NEDs are better monitors of management, such as outside, independent audit committee members. Overall, based on Bédard, & Gendron, (2009) which found that AC independence is positively associated with AC effectiveness.

2.4.2 AC independence and voluntary disclosure

Generally, the presence of independent members in AC influences the effectiveness of monitoring of management behavior (Madi et al., 2014). This is because the independent AC members who have no material relationships with management, thereby they will tend to function objectively under the influence of management (Bedard, & Gendron, 2010). Especially, Allegrini, & Greco (2011) suggested that an independent AC is more inclined to reduce and even eliminate management's chances to conceal information for their own interests. Thus, an AC with independent members will furthermore ensure the quality and the process of financial reporting, and mitigate the asymmetric information (Allegrini & Greco, 2011). Moreover, the monitoring function performed by an independent AC is considered as a further motivation for management to provide reliable and excessed information (Haniffa and Cooke, 2002).

According to prior studies, most of them show a positive relationship within AC independence and voluntary disclosure. Abbott et al., (2002) made sample selection by reviewing Accounting and Auditing Enforcement Releases (AAERs) filed between 1991 and 2000 and evidenced a negative relationship between the independence of AC and corporate disclosure frauds. Persons (2009) have made a logit regression analysis and emphasized that AC independence is a critical measurement of voluntary ethics disclosure. Persons (2009) stated that the independent AC positively influence the effectiveness of corporate disclosure process and it would result in voluntary ethics disclosure by ethically performing their duties. Madi et al. (2014) collected data from 500 non-finance listed firms on Bursa Malaysia as by end of 2009. They have detected the relationship between many AC characteristics and corporate voluntary disclosure by reading the annual reports and doing a multiple regression analysis. The result indicated that the AC independence is positively and significantly associated with corporate voluntary disclosure. Akhtaruddin and Haron (2010) have investigated the relationship between AC effectiveness and corporate voluntary disclosure. They tested a sample of 124 Malaysian listed firms and found that more independent NEDs on the AC is a means of enhancing voluntary disclosure level and reducing information asymmetry. Barros et al. (2013) use a panel of 206 non-financial firms in 2006–2009 to empirically analyze the impacts of corporate governance characteristics on voluntary disclosure in France. They have also found that AC independence is positively associated with voluntary disclosure. Especially, their research show that more independent members on audit committee strengthen the accuracy of voluntary disclosure, and reduce the probability of information fraud (Barros et al., 2013). Similarly, Patelli and Prencipe (2007) sampled 175 non-financial Italian listed companies and collected data from the annual financial statements in 2002 of each sampled company in order to detect the disclosure level and the control variables. Then, they implement an empirical analysis and finally provided evidence that voluntary disclosure in financial statements is enhanced by independent directors.

However, there are some inconsistent results rejected such positive relationship between AC independence and voluntary disclosure. Othman et al. (2014) made a sample of the top 100 listed companies in Bursa Malaysia and concluded that there is no significant positive association between AC independence and voluntary disclosure. They made a regression analysis which indicates that even the AC is effective and independent, it still cannot make sure that the firm is willing to disclose more information voluntarily. Moreover, Ramadhan (2014) surveyed all the listed firms in Bahrain, suggested that AC independence has no relationship with the level of voluntary disclosure. Thus, the assumption that corporates which has more independent members on the AC are more likely to have higher level of voluntary disclosure cannot be supported (Ramadhan, 2014).

2.5 Audit committee financial expertise

2.5.1 Definition of Audit committee financial expertise

People are specialized in auditing and accounting constitute an essential characteristic of audit committee effectiveness (McMullen & Raghunandan, 1996). The financial expertise can be defined as the *"ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer's financial statements"* (Canadian Securities Administrators, 2004). The Sarbanes-Oxley Act of 2002 (SOX) requires listed companies to have financial experts in audit committee. This requirement response a statement of U.S Senate (2002) that *"the effectiveness of the audit committee depends in part on its members' knowledge of and experience in auditing and financial matters"* (Carcello et al, 2006). According to the proposal of SEC (2002), it includes a definition of "financial expert":

> *"The Sarbanes-Oxley Act requires the Commission, in defining the term 'financial expert,' to consider whether a person has, through education and*

experience as a public accountant or auditor or a principal financial officer, or controller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions: 1. An understanding of generally accepted accounting principles and financial statements; 2. Experience in (a) the preparation or auditing of financial statements of generally comparable issuers; and (b) the application of such principles in connection with the accounting for estimates, accruals, and reserves; 3. Experience with internal accounting controls; and 4. An understanding of the audit committee functions."

There are regulatory actions have explicitly aimed at AC financial expertise with the goal of increasing AC effectiveness (e.g., U.S. Congress, 2002). Similarly, Bédard, & Gendron (2009) have found that higher competencies of AC members are considered to be positively associated with AC effectiveness. Moreover, prior research expected that an AC with financial experts will achieve their responsibilities efficiently, improve corporate financial performance (Salloum et al., 2014); reduce the likelihood of internal control weaknesses (Zhang et al., 2007); negatively associate with the probability of aggressive earning management (Bédard et al., 2004);

2.5.2 AC financial expertise and voluntary disclosure

AC members need to be financially literate in order to understand and assess financial statements and to evaluate financial information (Dhaliwal et al., 2010; Salloum et al., 2014). Financial expertise results in AC members to ask probing questions and identify financial situations in challenging management and external audit to obtain a greater extent of corporate disclosure quality (Bedard & Gendron, 2010). Consequently, this will improve the corporate disclosure transparency and furthermore contribute to mitigating agency problems (Madi et al., 2014).

The earlier studies have shown inconsistent relationships between AC financial expertise and voluntary disclosure. Kelton, & Yang (2008), collected a sample of 3488 firms traded in the NASDAQ and suggested that AC financial expertise is positively associated with financial reporting quality. They stated that corporate with a higher proportion of financial experts on the audit committee is more likely to achieve a transparent of corporate disclosure (Kelton, & Yang, 2008). Similarly, McMullen & Raghunandan (1996), stated that firms with AC financial expertise are less likely to have financial reporting problems. They indicated that firms have higher financial reporting quality when there is CPA on AC (McMullen & Raghunandan, 1996). However, these research results are based on firm's financial reporting and authors did not explicitly indicate the definition of financial reporting. Therefore, there is an assumption that if such financial reporting includes both mandatory reporting and voluntary disclosure, then it can be considered that there is a positive relationship between AC financial expertise and voluntary disclosure. Additionally, Bedard & Gendron, (2009) however reviewed academic publications between 1994 and 2008 and concluded that AC members with higher financial competencies are positively associated with corporate voluntary disclosure.

On the contrary, Madi et al. (2014) investigated listed companies in Bursa Malaysia and evidenced that financial expertise in AC have no significant influence on corporate voluntary disclosure. It might be reasonable that the corporate disclosure practices may require financial knowledge, such as accounting and auditing knowledge to effectively evaluate the disclosed information. Persons (2009) sampled listed firms that were investigated by the SEC for fraudulent financial reporting and have made a logit regression analysis. It indicated that AC financial expertise is insignificant associated with corporate voluntary disclosure. Akhtaruddin and Haron (2010) have also found that there is no evidence to support the great proportion of financial experts on the AC are effective in enhancing the corporate voluntary disclosure.

2.6 Audit committee diligence

2.6.1 Definition of Audit committee diligence

Audit committee diligence is a process that is needed to achieve AC effectiveness (DeZoort et al., 2002). AC diligence is defined by DeZoort et al., (2002) as:

> *The willingness of AC members to work together as needed to prepare, ask questions, and purse answers when dealing with management, external auditors, internal auditors, and other relevant constituent.*

The AC formal meetings are the heart of the AC's work, it is expected that AC members will keep in contact with the key people who are involved in the corporate governance (KPMG, 2013). In this respect, the frequency of meetings is perceived as a main indicator of AC diligence (Bédard, & Gendron, Y, 2009). Fewer meetings indicates a lack of insufficient time for effective monitoring (Bédard, & Gendron, Y, 2009). Gendron et al.'s (2004) research shows that AC generally keep best practices in regard to have meeting with only the external and internal auditors, without management, to discuss issues for instance the their relationships with management and the competencies of the management.

The meeting frequency of AC is considered as a main component of AC meetings. For instance, the BRC (1999) suggested that audit committee meet at least quarterly, to discuss corporate disclosure quality with auditors and provide newest result of dealing AC responsibilities. Moreover, the NACD indicated the importance of AC diligence and it recommended that AC should hold four meetings per year (NACD, 2000). By meeting frequently, AC functions effectively and improve the integrity of corporate disclosure process (Salloum et al., 2014). The importance of AC meeting frequency is supported and illustrate by recent research. Bédard, & Gendron, (2009) reviewed prior analyses and concluded that higher meeting frequency is associated with the AC effectiveness to some extent. Moreover, AC meeting frequency will have less fraud (Beasley et al., 2000); reduce audit and control risk (Stewart, & Munro, 2007); enhance internal audit function (Zain et al., 2006); provide a better monitoring environment; reduce financial reporting difficulties (Salloum et al., 2014).

2.6.2 AC diligence and voluntary disclosure

AC members meet frequently are likely to fulfill its responsibilities of its role effectively (Karamanou and Vafeas, 2005). Greco (2011) has claimed that higher frequency of AC meeting creates opportunities of AC members to express their judgments on corporate's accounting choices and on disclosed information. Karamanou and Vafeas (2005) suggested that frequent AC meetings is more likely to provide a better monitoring environment of corporate disclosure and reduce financial reporting problems. Raghunandan et al. (2001) empathized that an AC will be informed, diligent and knowledgeable regarding to financial issues when it meets more frequently, so that AC can be more effectively to carry out their duties. Similarly, Abbott et al. (2003) suggested that an AC meets at least four meeting per year, the financial report restatement will unlikely to happen.

The prior literatures have shown consistent relationships between AC meeting frequency and voluntary disclosure. However, most of these literatures aim to focus on one certain angle of voluntary disclosure. Karamanou and Vafeas (2005) sampled 275 of Fortune 500 firms from 1995-2000. They found that the AC meeting frequency is positively associated with the probability of voluntarily making earnings forecasts. Similarly, O'Sullivan et al. (2008) collected data from the published annual reports between 2000 and 2002 of the largest 300 listed firms and have found that the meeting frequency of AC is positively associated with making decision on voluntary forecast information in the annual financial statement. Li et al. (2012) selected UK IC-intensive sector companies which are fully listed on the London Stock Exchange (LSE) at the end of December 2005 and made a multiple regression analysis. They found that the number of AC meetings has positive relationship with voluntary intellectual capital disclosure. Their results indicate that AC's activities is an essential factor in improving intellectual capital disclosure in order to reduce information asymmetry. Moreover, Bronson et al. (2006) find a positive association between the frequency of AC meetings and voluntary disclosure in the perspective of internal controls. Kelton and Yang (2008) collected data from a sample of 3488 firms listed the NASDAQ and evidenced that the higher frequency of AC meeting is more likely to pursue voluntary internet financial reporting. Kelton & Yang (2008) also stated that most internet financial reporting is non-compulsory and unregulated and firms with a diligent AC is more likely to provide more Internet financial disclosures. Typically, Allegrini and Greco (2011) investigated voluntary disclosure as a whole, sampled all non-financial companies listed on the Italian Stock Exchange in 2007 and found the AC meeting frequency is highly positively associated with the extent of voluntary disclosure. They suggested AC at least meets quarterly will be more likely to enhance the level of voluntary disclosure (Allegrini and Greco, 2011).

3. Conclusion, Policies, & Limitations

3.1 Conclusion

This paper started with the description of recent corporate disclosure frauds. The dissatisfaction of mandatory disclosures have encouraged companies to enhance voluntary disclosure (Boesso, G. & Kumar, K., 2005). Hence there is a requirement for more abundant and diversified information disclosure by corporates on a voluntary basis (Schuster, & O'Connell, 2006). Voluntary disclosure will mainly contribute in increasing firm's value (Othmana et al., 2014; Peters, Abbott & Parker, 2000), mitigating information asymmetry (Balakrishnan, Li, & Yang, 2012; Madi et al., 2014) and reducing agency costs (Madi et al., 2014). The level of voluntary disclosure is affected by number of factors, such as ownership structure (Chen et al, 2008; Elmans, 2012), corporate culture (Rouf, 2011; Alvesa et al, 2012). Among these factors, there is a significant attention has been paid to audit committee which plays a crucial role in corporate voluntary disclosure (Bédard, & Gendron, Y, 2009; Akhtaruddin, & Haron, 2010). Furthermore, an effective AC essentially functioning on AC characteristics which can be concentrated on three main characteristics: independence, financial expertise and diligence (DeZoort et al., 2002). Hence, this paper devotes to enhance the understanding of voluntary disclosure from a perspective of three AC characteristics based on a literature review study.

The main research question of the study is *"What is the influence of independence, financial expertise and diligence of the audit committee on the effectiveness on their monitoring the extent of voluntary disclosure according to the literature?"* In order to develop an answer, this paper reviewed a variety of prior resources. The role of AC in voluntary disclosure has been investigated which combined with agency theory. Then, the AC effectiveness which indicated the approaches in which the AC achieves its goal was investigated based on the three major AC characteristics: independence, financial expertise and diligence. After extraction of enormous research findings and arguments from previous studies, we concluded the final results to main question are dominated respectively by positive relationships, but inconsistent opinions exist.

First of all, most literature suggest a positive relationship between AC independence and voluntary disclosure (Abbott et al., 2002; Persons, 2009; Madi et al., 2014; Akhtaruddin and Haron, 2010; Barros et al., 2013; Patelli, & Prencipe, 2007). These studies generally sampled and reviewed annual reports of hundreds of listed firms in certain countries. Furthermore, these studies have made the regression analysis and found the results which is in the accordance with the notion that AC independence enhance AC effectiveness, hence improve voluntary disclosure. On the contrary, there are less inconsistent results rejected the positive relationship between AC independence and voluntary disclosure (Othman et al., 2014; Ramadhan, 2014). These two studies collected data from listed firms in Malaysia and Bahrain. They found that there is no evidence to support a positive relationship between AC independence and voluntary disclosure. Especially, Othman et al., (2014) made a regression analysis which indicates that even the audit committee is effective and independent, it still cannot ensure that the firm will disclose information voluntarily.

Secondly, the reviewed studies have shown multiple results of relationships between AC financial expertise and voluntary disclosure. Bedard & Gendron, (2009) reviewed numbers of academic publications between at the end of 2008 and concluded that AC members with higher financial competencies are positively associated with corporate voluntary disclosure. Many other studies indicated a positive relationships between AC financial expertise and financial reporting (Kelton & Yang, 2008; McMullen & Raghunandan, 1996; Bedard & Gendron, 2009; Kent et al., 2010). It is noteworthy that these findings are based on financial reporting as a whole. They are unclear that whether such financial reporting includes both mandatory reporting and voluntary disclosure. Thus, an assumption that if such financial reporting includes both mandatory reporting and voluntary disclosure, then it can be considered that there is a positive relationship between AC financial expertise and voluntary disclosure. Inversely, there are some studies suggest that there is no significant influence of financial expertise in AC on corporate voluntary disclosure (Madi et al., 2014; Akhtaruddin and Haron, 2010; Persons, 2009).

Finally, the prior literatures have shown consistent relationships between AC meeting frequency and voluntary disclosure (Karamanou and Vafeas, 2005; O'Sullivan et al., 2008; Li et al., 2012; Bronson et al., 2006; Kelton & Yang, 2008). However, these literatures aim to focus on one certain angle of voluntary disclosure, such as voluntary forecast information in annual reports (Karamanou and Vafeas, 2005; O'Sullivan et al., 2008), voluntary intellectual capital disclosure (Li et al., 2012), voluntary disclosure on internal controls (Bronson et al., 2006) and voluntary internet financial reporting Kelton & Yang (2008). Only a few studies investigated voluntary disclosure as a whole. Allegrini and Greco (2011) have found the meeting frequency of AC is highly positively associated with extent of voluntary disclosure.

3.2 Policies

This paper provides suggestions and policies aiming at enhancing voluntary disclosure in the perspective of audit committee characteristics. This paper investigates the relationship between voluntary disclosure and AC independence, financial expertise and diligence, in order to improve AC effectiveness, hence enhancing voluntary disclosure. These suggestions are provided based on the conclusion stated above and current regulations or standards. Firstly, according to the result of this paper which mostly shows a positive relationship between AC independence and voluntary disclosure, we suggest that listed firms shall establish AC with solely independent AC members. This suggestion is in accordance with the accommodations of SEC and SOX. Independent AC members provides the absence of material relationship with management, thus eliminate adverse interference for voluntary disclosure from management. Independent AC members also ensures the objectiveness, completeness, transparency of voluntary disclosure. Secondly, the conclusion shows an unclear relationship between AC financial expertise with voluntary disclosure. Because those studies are mostly based on financial reporting. Thus, our own practical suggestion in the perspective of AC financial expertise and voluntary disclosure is unable to provide. However, according to regulations of SEC, which require AC having at least one financial expert as defined by SEC rules. Thus, we could say that people with financial knowledge and experience shall be primary considered as AC members. Finally, based on consistent result that AC diligence positively affect voluntary disclosure in many aspects. The suggestion is provided as AC shall meet at least 4 times every year. It is in line with both academics and regulations. Frequent AC meetings is considered to ensure proper decision-making and better timeliness of voluntary disclosure.

3.3 Limitations

This paper is subject to following limitations. First of all, all the findings and recommendations of this study are based on previous literatures and regulations years ago, thus, the timeliness, applicability and reliability those publications may lead to defects of this paper's conclusion and suggestions. Secondly, the conclusion and suggestions of this paper are based on the review of prior literatures, some of those literatures are using smaller sample sizes, which could lead to our results may be biased to missing significant information. Finally, some of those literatures are aiming at a certain country, it might result in our suggestions are not applicative for all counties.

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