Chapter 1
Audit Committee Effectiveness, Audit Quality, and Internal Control Information Disclosures:
An Empirical Study

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ABSTRACT

This chapter examined the linkages between audit committees' effectiveness, audit quality, and internal control information disclosure. Empirical evidence on the effect of audit committee effectiveness and audit quality on internal control information disclosure is scanty. Using a 210 firm-year sample of firms listed on the Ghana Stock Exchange for the period 2013-2017, the chapter tried to fill the research gap. After controlling for board size, proportion of independent directors, and leverage, the results from univariate and multivariate analyses indicated that effective audit committee and audit firm size play complimentary and substitution roles in ensuring internal control information disclosure. Board size and proportion of independent directors were also found to influence the disclosure of quality voluntary information.

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INTRODUCTION

The purpose of this paper is to investigate the influence of audit committee effectiveness and audit quality on disclosure of internal control information in corporate annual reports. The paper wants to test whether there is a substitute or complementary effect between the presence of Big Four auditor and effective audit committee in influencing disclosure of internal control information.

Establishment of proper corporate governance mechanisms is essential for the optimal application of resources, enhancement of responsiveness, transparency and protecting the rights of the stakeholders (Sun *et al.*, 2010; Grougiou *et al.*, 2014). According to Deumes, (2004) reporting on internal control improves the quality of financial reporting and reduces governance problems. Internal control also helps to ensure that information is reliable and that firms comply with laws and regulations (Beretta et al., 2010; Hunziker, 2013).

Lack of proper attention to proper internal controls could either result in a direct loss of earnings or may result in imposition of constraints on the firm's ability to meet its profit-making objectives. In the wake of recent corporate failures, the necessity of establishing audit committees and engaging quality audit in enhancing quality financial reports has been emphasized. A company that has an effective audit committee will have less likelihood of experiencing problems with internal control (Zhang et al., 2007; Krishnan, 2005). According to Ashbaugh-Skaife et al. (2007), lack of internal control disclosures raises shareholders' uncertainty about the reliability of the reported earnings and appear to elicit a significant negative market reaction. An effective internal control system can prevent large losses (Jaya et. al., 2016). The interaction among corporate governance actors is crucial to the issue of quality financial reports. This study focuses on two of these corporate governance actors, namely audit committee and external auditors. In particular, this study attempts to investigate the nature of relationship between audit committees and external auditor on internal control information disclosure. Zhang et al. (2007) posit that audit committees with financial expertise or accounting expertise have a smaller probability of experiencing internal control issues. Ho and Wong (2001) also argue that the presence of an audit committee influence the level of corporate disclosure. In emerging economies, where corporate governance mechanisms are typically weak to contain agency problems, external auditors provide assurance on the reliability of financial statements of listed companies (Fan and Wong, 2005). This study focused on the audit committee because it is one of the elements responsible for overseeing the interests of shareholders and supervising financial statements. The audit committee should be efficient and provide maximum transparency. This organ of control needs other mechanisms, such as the quality of external auditor, to mitigate annual report manipulation.

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