

# A Study of Identifying Relationship between Financial expertise of the Audit Committee Members and Presentation of Financial statements in the Tehran stock exchange

Hossein Rastegar

Dept. of Accounting,  
Shriven Branch, Islamic Azad University,  
Shriven, Iran

Hamid Mohammadi

Dept. of Accounting,  
Shriven Branch, Islamic Azad University,  
Shriven, Iran

Hamid Saremi

Dept. of Financial Engineering,  
Quchan Branch, Islamic Azad University,  
Quchan, Iran

## Abstract

The purpose of this study is to investigate the relationship between independence, financial expertise of the members of the audit committee and the presentation of the statements in the companies of Tehran stock Exchange.

In this study, the independent variables are: financial expertise, independence. Size of Audit Committee and to be formal accountant of internal auditor head and the dependent variable is: restate financial statement and control variables included: the firm size, leverage, size of audit Firm and delay of audit report.

For this purpose, the information of 73 companies in Tehran stock Exchange has been extracted during 2012-2015.

Several variables with the data panel technique were analyzed using a multivariate regression.

The results indicate that there is a significant and positive relation between the size of the audit committee and financial expertise of audit committee members with restate of financial statements. There is no meaningful relationship between the size of the audit committee and to be formal accountant of internal auditor head with restate of financial statements.

**Keywords:** audit committee, financial expertise, restate of financial statement.

## Introduction

The great corporate financial scandals and the subsequent results was the main reason for attention to the quality of financial statements. These financial crises have caused to increase the demand for auditing with high quality. Auditors should be more intelligent after the recent crisis. The audit quality is one of factors which add financial data credit (Jagy et al. 2012). Targeted restate incentives of financial statements divided into three categories: The first group is motivations of companies which have the problem of low profitability and cash. These companies are more inclined to improve their financial results by committing fraudulent acts and intentional mistakes. The second group: motivations of companies that tend to meet market expectations and predictions by committing fraudulent acts and intentional mistakes. The third group, the motivation resulted of some conventions. The bonus conventions independent to stocks firm performance are an example of these conventions (Palmors and

Shoulz, 2004). Jensen and McIning (1979) stated that audit is an important tool to reduce agency costs between managers and shareholders. Auditing is monitoring tool for stakeholders because auditors report false cases in the financial statements. The audited financial statement is as one of confident sources of information to users, but this information can be used by users when they have some qualitative features. One of these features is no latency at information or is to be on time. Also, one of the most important of the qualitative features related to financial published information is to be useful information. To be on time is also one of qualities features related to information and according to accountants forum of America, subset of qualities feature, information related will be classified and account standards of Iran is one of on time factors which limits the characteristics of qualified data (Barzide & Madanchiha, 2014).

### Statement of problem

Recent financial Scandals around the world, from Enron and world com in America to Parameters in Europe have created some concerns regarding the reliability of financial statements. While the primary responsibility of financial statements is responsibility of the management company. But following these events, the charge is pointed to the auditors to where these events generally are known as "audit failure" and the role of the Audit Committee in financial reporting process has increasingly attracted the attention of the regulation drafter (Cansuelo and de Fuentes, 2007). The main role of the companies audit committee is supervision on process of companies financial reporting even though the audit committee provides the most reliable protections from public interests, but pervious reviews and studies about audit committee show both a lot of variation at expertise and skills of audit committee members and lack of experience and expertise financial of many committees members in the field of financial affairs and accounting. Recent reforms of companies audit committee have targeted the increase of managers with financial expertise as one high light features in audit committee (Wallac Davison et al, 2004). In literature of financial reporting, latency in presenting financial statements and latency in presenting audit report have close relationship together and in most cases, the topic of to be on time financial statements will be discussed with to be on time audit report presentation (Leventise et al. 2005). Incentives of targeted restate have divided financial statements into three groups: The first group is the incentives (motivation) of companies which have the problem of low profitability and cash. These companies tend to improve their financial results. The main reasons of statements are included revenues (for example false & questionable indentifying of expenditures) and

reclassifying and disclosing (for example classifying debt as an investment) (Shoulz, 2008).

According to section 13 of Accounting Standard 1 of Iran, where the way of offering and classifying the financial statements are amended, in order to ensure the ability of comparing items of financial statements, the comparable amount should be reclassified unless it isn't possible. Also the nature, amount and reason of reclassification should be disclosed. In addition, according to necessity of standard. Account NO9 with title of financial performance, if the accounting policy changes to other way, the comparative numbers of the previous periods should be representing based on new procedure (International Accounting Standard Committee-2016).

### Audit Committee

Audit committee is a committee of the Board of Directors. Its primary role is to help to the Board of Directors for doing their supervisory responsibility by considering financial information provided to share holders and other users of financial and accounting information, internal control of directors and the audit section (Takhtae, Tamimi and Mousavi, 2011).

### Financial expertise:

Financial expertise is a member that has education and experience in accounting, auditing, financial investment and analysis (John et al, 2014).

### Restate of financial statements:

The definition of financial restatements is mentioned as performed amendments which usually resulted from failure to comply with generally accepted accounting principles. General Accounting office (2002) has announced that the restatement of financial statements will be occurred when the company reviews voluntarily or according law of lawgivers or auditors the reported financial information (Abdullah et al, 2010).

### Research Background

Alami (2017) examined the over confidence of managers and restatement of financial statements by using the combined data method over the 2009-2013. The results of data analysis showed that there is a significant relationship between over confidence of managers and restatement of sale heading. There is no significant relationship between managers' overconfidence and restatement of accounts heading and payable documents. There is a significant relation between mangers over confidence and restatement of goods heading and materials.

Sayadi (2016) studied relationship between latency in the audit report and financial statement restatement with

emphasis on audit quality in 105 companies accepted in the stock exchange over a 5 years period between 2009–2013. The results of research indicate that latency in the audit report has a significant positive relationship with the restatement of financial statement and also these results indicate that audit quality (auditor industry expertise, tenure of auditor selection and size of audit office) has negative and significant effect on the relationship between latency to offer audit report and financial restatement.

Mousavi et al, (2015) review features of the corporate governance such as board independence, CEO duty duality, management property, the property of the external major shareholders and the audit quality on financial restatements. The sample consist of 40 companies.

Mitchell et al, (2017) examined the relationship between audit size with delay in audit report and financial statement on the stock exchange of America during 2000 – 2009. The results indicate that there is a positive and significant relationship between audit size with delay in audit report and financial restatements.

Khalid et al, (2017) examined the characteristic related to the audit and disclosed in time audit report. The results of the research showed that there is significant and significant relationship between audit size with delay in audit report and financial restatement.

Khalid et al (2017) examined the characteristic related to the audit and disclosed in time audit report. The results of the research showed that there is significant and positive relationship between the size of the audit institution and financial expertise of the audit committee with delay. There is significant and negative between the auditor's remarks, the dichotomy of the board of directors and the latency of audit report. There is no relationship between ratio of goods inventory and debt to total assets, the size of the board of directors and the latency of the audit report.

Rohami et al (2016) examined the relationship between the characteristics of the audit committee and restatement of financial restatements in stock exchange companies of Malaysia. The results indicate that there is a significant and negative relationship between independence of the audit committee members and restatement of financial restatements, but there is no significant relationship between the financial expertise of the audit committee and the experience of the audit committee manager with restatement of financial restatements.

Negar Soltan et al (2015) examined the relationship on the characteristics of on time audit committee of the audit report. They concluded that there is negative relationship between on time state of audit report and financial expertise and experience and the independence of the audit

committee.

## Methodology

The recent research is functional in terms of purpose because research data belongs to Past Period and without any interference it achieved. It is classified to post-hoc quasi- experimental research in search group. According to the analysis of the relationship between independent and dependent variables and according to statistics consultants it is type of correlation. In order to test hypotheses, multiple regression method was used. In required data based on the definition of dependent and independent are used for research hypotheses test. At first we put the data and panel data after collecting the data and determining the model. It should be noted, descriptive statistics such as central and dispersion are obtained separately for each variable.

## The statistical model

In this research following Rohami, et all's research (2016), we use the statistical model.

To the first hypothesis test, regression equation is used as follows:

$$RES_{i,t} = \beta_0 + \beta_1 F\_Expertise_{i,t} + \beta_2 \log Size\_A_{i,t} + \beta_3 FL_{i,t} + \beta_4 Size_{i,t} + \beta_5 ARL_{i,t} + \epsilon_{i,t}$$

Where

RES it: restatement of financial statement, company i for year t.

F- Expertise i.t: the financial expertise of the audit committee members, company i for year t.

Log Size - Ait : The logarithm of company size, company i for year t.

FL it: financial leverage, company i for year t.

SIZEit: The size of the audit firm, company i for t.

ARL it: The latency of the audit report, company i for t.

Eit: The error of the model.

The regression equation is used for second hypothesis test as follows:

$$RES_{i,t} = \beta_0 + \beta_1 Independence\_Ac_{i,t} + \beta_2 \log Size\_A_{i,t} + \beta_3 FL_{i,t} + \beta_4 Size_{i,t} + \beta_5 ARL_{i,t} + \epsilon_{i,t}$$

Where,

RES it: the restatement of financial restatement: company i for year t.

Independence- Ac i.t: independence of audit committee members, company i for t.

The regression equation is used to third hypothesis test as follows:

$$RES_{i,t} = \beta_0 + \beta_1 Size\_Ac_{i,t} + \beta_2 \log Size\_A_{i,t} + \beta_3 FL_{i,t} + \beta_4 Size_{i,t} + \beta_5 ARL_{i,t} + \epsilon_{i,t}$$

Where,

RES it: restatement of financial statements, company i for t.

Size – Ac it: The size of the audit committee members, company i for year.

The regression equation is used for forth test as follows:

$$RES_{i,t} = \beta_0 + \beta_1 CAIC_{i,t} + \beta_2 \log Size_{i,t} + \beta_3 FL_{i,t} + \beta_4 Size_{i,t} + \beta_5 ARL_{i,t} + \epsilon_{i,t}$$

RES it: restatement of financial statement, company i for year t.

Calc it: to be formal accountant of internal audit manager, company i for year t.

Variables and how to measures them .

Source	Calculation method	Variable name	Type of variable
Report of the directors board and market information	Number of audit committee members	The size of the audit committee	Independent
Report of the directors board and market information	If more than 50 percent of members are experts, the number is 1 and otherwise the number is 0.	Expertise of audit committee member	
Report of the directors board and market information	If more than 50 percent of members are experts, the number is 1 and otherwise the number is 0.	Independence of audit committee members	
Report of the directors board	If internal auditor director is formal accountant, the number is 1 and otherwise the number is 0.	Being formal accountant of the internal audit manager	
Balance sheet, explanatory notes	For restatement of financial restatement, the number is 1, and otherwise the number is 0.	Restatement of financial statement	Dependent
Balance sheet	Total debt Total assets	Financial leverage	Control
Audit report	If the auditor of company is auditor firm the number is 1 and otherwise the number is 0.	Audit size	
Balance sheet	Natural logarithms of assets.	Size of company	
Audit report	From the end of fiscal year 12.29. audit report	Audit report delay	

Statistical population, statistical sample and sampling method

According to the time span of the study (2012-2015) the statistical population is apart of these listed companies in Tehran stock Exchange which has below conditions:

- 1- The selected companies which have formed the audit committee from 2012.
2. The company financial year is ended in 29 March each year. (The listed companies in Tehran Stock Exchange have different dates for the end of the financial year. The reason of difference in companies' financial years is because of difference of activities and therefore variety production cycle. These companies are selected because of same reporting period, removing the seasonal effects and as well because most stock companies end to March end).

3. The data should be available to calculate the research variables about the company throughout the study.
4. It should not be part of investment companies and banks.

After taking into account the above conditions, 73 companies were selected as statistical sample.

**Test of the first hypothesis**

**H0:** There is no significant relation between the financial expertise of audit committee members and restate of financial restatement.

**H1:** There is significant relation between the financial expertise of audit committee and restate of financial restatement.

**Table 1-7: The results of fitting the regression model and estimating coefficients in first hypothesis.**

result	Significant level	Z statistics	Standard error	Coefficient	Coefficient symbol	Variables
	0.340	0.953	1.033	0.985	0β	Constant coefficient
Direct and meaningful	0.000	11.095	0.337	3/739	1β	Expertise of audit committee members

No meaningful	0.496	0.680	0.232	0.185	$\beta_2$	The size of firm
No meaningful	0.804	-0.247	0.296	-0.073	$3\beta$	Financial leverage
Adverse and meaningful	0.006	-2.999	0.062	-0.188	$4\beta$	Size of company
Direct and meaningful	0.000	3.789	0.003	0/013	$5\beta$	Latency of audit report
5.723	Statistics of likelihood			0.1093	Mac Faden Determination	Overall model outcomes
0.014	Significance level			1.245 0.4136	Hamster Lemsho H-L statistics (Significance level)	

According to Table 4-10, the coefficient of determination Mc Fadden that its value changes to between zero and one, the mentioned statistics in estimated model in %10.93 which this number is acceptable for logistics regression. H-L statistics is 1.245 and the possibility is obtained greater than %10 and equal to 0.4136. Therefore the null (0) hypothesis that reflects the goodness of fit is confirmed (it is not confirmed), then the independent variables have explanatory power for the decision of the company about the restate of the financial restatement. However, based on the estimated regression coefficient corresponding to the expertise of audit committee members is 3.739 and the level of significance corresponding with it is %5. So with confidence %95, the effect of the audit committee

member's expertise and restate of financial restatement are meaningful and the first and the first hypothesis of research is confirmed based on that "there is significant relationship between the financial expertise of the audit committee members and restate of financial restatement.

#### Test of second hypothesis

**H0:** There is no significant relation between the financial expertise of audit committee members and restate of financial restatement.

**H1:** There is significant relation between the financial expertise of audit committee and rotate of financial restatement.

**Table 1-8: The results of fitting the regression model and estimating coefficients in second hypothesis**

result	Significant level	Z statistics	Standard error	Coefficient	Coefficient symbol	Variables
	0.578	0.554	0.928	0.515	$\beta_0$	Constant coefficient
Direct and meaningful	0.001	4.645	0.210	0.976	$\beta_1$	Independence of audit committee members
No meaningful	0.480	0.705	0.232	0.163	$\beta_2$	The size of firm
No meaningful	0.054	-1.828	0.296	-0.541	$\beta_3$	Financial leverage
No meaningful	0.868	0.165	0.061	0.010	$\beta_4$	Size of company
Direct and meaningful	0.000	9.359	0.003	0.032	$\beta_5$	Latency of audit report
8.542	Statistics of likelihood			0.2052	Mac Faden Determination	Overall model outcomes
0.008	Significance level			9.867 0.2744	Hamster Lemsho H-L statistics (Significance level)	

to Table, the determination coefficient of Mc Fadden that its value changes to between zero and one, the mentioned statistics is 20.52 in the estimated model that this number is acceptable for logistics regression. From one hand, statistics H-L has X2 distribution with free degree J-Z (J is the number of groups). From other hand, the statistics H-L is obtained 9.867 and the possibility is greater than %10 and equal to 0.2744. Therefore the null (0) hypothesis that reflects the goodness of fit is confirmed (it is not confirmed), then the independent variables have explanatory power for the decision of the company about

the restate of the financial restatement. However, based on the estimated regression coefficient corresponding with the independence of audit committee members is 0.976 and the significance level corresponded is less than 0.05, so with confidence 0.95, the effect of independence of the audit committee and restate of financial restatement is meaningful and the second hypothesis of research based on "there is significant relationship between independence of audit committee and restate financial restatement is confirmed.

**Test of third hypothesis**

**H0:** There is no significant relation between size of audit committee and restate financial statement.

**H1:** There is significant relation between audit committee and restate of financial statement.

**Table 1-9: The fitting results of regression and estimation of coefficient in third hypothesis.**

result	Significant level	Z statistics	Standard error	Coefficient	Coefficient symbol	Variables
	0.370	0.895	0.977	0.874	$\beta_0$	Constant coefficient
No meaningful	0.208	-1.261	0.129	-0.163	$\beta_1$	The size of audit committee members
No meaningful	0.342	0.949	0.237	0.225	$\beta_2$	The size of firm
No meaningful	0.952	-0.060	0.294	-0.017	$\beta_3$	Financial leverage
No meaningful	0.794	0.260	0.062	-0.016	$\beta_4$	Size of company
No meaningful	0.357	0.920	0.003	0/003	$\beta_5$	Latency of audit report
2.973	Statistics of likelihood			0.0102	Mac Faden Determination	Overall model outcomes
0.704	Significance level			11.565 0.1717	Hamster Lemsho H-L statistics (Significance level)	

According to Table 4-12, the coefficient of determination Mc Fadden that its value is changed between zero and one. The mentioned statistics in the estimated model is y01 102. The number is acceptable for logistic regression. From are hand, the statistics H-L has distribution X<sup>2</sup> with degrees of freedom j-z (J is number of groups). From other hand, the statistics H-L is 11.565 and the possibility is obtained more than 10% and equal to 017.17. Therefore, the null (0) hypothesis that reflects goodness of fit is confirmed (isn't denied). Then independent variables have power explaining of company decision about restate the financial restatement. However, based on the estimated regression coefficient, the rate of regression coefficient corresponding the size of audit committee members is 0.063 and the

significance level corresponding is 0.208 and more than 5%, so with confidence 95%, the effect of audit committee size and restate financial restatement aren't meaningful and third hypothesis based on "there is no significant relation between audit committee size and restate financial restatement" will be rejected.

**The fourth hypothesis test.**

**H0:** There is no significant relation between being formal accountant of internal auditor director and restate financial restatement.

**H1:** There is meaningful relation between be formal accountant of internal audit director and restate financial restatement.

**Table 1-10: Results for regression model and estimating the coefficient of fourth hypothesis.**

	Significant level	Z statistics	Standard error	Coefficient	Coefficient symbol	Variables
	0.694	0.392	0.962	0.377	$\beta_0$	Constant coefficient
	0.781	0.277	0.210	0.058	$\beta_1$	Being formal accountant of the internal audit manager
	0.457	0.742	0.233	0.173	$\beta_2$	The size of firm
	0.846	-0.193	0.296	-0.057	$\beta_3$	Financial leverage
	0.844	0.196	0.061	0.012	$\beta_4$	Size of company
	0.344	0.945	0.003	0/003	$\beta_5$	Latency of audit report
	Statistics of likelihood			0.0102	Mac Faden Determination	Overall model outcomes
	Significance level			0.0051 18.155	Hamster Lemsho H-L statistics (Significance level)	

According to Table 4-13, the coefficient of determination Mac Fadden whose value changes between zero and one, the statistics in the estimated model is 0.0051 which this number is acceptable for logistic regression. From one hand, statistics H-L has distribution  $X^2$  and degrees of freedom  $jz$  ( $J$  is number of groups). From other hand, statistics H-L is 18.155 and the possibility is obtained smaller 10% and equal with 201%. So the null hypothesis the reflects the goodness of fit is confirmed (isn't denied), then independent variables have the financial restatement. However, based on the estimated regression coefficient, the rate of regression coefficient corresponding to be formal accountant of internal audit director is 58% and the level of significance corresponding with is 781% more than 5%, So with confidence 95%, the effect of being formal accountant of internal audit director and restate the financial restatement isn't meaningful and forth hypothesis of research based on that "there is significant relation between being accountant of internal audit director and restate the financial restatement isn't meaningful and fourth hypothesis of research based on that "there is significant relation between being accountant of internal audit director and restate the financial restatement" will be rejected.

### Practical Suggestions

According to the first hypothesis test result, it is suggested that:

- 1) Companies act in order to attract more qualified personnel in audit committee.
- 2) The audit companies are suggested that step by programming, contracting with companies, being specialists in different industries in order to present on time and more qualities audit reports.
- 3) The directors of the stock companies should be act in order to hire more professionals in the audit committee.
- 4) The members of the Board of Directors should consider audit quality at the time of audit contracts, relying on the expertise of the audit committee members.

According to the test result of the second hypothesis, it is proposed that:

- 1) The directors of companies act to attract more independent members in audit committee because independent members can present financial reporting by using impartial and negotiating.

According to the test result of third hypothesis, it is proposed that:

1. Tehran Stock Exchange organization should notice to audit committee variables, restate the financial restatement in order to provide information.
2. The Stock Exchange organization, managers and companies' owner should consider some encouraging presenting on time reports.

According to the test result of the fourth hypothesis it is proposed that:

1. User of financials restatement should have special attention to the experience of audit committee members when purchase and sale stock, because it will be led to decrease the audit costs and to manage other costs and it will follow the proper performance and allocation of costs.

### Suggestions for future research

1. It is proposed that the relation of audit committee members expertise and the expertise of the board of directors is considered with delay of audit report.
2. It is proposed that in future research, the role of the audit committee members and the board of directors that have the expertise of formal accountant are considered by restate financial restatement.
3. It is proposed that the role of the audit committee features such as the size of the audit committee, the audit committee independence, the percentage of stock ownership of the audit committee members with being on time financial reporting are considered.
4. It is proposed that consider the relationship between restate financial restatement and investment opportunity.
5. It is proposed that consider the relationship between the features of the audit committee and quality of the financial restatement items.
6. It is proposed that consider the relationship of the audit committee features and unexpected accrual items.
7. It is proposed that consider the relationship of the internal auditor's function quality and restate financial restatement.
8. It is proposed that that consider the relationship between the fraud financial reporting and financial restatement.
9. It is proposed that consider the effect of financial restatement on the latency of the audit report.
10. It is proposed that consider the relationship between transparency of information and financial restatement.

**References:**

- Barzideh, F., Madanchiha, M. (2014). The effect of audit firm expertise in industry on delay of audit report, quarterly journal audit, Theory and Act, First year, No. 1. Pages 1-19.
- Takhtaie, N., Tamimi, M., Musavi, Z., (2011). The role of the audit committee in financial reporting quality. Formal accounting. No. 45. Pages 45-56.
- Alemi, A. (2017). Study of relationship between over confidence of managers and restate financial restatements in the listed companies in Tehran Stock Exchange. MSc thesis in accounting. Azad University of Shahroud.
- The committee of accounting standards collecting. (2016). accounting standards. Publication of audit organization.
- Musavi, S.R., Jabbari, H., Beidokhti. A., (2015). Corporate governance restate financial restatements, researches of financial accounting and audit. 7th year, No. 25. Pages 97-119.