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Relationship between audit committee characterizes and the accounting quality

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by

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Relationship Between Audit Committee Characterizes and the Accounting Quality

Abstract

In this paper, I empirically examine the relationship between the three audit committee characterizes - the size of the audit committee, the percentage of the expertise with CPA backgrounds, the percentage of the independent directors - and the accounting quality. After controlling the firm's size and the firm's return on assets rate, I found that the percentage of the expertise with CPA backgrounds and the size of the audit committee have a significant and positive relationship with the accounting quality, and that the percentage of the expertise with CPA backgrounds have more significant influence on accounting quality than the audit committee size. However, there is no relationship between the percentage of the independent directors and the accounting quality. In conclusion, my results suggest that to improve accounting quality, firms should increase the percentage of expertise with CPA backgrounds in their audit committees as well as enlarge their audit committee size.

Key Words: Accounting Quality, Audit Committee Characterize, China

Data Availability: From public sources

1.Introduction

In the recent times, the accounting quality is more and more important: Based on the data retrieved from China Stock Market Accounting Research (CSMAR) database, from 2012-2018, the audit expense for preparing financial reports for the listed company is increased year by year, which indicates the firms are paying more attention and financial resources to guarantee the accuracy of the financial reports, in other words, the accounting quality; Also, in July, 2013, the Securities and Exchange Commission (SEC) announced three new rules to strengthen its law enforcement efforts for preventing false and fraudulent reports of the company, and it also founded Center for Risk and Quantitative Analytics (CRQA) for ensuring the quality of the information source(CFA Institution), which suggests that governments are also very concerned about the accounting information and its quality.

Financial statements are formal written records that convey information about the financial activities and the financial performance of a company(Murphy, 2019). It provides information to external user like bankers and shareholders. Based on these information, bankers would decide whether they should lend money to the company or not, and shareholders would decide whether they should keep holding the company's stocks. Hence, the accuracy of the financial statement, in other words, the accounting quality is very important.

In this paper, I use sample of firms from CSMAR during the period from 2015-2016 and provide an empirical analysis of whether audit committee characterizes would impact the accounting quality in China. The audit committee characterizes can be represented by the size of the audit committee characterize, the percentage of the expertise in the audit committee

characterize, the percentage of the independent directors in the audit committee characterize. The sample size of my research is 2833 and my main results - the relationship between each audit committee characterizes and the accounting quality are as follows.

First, I find that there is a positive and significant relationship between audit committee size and accounting quality after controlling the firm's size and return on assets rates. Second, I examine the relationship between the percentage of expertise with CPA backgrounds in the audit committee and the accounting quality, and find out that there is also a positive and significant relationship between these two. Also, I figure out that the percentage of expertise with CPA backgrounds are more significant than the size of the audit committee in determining the accounting quality. However, when investigating the relationship between the percentage of independent directors in the audit committee and the accounting quality, I find that there is no significant relationship between them. Based on my results, company with more expertise with CPA backgrounds and larger audit committee size would have higher accounting quality. Also, when the audit committee size is similar, the company with more expertise with CPA backgrounds would have higher accounting quality.

However, there has been some diabetes on whether the audit committee would fully perform their duties. For instance, Enron, before it went bankruptcy, it was one of the biggest energy company in the world, and it had 4 expertise in the their totally 6 members audit committee. However, because of their frauds on financial reports and negligence of duty, the company with over billions of assets became nothing within few weeks(Felo et al., 2003).

The rest of the paper is organized as follow. In the section 2, I would review the previous related literature and research and explain my hypothesis, in which I would first give the

definition of the accounting quality and the audit committee as well as its characterizes based on the previous research, also I would involve the history of audit firms, then I would explain the relationship between audit committee characterizes and accounting quality in the previous research. Base on the previous research, I would explain my knowledge gap, the difference between my paper and the previous ones, and the hypothesis.

In the section 3, I would describe the research design and the methodology, in which I would first introduce my main model that would help me to figure out the relationship between the audit committee characterizes and accounting quality, then I would explain specifically about how to calculate or get the data of each variables in the my main model.

In the section 4, I would explain the data processing, in which I would first give a general introduction of my samples, then I would explain where I get data from, how I eliminate the unrelated data and filter useful data of my variables, how I scale down my independent variables, and how I select the control variables - return on assets rates and firm size.

In the section 5, I would introduce the empirical results of the data, in which I would first give the summary of my variables - total cost, audit committee size, percentage of expertise, percentage of independent directors, firm size, and return on assets rate, and I would introduce the correlation between each variables, then I would demonstrate the regression analysis result, and explain the result in detail. Last, I would talk about the variance inflation factor results to test my research's reliability and validity.

In the section 6, I would give a conclusion of my results, in which I would explain the relationship between the audit committee characterizes and the accounting quality, then I would compare the results with the previous related research to test the robustness of my

results. Also, I would talk about the changes and improvements of my research compared with the previous research. Last, I would point out some limitations on my study and some suggestions to the future study related to the accounting quality and audit committee characterizes.

2.Review of Previous Related Literature

In the recent years, more and more study are focusing on examining the relationship between the accounting quality and other factors. In 2008, Barth et al. examine whether International Accounting standard(IAS) is associated with higher accounting quality(Barth et al., 2008); In 2015, Christensen et al. examine the impact of managerial financial reporting incentives on accounting quality changes around IFRS adoption(Christensen et al., 2015); In 2003, Felo et al. examine the relationship between the audit committee characterize and the quality of financial report. (Felo et al., 2003); In 2003, Imoff provides an analysis of past and present dimensions of accounting, auditing and corporate governance. (Imoff, 2003); In 2007, Soderstorm and Sun test how International Financial Reporting Standards (IFRS) changes the accounting system(Soderstorm & Sun, 2007). Based on the previous research, the topic about the accounting quality is very frequently used in the literature.

For accounting quality, Nikolaev defines it as the degree to which accrual-based accounting helps to measure its basic economic performance(Nikolaev, 2014). Also, in the study of *Accounting Quality, Stock Price Delay and Future Stock Returns*, Callen and her coworkers point out that accounting quality is the quality of the accounting information, in

other words, the accuracy of the financial reports(Callen et al, 2011). From the previous definitions, the importance of the accounting quality is self-evident. Apparently, the high quality of the accounting quality for a certain corporation would provide investors and bankers confidences to involve in one's financial activities. Because of its importance, many studies have been done in order to find the determinants of the accounting quality. In my research, I would apply annual total audit expense as the proxy for the accounting quality. Apparently, with higher audit expense, the firm would have more budget to ensure the financial report quality, in other words, the accounting quality.

According to Imhoff, in the 1970s, major CPA firms started to merged: Peat, Marwick, and Mitchell merged to become KPMG; Ernst & Whinney and Arthur Young merged to become EY; Haskins & Sells and Touche Ross & Co merged to become Deloitte; Price Waterhouse and Coopers & Lybrand merged to become PWC(Imhoff, 2003). In this process, these four firms become the biggest accounting firms in the world, which refers to Big 4. The Big 4 is known for its high quality of services, and one of the major services they provide is the auditing and ensuring the fairness of corporations' financial reports. Besides, today almost all the public companies are the Big 4 clients. In my research, all my samples would be Chinese listed company, and most of their financial reports would be audited by the Big 4.

For audit committee, according to Tuovila, an audit committee is one of the major operating committees of a company's board of directors, the role of which includes oversight of financial reporting, accounting policies, as well as any external auditors, compliance with regulatory requirements, and discussion of risk management policies with management. Since an audit committee is the institution for investigating the accuracy of the financial statements,

it could be regarded as an internal control for a company to guarantee its financial report quality(Tuovila, 2019). For audit committee characterizes, according to Felo and his coworkers, in their study, they use three dimension to measure it, which is proportion of members with financial or accounting expertise, independence of members, and the size of the audit committee(Felo et al, 2003). In my study, I would also use percentage of members with financial or accounting expertise, independence of members and accounting quality, and the size of the audit committee and accounting quality as the audit committee characterize to exam its impact on the accounting quality. I defined the percentage of members with financial or accounting expertise is the expertise with CPA backgrounds. For the independence of members, I would use the number of independent directors in the audit committee.

Considering that there might be other factors that would affect the firm's accounting quality, I would add some control variables. According to Felo et al. and Liu et al., in their study, they both use firm size as one of their control variables in examining the relationship with accounting quality(Felo et al., 2003, Liu et al., 2011). According to Barth et al., they use return on assets rate(ROA) as one of their control variables in examining the relationship with accounting quality(Barth et al., 2008). Based on previous research, I would also use ROA and firm size as my control variables.

According to Felo et al., their study indicates that among the three characterizes of audit committee(the proportion of members with financial or accounting expertise, independence of members, and the size of the audit committee), there is a positive relationship between the percentage of members with financial or accounting expertise as well as the size of the audit committee and accounting quality, but there is no significant relationship between the

independence of members and accounting quality(Felo et al., 2003).

Based on the previous research, I found that there is a positive relationship between audit committee characterize and accounting quality. However, the Felo's research is based on the 1992-1993 and 1995-1996's data. After over 20 years, there are many changes. First of all, in 2001, International Accounting Standards Board (IASB) issued International Financial Reporting Standards (IFRS). In 2005, most of listed companies in Asia and Europe were required to adopted(Barth, 2008). Besides, according to Barth, there is a positive relationship between IFRS adoption and accounting quality. Therefore, after the IFRS adoption, how accounting quality would change around the audit committee characterizes change becomes a question. In addition, Felo's research is only examine these relationships in the some foreign countries(not includes China as the listed firms at that time China was very few), whereas in my research, I would focus on Chinese listed companies. Also, apart from those changes I mentioned, China's entry into World Trade Organization (WTO) in 2001, its rapid economy growth as well as Chinese characteristics economic system are also the differences. After those changes, is there still a positive relationship between audit committee characterizes and accounting quality would be a knowledge gap. In other words, examining the relationships between audit committee characterizes and accounting quality in China would be the major topic in my paper. For the data, I would select sample of firms from China Stock Market Accounting Research (CSMAR) during the period from 2015-2016, which I would explain in detail in the following sections.

Hypothesis

The purpose of the research is to figure out the relationship between audit committee

characterizes and the accounting quality. The audit committee characterize, as it mentioned in the previous section, it consists of the audit committee size, the percentage of expertise with CPA backgrounds, and the percentage of independent directors. Hence, I would correspondingly have three hypotheses, which I would predict the relationship between each variables and the accounting quality separately. The hypotheses are as follow.

H1. There is a positive and significant relationship between audit committee size and the accounting quality.

Audit committee is one of the board of directors that responsible for supervising the financial report and disclosure. With the larger audit committee size, the number of people supervise on the financial reports would be larger, thus it would reduce the possibility of errors on the financial statements, and therefore, increase the accounting quality.

H2. There is a positive and significant relationship between percentage of expertise with CPA backgrounds and the accounting quality.

People with CPA backgrounds are the certificated expertise in the accounting and financial field. With more people have CPA backgrounds in the audit committee, company would be more confident and fluent in preparing its financial reports, thus ensure the accounting quality.

H3. There is a no significant relationship between percentage of independent directors and the accounting quality.

According to Cooperate Finance Institution(CFI), it defines the independent director as the non-executive director of the company, helping the company to improve its reputation and governance standards. Though there might be some independent directors in the audit

committee, they have nothing to do with the accounting quality as most of them know nothing about auditing.

3.Methodology

The purpose of my study is to examine the relationships between audit committee characterizes and accounting quality. To find out their relationship, I have to do the regression analysis, which I would explain in detail in the following sections. In this section, I would introduce the main model of my research and other models for calculating each of my variables. In order to ensure my results is as closely as possible to the prior research, I would apply the similar model as Felo et al.:

$$AQ=a1+a2Audt_SZ+a3Audt_INDP+a4Audt_EXPT+a5Co_Size+a6Co_ROA$$

Where AQ is the accounting quality; a2Audt_SZ is the firm's audit committee size; a3Audt_INDP is the percentage of independent directors in the firm's audit committee size; a4Audt_EXPT is the percentage of members with CPA backgrounds in the firm's audit committee, in other words, the percentage of expertise; a5Co_Size is the size of the firm; a6Co_ROA is the return on assets rate of the firm. (Felo et al, 2003)

To measure the dependent variable, the accounting quality, I would apply the firms annually audit fees(Total Costs) as the proxy. The reason why I choose this proxy is that apparently, the higher the audit fees is, the more budget the audit would have to ensure the accuracy of the firms' financial report, hence, the accounting quality.

For the independent variables, the audit committee size is the total members in the firm's

audit committee. The percentage of independent directors is calculated as the number of independent directors in the firm's audit committee divided by the total audit committee members. The percentage of expertise is calculated as the number of expertise with CPA backgrounds in the firm's audit committee divided by the total audit committee members. The model of calculation each variables are as follow.

$$a3Audt_INDP = \text{Number of Expertise} / \text{Total Number of Audit Committee}$$

$$a4Audt_EXPT = \text{Number of Independent Directors} / \text{Total Number of Audit Committee}$$

For the control variables, the firm size is calculated by natural logarithm of total assets, and the return on assets rate of the firm is calculated as the firm's net income divided by the firm's total assets. The model of calculation each variables are as follow.

$$a5Co_Size = \ln \text{ of Total Asset}$$

$$a6Co_ROA = \text{Net Income} / \text{Total Asset}$$

4. Data and Sample

I would examine the relationship between audit committee characteristics and accounting quality during the period from 2015-2016 and also examine how the changes in the audit committee characteristics would affect the accounting quality during the period. In this section, I would describe the data selection process and then explain each variables.

My sample consists of Chinese list firms from 2015-2016 in China Stock Market Accounting Research (CSMAR) database. I select these years since a) there are exactly the corresponding the audit fees, the proxy for the accounting quality, and b) they are the latest

years data I can deprive. In the selection of the data, I eliminate firms if I cannot obtain the audit committee number, without which I cannot calculate the percentage of the expertise and the percentage of the independent director. I also eliminate some fiscal years of one firms if the data in that fiscal year cannot be obtained. My sample for the 2015-16 period has 5154 records.

My dependent variable is the accounting quality, using the firms annually audit fees (Total Costs) as the proxy. The data for the Chinese list firms' audit fees are also obtained from CSMAR. I assume that the higher audit fees is, the higher the accounting quality would be, since the audit fees would apparently affect the accounting quality: With the low charge of the audit fees, it would definitely force auditors to reduce their budget, therefore, it would pose the negative impact on the accounting quality; On the contrary, with the high audit fees, auditors would be more flexible when providing audit services and preparing the financial reports. In the selection of the data, I eliminate the years if the data in that years cannot be deprive. Besides, as the total cost of audit fees have large amount, to have a relative normal coefficient, I scale down the number by one million when running the regression analysis. The reason why I scale it down by one million is most of the listed company's fees is over one million(the average of the total cost is 2.35 million CNY). After the processing of those three set of data, my final sample for the 2015-2016 period has 2833 records.

My independent variable is the audit committee characteristics, which could be represented by the size of the audit committee, the percentage of the expertise with CPA backgrounds, the percentage of the independent directors. The data of the audit committee characterize is also deprived from CSMAR. The size of the audit committee is the number of

people in the firms' audit committees, the percentage of the expertise with CPA backgrounds is calculated as the number of people with the CPA backgrounds in the firms' audit committees divided by the total number of the people in the firms' audit committees, and the percentage of the independent directors is calculated by the number of the independent directors in the firms' audit committees divided by the total number of the people in the firms' audit committees.

I select the return on assets rates and the firm size as the control variables. The data is also deprived from CSMAR. The return on assets rates can be calculated as the firm's net income divided by the firm's total asset. For the firm size, I adopt the natural logarithm of total assets as its proxy, which is same as Felo et al. There is two reasons for using those two variables. First, apparently, with larger firm size, the audit fees(total costs) would be higher. Second, in most research when examining the relationship with accounting quality, they would adopt firm size and ROA as their control variables. For examples, in Barth et al. research, they use ΔNI (net income divided by the total assets) as the control variables, their calculation formulas are same as my calculation for the ROA(Barth et al., 2008). Also, in Felo et al. research, they also adopt the firm size as their control variables(Felo et al., 2003). Hence, with these two control variables, I expect they would have positive contribution to the accounting quality.

5. Empirical Results

In this section, I would begin with the summary of each variables, and then I would

investigate the correlation and the regression analysis between the audit committee characterize and the accounting quality. After that, I would explain the analyze result, and exhibit the variance inflation factor test to examine the robustness of my research.

The summary of the variables is shown on the Table-1 below, the sample size is 2833, where the average of the size of the audit committee is 5.4, with 0.87 standard deviation; The average percentage of the expertise with CPA backgrounds is 0.40, with 0.11 standard deviation, which indicates the percentage of expertise in the audit committee in most Chinese listed company are close; The average percentage of the independent directors is 0.38, with 0.06 standard deviation, which indicates the percentage of dependent directors in the audit committee in most Chinese listed company are also very close; The average total cost for the audit fees is 2.35 million CNY, with 8.96 standard deviation. For the control variables, the average of ROA is 6.1%, with 0.153 standard deviation; the average firm size is 44.37, with 4.29 standard deviation.

Table-1. Summary of the Variables
Descriptive Statistics

Variable	Obs	Mean	Std.Dev.	Min	Max
Totalcost	2833	2.35	8.957	.1	214
ROA	2833	.061	.153	-2.38	2.435
SIZE	2833	44.472	4.289	19.545	61.572
Audt-EXPT	2833	.396	.112	0	.8
Audt-SZ	2833	5.409	.87	3	10
Audt-INDP	2833	.383	.056	0	.667

Notes:

Totalcost is firms annually audit fees.

ROA is the return on assets rate of the firm.

SIZE is the size of the firm.

Audt-EXPT is the percentage of expertise with CPA backgrounds in the firm's audit committee.

Audt-SZ is the firm's audit committee size.

Audt-INDP is the percentage of independent directors in the firm's audit committee size.

The Table-2 is the correlation of the each variables, which indicates the audit committee size and percentage of expertise in the audit committee both have the positive relationship with total cost, whereas the percentage of independent directors in the audit committee has a negative relationship with total. Also, all my independent variables have a significant correlation with my independent variables. The result suggests that the correlation of my research topic is very high.

Table-2. Correlation of the Variables

Pairwise correlations

Variables	(1)	(2)	(3)	(4)	(5)	(6)
(1) Totalcost	1.000					
(2) ROA	-0.018	1.000				
(3) SIZE	0.348*	0.002	1.000			
	**					
(4)	0.114*	-0.031	0.131*	1.000		
Audt-EXPT	**	*	**			
(5)Audt-SZ	0.168*	-0.023	0.229*	0.111*	1.000	
	**		**	**		
(6)	-0.145	0.028	-0.205	-0.244	-0.819	1.000
Audt-INDP	***		***	***	***	

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

Notes:

Totalcost is firms annually audit fees.

ROA is the return on assets rate of the firm.

SIZE is the size of the firm.

Audt-EXPT is the percentage of expertise with CPA backgrounds in the firm's audit committee.

Audt-SZ is the firm's audit committee size.

Audt-INDP is the percentage of independent directors in the firm's audit committee size.

The Table-3 is the regression results for the dependent variables(total cost for the audit fees), control variables(ROA and firm size) and the independent ones(the size of the audit committee, the percentage of the expertise with CPA backgrounds, the percentage of the independent directors). Where both the selected control variables are significant related with total cost, which indicates that my selected control variables have positive contribution to the accounting quality. For the percentage of the expertise, the coefficient is 5.25, with the t-value of 1.52; For the audit committee size, the coefficient is 1.086, with the t-value of 0.63; For the percentage of independent directors, the coefficient is 3.75, with the t-value of 5.03.

The regression results can be explained as the percentage of the expertise with CPA backgrounds has a very significant and positive relationship with the accounting quality; the size of the audit committee has the significant and positive relationship with the total cost audit fees, in other words, the accounting quality; The percentage of the independent directors has the insignificant relationship with the accounting quality on the level of 5 percent.

Table-3 Regression Results

VARIABLES	(1)	(2)	(3)	(4)
	OLS1	OLS2	OLS3	OLS4
	Totalcost	Totalcost	Totalcost	Totalcost
ROA	-1.119** (0.509)	-0.992** (0.499)	-0.888* (0.482)	-0.895* (0.485)
SIZE	0.727*** (0.136)	0.708*** (0.133)	0.669*** (0.118)	0.669*** (0.118)
Audt-EXPT		5.526*** (1.513)	4.961*** (1.404)	5.249*** (1.519)
Audt-SZ			0.894** (0.440)	1.086* (0.631)
Audt-INDP				3.747 (5.034)
Constant	-29.93*** (5.889)	-31.28*** (6.043)	-34.13*** (7.060)	-36.72*** (9.391)
Observations	2,833	2,833	2,833	2,833
R-squared	0.122	0.126	0.133	0.134
Year FE	YES	YES	YES	YES
Industry FE	YES	YES	YES	YES

Robust standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Notes:

Totalcost is firms annually audit fees.

ROA is the return on assets rate of the firm.

SIZE is the size of the firm.

Audt-EXPT is the percentage of expertise with CPA backgrounds in the firm's audit committee.

Audt-SZ is the firm's audit committee size.

Audt-INDP is the percentage of independent directors in the firm's audit committee size.

The regression results are same as the previous research in the Felo et al. in 2003. In the study of Felo et al., it also shows there is a significant and positive relationship between the percentage of members with financial or accounting expertise as well as the size of the audit committee and the accounting quality, but there is no significant relationship between the

independence of members and accounting quality during the period from 1992-1993 and 1995-1996(Felo et al., 2003). The coincident of my result and his result indicates that my result is correct.

In addition, apart from the confirmation of the results for the previous research, my results also indicates that after so many years and so many changes, the positive relationship between audit committee size as well as percentage of expertise and the accounting quality still exists. Furthermore, as Felo et al. only examine these relationships in the some foreign countries(not includes China as the listed firms at that time China was very few), my results further prove that these relationships also exists in the Chinese listed firms. Besides, I also found out that although both the size of the audit committee and the percentage of the expertise with CPA backgrounds have the significant and positive relationship with accounting quality, the significance of the percentage of the expertise with CPA backgrounds are higher than the size of the audit committee.

The table 4 shows the result of variance inflation factor(VIF) test, where the VIF value of percentage of independent director is 1.609; The VIF value of audit committee size is 1.479; The VIF value of firm size is 1.121; The VIF value of expertise with CPA backgrounds is 1.115; The VIF value of ROA is 1.072; The average VIF value is 1.279. The VIF value should be greater but closer to 1, which is used to test the nonexistence of multicollinearity. The result indicates that my research is valid.

Variance inflation factor

	VIF	1/VIF
Audt-INDP	1.609	.622
Audt-SZ	1.479	.676
SIZE	1.121	.892
Audt-EXPT	1.115	.897
ROA	1.072	.933
Mean VIF	1.279	.

Notes:

Totalcost is firms annually audit fees.

ROA is the return on assets rate of the firm.

SIZE is the size of the firm.

Audt-EXPT is the percentage of expertise with CPA backgrounds in the firm's audit committee.

Audt-SZ is the firm's audit committee size.

Audt-INDP is the percentage of independent directors in the firm's audit committee size.

6. Conclusion

Overall, after controlling the firm size and the return on assets rate of the firm, I find out that there is the positive and significant relationship between audit committee size as well as the percentage of expertise with CPA backgrounds in the audit committee and the accounting quality. However, there is no significant relationship between the percentage of independent directors in the audit committee size and the accounting quality.

Compared with the previous research, in 2003, Felo et al. also test these three dimension of the audit committee characterizes based on the data from 1992-1993 and 1995-1996, and they have the same results with me: the percentage of expertise and the size of the audit committee both have the positive and significant relationship with the accounting quality, and the percentage of the independent directors does not significantly relate with accounting quality. The coincidence of the two results confirms the robustness of my results.

Also, different from the previous research, my results also indicates that the percentage

of expertise with CPA backgrounds are more significant than the size of the audit committee in determining the accounting quality. In addition, in Felo et al.'s research test samples, there is no Chinese listed company, whereas my results is based totally on the Chinese listed company, which indicates that the conclusion of Felo et al. are also suitable in Chinese listed company. Besides, Felo et al.'s research has been published for more than 20 years, and there are numerous changes during the 20 years. For instance, the mandatory adoption of IFRS, China's accession to World Trade Organization etc. My results suggests even though with those changes, there is still a positive and significant relationship between the audit committee size as well as percentage of expertise with CPA backgrounds and the accounting quality. It further indicates that firms with larger audit committee size and higher percentage of expertise with CPA in their audit committee size would have higher accounting quality. In other words, if company want to improve their accounting quality, they should enlarge the audit committee size and increase the expertise number in their audit committees. In conclusion, my results verify my hypothesis - There is a positive and significant relationship between audit committee size as well as percentage of expertise and the accounting quality, whereas there is no significant relationship between percentage of independent directors and the accounting quality.

Still, there is some limitations and improvements on my study. In my test, I only exam the listed companies in China, and I only test three audit committee characterizes and their relationships with accounting quality. Even though my results indicates that there is a significant and positive relationship between percentage of expertise as well as the size of the audit committee and accounting quality, if expertise in audit committee do not perform, the

accounting quality would still not very good. For instance, Enron, before it went bankruptcy, it was one of the biggest energy company in the world, and it had 4 expertise in the their totally 6 members audit committee. However, because of their frauds on financial reports and negligence of duty, the company with over billions of assets became nothing within few weeks(Felo et al., 2003).

For the further study, researchers can examine relationship between audit committee characterizes and the accounting quality in the foreign countries like Europe, Japan, and the United States. As Europe has a mandatory IFRS adoption since 2005, whereas the U.S. used GAAP for preparing the financial statements. Due to the different reporting standards, the accounting quality might be different. Hence, the relationship between audit committee characterizes and the accounting quality might be different. Also, researchers can examine the relationship between accounting quality and other audit committee characterizes, for instance, the tenure of each member in the audit committee, the gender ratio in the audit committee, and the meeting rates in the audit committee. Besides, researchers could use other proxy for measuring the accounting quality. For instance, in Felo et al. research, they use Association for Investment Management and Research(AIMR) financial reporting quality score as their proxy(Felo et al., 2003). In Chen et al. Research, they use earnings management, timely loss recognition as their proxy.(Chen et al., 2008).

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