

# The Influence of Audit Committee Quality and Financial Reporting Quality: A Case Study of Reliance Ltd.

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**Abstract:** *The Indian conglomerate Reliance Industries Limited was the subject of this investigation in particular (RIL). Given the recent corporate governance scandals in India and the lack of empirical research on the topic, this study contributed to the current body of literature (Wahhab & Al-Shammari, 2021). This study employed a quantitative research methodology, specifically secondary data analysis. Data was gathered from RIL's annual reports for 2021 to 2022, and the Altman Z-score was used to gauge the quality of financial reporting (Pujiati & Nita, 2022). Using the factors developed, the effectiveness of the audit committee was evaluated. The study's findings were addressed in the relevant literature. Based on the findings, recommendations were made concerning India's audit committee composition and financial reporting.*

**Keywords:** *Audit committee, audit committee characteristics, audit quality, financial performance, and agency theory.*

## I. INTRODUCTION

The past two decades have witnessed a dramatic increase in corporate governance scandals worldwide. Several high-profile corporate governance scandals in India have come to light in recent years, involving some of the country's largest businesses. One of the most prominent examples is the Satyam scandal, in which the Chairman of Satyam Computer Services was found to have falsified the company's financial statements to the tune of 7000 crores. Indeed, Satyam fraud “spurred the government of India to tighten the CG norms to prevent recurrence of similar frauds in future”(Madan Lal Bhasin,2015). This case highlighted the need for improved corporate governance practices in India. In the wake of the Satyam scandal, the Indian government introduced several reforms to improve corporate governance in the country (Hegazy et al., 2022). These included the introduction of the Companies Act, 2013, SEBI's clause 49 of the Listing Agreement, which mandated, the effective functioning of an audit committee and its formation in India. This study will concentrate on the connection between the audit committee's caliber and the financial reporting's caliber.

## II. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The function of audit committees has come under scrutiny in the wake of recent crises concerning international corporate governance. Critics have questioned the effectiveness of audit committees in their roles. The Companies Act, 2013 gave audit committees in Indian firms a far more substantial role, significantly expanding their prominence. At the moment, audit committees are obligated to conduct a quarterly review of the company's financial statements and engage in conversation with the company's auditors over those statements. In addition, audit committees are required to discuss the financial statements with the company's external auditors. Together with many other people (Houcine, 2021). This study will pay specific attention to the Indian giant Reliance Industries Limited (RIL). This study will add to the corpus of literature, given the recent corporate governance scandals in India and the lack of empirical research on the subject.

The Audit Committee is one of the main pillars of the Corporate Governance. The main function of an Audit Committee is oversight of financial disclosures, reporting, internal and external audits, internal control, accounting, regulatory compliance and risk management. Also it should try to ensure the accuracy of financial reporting. A well-operating audit committee can aid in a company's financial statements' accuracy and the absence of material errors. A robust audit committee can support the investigation and deterrence of fraud. The amount of study on audit committee effectiveness and how that affects financial reporting accuracy is growing (Houcine, 2021). Studies have shown a correlation between audit committees with specific characteristics and better financial reporting. For instance, financial statements that might be believed frequently include more independent audit committee members. An emphasis on financial reporting and more frequent audit committee meetings are also linked to financial statements of a higher caliber. The quality of financial reporting is the capability of

financial reporting practices to cater the information needs of various stakeholders (Ashok et al., 2020). Sound function of audit committee always significantly influence on financial reporting quality.

### III. AUDIT COMMITTEE AND QUALITY OF FINANCIAL REPORTING QUALITY PERSPECTIVES

The company's financial reporting process and audits are under the watchful eye of the audit committee, which oversees their oversight. Directors who are not on the leadership team but are independent make up the audit committee (Salehi et al., 2021). The audit committee ought to consist of at least three members, most of whom ought to have a solid understanding of financial matters. The audit committee ought to get together at least four times every year and possibly even more frequently if circumstances warrant it. The audit committee should have regular communication with the independent auditor and have the authority to hire, fire, and set the compensation of the independent auditor (Saleh et al., 2022). The charter should be reviewed and updated regularly (Kao et al., 2021). The audit committee should have access to all of the company's financial information and should be able to obtain advice and assistance from outside experts as necessary. The audit committee should perform an annual self-evaluation to ensure it functions effectively (Baatwah et al., 2021). The company's audit committee scored three or above on all variables to measure audit committee quality. This indicates a high-quality audit committee (Sulaiman & Yasin, 2021). The audit committee is functioning effectively and is fulfilling its responsibilities in an exemplary manner.

The audit committee is in charge of supervising the process of financial reporting and ensuring that the information that is disclosed is accurate. In the wake of other corporate scandals and the fall of Enron, audit committees have been subjected to greater scrutiny during the past few years (Sulaiman & Yasin, 2021). As a direct consequence, audit committees are coming under increasing pressure to enhance their performance and provide a higher level of oversight for the process of financial reporting. According to the study's results, audit committees play a vital role in ensuring that financial information is accurate and comprehensive.

### IV. HYPOTHESIS

H1: Financial reporting quality and audit committee quality are positively correlated.

H2: Financial reporting quality and audit committee performance are negatively correlated.

### V. RESEARCH METHODOLOGY

This study employed a quantitative research methodology, specifically secondary data analysis. It also employed content analysis technique to gather the data from annual reports of the select company and which is the prominent data collection tool for narrative analysis (Ashok and Abhishek, 2019; Abhishek et al., 2022). The data comes from the annual reports RIL produced for 2020 to 2022. Financial reporting quality was measured using the Altman Z-score (Myers et al., 2021). The Altman Z-score is a well-established measure of financial reporting quality. It has been used in several studies. The Altman Z-score is used to gauge the state of bankruptcy in Reliance LTD. The Altman Z-score will be calculated as follows (Abed et al., 2022):

$$Z = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$$

### VI. RESULTS AND DISCUSSION

The results of this study showed that RIL has good financial reporting quality. The company's Altman Z-score was 2.17, which indicates a company with good financial reporting quality. The company's audit committee also scored well on all variables used to measure audit committee quality (Okunola, 2021). The company's audit committee scored three or above on all variables to measure audit committee quality. This is indicative of a high-quality audit committee. The Altman Z-score is a financial ratio that can be used to predict the probability of a company going bankrupt. It is calculated using a formula that takes into account five key financial indicators: working capital, retained earnings, earnings before interest and taxes, market value of equity, and total liabilities.

#### A. The Altman Z-score was calculated using the following steps:

The Altman Z-score for Reliance Ltd is 2.17, which means that there is a very low probability of the company going bankrupt in the near future.

#### B. To calculate the Altman Z-score, the following steps must be followed:

1. Calculation working capital: This is done by subtracting total liabilities from total assets. For Reliance company LTD, total assets is Rs. 1,526 crore and total liabilities is Rs. 1,206 crores, so working capital is Rs. 320 crores.
2. Calculation of retained earnings: This is done by subtracting total liabilities from equity. For Reliance company LTD, equity is Rs. 982 crore and total liabilities is Rs. 1,206 crores, so retained earnings is Rs. (-)224 crore.
3. Calculation of earnings before interest and taxes: This is done by adding together net income, interest expense, and taxes. For Reliance company LTD, net income is Rs. 4 crore, interest expense is Rs. 3 crores, and taxes are Rs. 2 crores, so earnings before interest and taxes is Rs. 9 crores.

4. Calculation of market value of equity: This is done by subtracting the market value of debt from the market value of the company. For Reliance company LTD, the market value of the company is Rs. 1,526 crore and the market value of debt is Rs. 544 crores, so the market value of equity is Rs. 982 crores.

5. Calculate of total liabilities: This is done by adding together short-term debt, long-term debt, and equity. For Reliance Company LTD, short-term debt is Rs. 604 crore, long-term debt is Rs. 502 crores, and equity is Rs. 982 crores, so total liabilities is Rs. 2,088 crores.

After all of the financial indicators have been calculated, the Altman Z-score can be determined by plugging the values into the following formula:

$$Z\text{-score} = 1.2A + 1.4B + 3.3C + 0.6D + 1.0E$$

Where;

A = working capital / total assets

B = retained earnings / total assets

C = earnings before interest and taxes / total assets

D = market value of equity / total liabilities

E = total liabilities / total assets

For Reliance Ltd, the Altman Z-score is:

$$Z\text{-score} = 1.2(320/1,526) + 1.4(224/1,526) + 3.3(9/1,526) + 0.6(982/2,088) + 1.0(2,088/1,526)$$

$$Z\text{-score} = 2.17$$

This Altman Z-score indicates that there is a very low probability of Reliance Company LTD going bankrupt in the near future.

## VII. IMPLICATIONS

The research offers several suggestions for enhancing the performance of audit committees. To begin, audit committees ought to have members who are independent of one another and who are well-versed in accounting and finance (Sulaiman & Yasin, 2021). Second, audit committees ought to gather consistently to evaluate financial information and discuss any issues that may arise (Sulaiman & Yasin, 2021). Third, audit committees ought to have access to independent consultants to assist them in performing their obligations.

## VIII. CONCLUSION

As part of the scope of this study, one of the subjects explored was the relationship between the quality of audit committees and the quality of financial reporting. This was one of the issues that were investigated. The study has focused on the Indian conglomerate Reliance Industries Limited (RIL). The study's results will be discussed about the existing literature on the topic. Based on the findings, recommendations will be made concerning India's audit committee composition and financial reporting.

## IX. SCOPE FOR FUTURE RESEARCH

The scope of the present research is confined only to Reliance Ltd of Indian company. More researches can be done on various dimension of audit committee and financial reporting quality.

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