CASH HOLDING STRATEGY: EARNINGS QUALITY AND AUDIT COMMITTEE EXPERTISE AN ANALYSIS BASED ON THE ASYMMETRY INFORMATION PERSPECTIVE

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ABSTRACT

From the perspective of agency theory, the quality of income information reflects the range of information asymmetry. Accurate earnings quality tends to minimize cash holding because investors believe that the company will get external funding easily and cheaply. Income information generated from the expert audit committee oversight process tends to be of higher quality so that it can improve the accuracy of the information. The test was conducted on a panel of random effects model data with a sample of 130 non-financial and banking companies listed on the Indonesia Stock Exchange on 910 observations from 2012-2018. This study was able to prove that the earnings quality and expertise of the audit committee had a negative effect on holding cash. The study also found that audit committee expertise can improve earnings quality so that it can strengthen its relationship by holding cash.

Keyword: Earnings Quality, Audit Committee Expertise, Cash Holding, Asymmetry Information.

INTRODUCTION

The Cash holding helps avoid liquidity problems but the opportunity costs of cash holdings (such as agency cost) can be high. Therefore, determining the right amount of cash holdings remains a problem for managers (Lin & Chiu, 2017). From a different perspective, cash holding can cause agency problems because cash policies provide sufficient internal capital for managers to fund all good projects efficiently, but on the other hand, cash holding can also be used to fund projects, acquisitions or additional profitable consumption for managers (Xu & Han 2013; Ismail, 2015). Basically, companies prefer holding cash to reduce information asymmetry and avoid high external financing (Lin & Chiu 2017) because high information asymmetry will result in high agency costs.

This study aims to examine the effect of earnings quality on cash holding, the effect of audit committee expertise on holding cash and the effect of audit committee expertise on the relationship between earnings quality and cash holding. The general idea about information asymmetry and cash holding, information asymmetry in most studies is that improving earnings quality and governance quality is associated with a decrease in the company's cash holding. The theoretical framework and empirical research imply that the quality of corporate earnings plays an important role in reducing capital costs. Earnings quality reflects the accuracy of earnings information as a form of management accountability. The accuracy of corporate financial reporting is a major determinant of information asymmetry. High-quality financial reporting reduces the problem of information asymmetry that causes economic friction, such as adverse selection and moral hazards (Verrecchia, 2001 and Ball & Shivakumar 2008). This perspective assumes that the quality of accounting information is a risk factor that is not diversified and, therefore, differences in information between investors affect the cost of capital for the company. Francis et al. (2005) states that higher earnings quality increases trust among stakeholders and reduce information asymmetry. Hasanzadeh et al. (2012) found that earnings quality based on net income has a negative effect on the level of holding cash. Furthermore, Farinha et al. (2018) and Sun et al. (2012) show that earnings quality has a negative impact on the value of a company's cash holdings. Shin et al. (2018) prove that discretionary accruals as a proxy for earnings quality have a positive effect on the excess cash holdings of the company. Meanwhile, Hasanzadeh et al. (2012) for proxies based on operating income found no effect on cash holdings. Chung et al. (2015) found that the results of this study were consistent with the findings of Leary & Roberts (2010) that company managers did not consider information asymmetry important in financing decisions.

The audit committee oversees the company's financial policies and processes so that with an audit committee the information asymmetry will be reduced. In the perspective of agency costs, low information asymmetry encourages management to choose strategies to minimize cash holding. Narwal & Jindal (2017) prove that audit committee members have a positive effect on cash holding. Meanwhile, Benjamin & Karrahemi (2013) found a positive coefficient but failed to prove the relationship of the audit committee with free cash flow. In referring to agency theory, Hashim & Amrah (2016) succeeded in proving that the audit committee had a negative impact on debt costs. In contrast to previous research, this study examines the relationship between audit committee expertise and cash holding in a corporate governance perspective as a mechanism for reducing asymmetric information.

Referring to the theoretical framework and previous research, this research examines the theory of information asymmetry and corporate governance from the perspective of agency conflict. This research reexamined the effect of earnings quality on holding cash (Farinha et al., 2018; Sun et al., 2012; Yung & Rahman, 2012 and Shin et al., 2018) and tested the effect of corporate governance on cash holding (Narwal & Jindal, 2017). In contrast to previous research that proves information asymmetry only from earnings quality, this study also examines information asymmetry from a corporate governance perspective. In addition, different from previous, this study measures the audit committee with the audit committee expertise. Audit committee expertise was chosen as a proxy for governance because the audit committee's duties are directly related to the quality of financial statements. Accordingly, the novelty of this study also exists on testing the effect of the interaction of the audit committee's expertise with earnings quality.

This research contributes to the development of agency theory, which is the role of the audit committee's expertise in monitoring the process of preparing financial statements so that it is more accurate, transparent and accountable and can be used as a reference for determining cash holding strategies. The audit committee in assisting the board of commissioners in overseeing the financial reporting process and the whole process becomes more important to build good corporate governance. Audit committees as a result of corporate governance and audit committees are important for improving the quality of financial reporting (Al-Rassas & Kamardin, 2015 and Inaam & Khamoussi, 2016). The quality of financial statements produced by good governance through the audit committee expertise will provide confidence for management to set a low cash holding because of the low information asymmetry so as to provide certainty for cash in the future.

LITERATURE REVIEW

Agency relationships are defined as contracts between one or more people (principles/owners) who use other people (agents/management) to carry out a number of tasks for their interests who include the delegation of some decision-making authority to the agent (William & Michael, 1976). Differences in interests between management and owners cause conflicts of interest, each party acting in their own interests and trying to maximize their own interest. Management is directly involved in managing the company so that it knows more information, while the owner only gets information from the manager. This condition results in information asymmetry. Information asymmetry will be reduced when the information conveyed by management to the owner is accurate and of high quality. In addition, good governance practices will also influence management in making decisions that can reduce information asymmetry.

In financial reporting, asymmetric information is determined by the accuracy of the company's financial reporting (Sun et al., 2012). In accurate earnings quality leads to internal and external ambiguity, thus encouraging companies to have cash amounts greater than normal levels. This happens because high information asymmetry and support for external finance are too expensive to encourage companies to hold internal cash for investment and maintain a higher balance. Furthermore Shin et al. (2018) argue that opaque informative companies are more likely to make money than transparent information companies, because companies with a high degree of information asymmetry have higher external funding costs, so companies must rely more on internal funding sources, and of course must increase money cash for operational and investment needs. The same thing was said by Sun et al. (2012) shows that there is a direct relationship between the level of information asymmetry and the level of cash ownership so that an informative low public company will have a higher cash balance compared to a more transparent informative company. Companies that have a high level of information asymmetry incur higher costs for external financing in the form of debt due to heavier agreements, or equity because the discount rate is loaded at high agency costs. Such companies must rely more on internal funding sources and must have a higher cash balance for their operational and investment needs. Another perspective on the relationship of earnings quality with investors, when the quality of income is considered low by investors, the company will overcome it by presenting a comfortable financial position that has a greater amount of cash reserves aimed at increasing investor confidence to reduce capital costs, thereby leading to a negative relationship between quality of income and cash reserves (Koo et al., 2017). Based on the description above can be arranged the following hypothesis:

H_1 The earnings quality has a negative effect on cash holding

Good corporate governance is broadly characterized as an internal or external mechanism for companies to reduce agency problem. The audit committee is considered an internal governance mechanism to reduce agent conflicts by separating management and monitoring aspects of control and decision-making processes. Low information asymmetries and strong shareholder protection, an incremental increase in corporate governance quality encourages shareholders to allow higher cash holdings (Weidemann, 2018). The greater the proportion of competent audit committees, the better the quality of governance so that the information produced by the company is also better and the impact is the loss of information asymmetry. The general idea about indicators of quality in corporate governance or, as an alternative, information asymmetry in most studies is that increasing information asymmetry and decreasing quality of governance are associated with increases in corporate cash levels. In short, it is therefore theorized that the presence of financial expertise in audit committee shows better corporate governance practices that lead to strong free cash flow management, where the subjective element of investment options will be challenged in terms of future returns. Regarding agency theory, an audit committee with a higher proportion of members with financial expertise must be able to limit management's access to free cash flow (Benjamin & Karrahemi 2013).

The main role of the audit committee is to monitor the financial reporting process of an organization. An audit committee with financial expertise and competence is effective monitoring. The audit committee is tasked with overseeing the process of preparing financial statements so that they are in accordance with applicable procedures so that they must have high integrity (Benjamin & Karrahemi 2013), adequate abilities, knowledge and experience in accordance with their educational background (Dezoort & Salterio, 2001). Educational background is an important characteristic to ensure audit committees perform their roles effectively. Audit committee members who are financially literate are more professional in their approach and more adaptable to change and innovation (Hambrick & Mason, 1984). Therefore, the audit committee with members who are financially and accounting literate is expected to adopt high accountability standards and high levels of achievement as well as strive for superior company image and performance. It is clear that audit committees perform poorly when they are less financially literate (Kalbers & Fogarty 1993). Based on the description above can be arranged the following hypothesis:

H_2 The audit committee expertise has a negative effect on cash holding

H_3 The audit committee expertise strengthens the relationship between earnings quality and cash holding.

RESEARCH METHODOLOGY

This research was conducted at non-financial and banking companies listed on the Indonesia Stock Exchange for the 2012-2018 periods. The Companies of non-financial and banking listed on the Indonesia Stock Exchange in 2012 were 307 companies. Companies with complete financial statement data from 2012 to 2018 are 212 companies (105 companies from incomplete data). The sample chosen in this study was 130 companies or 910 observations. This research was conducted at non-financial and banking companies because in this company has flexibility in cash management, while in financial and banking companies there are regulations that limit the company's cash management.

The data used in this study is panel data. Panel data is data that combines cross-section and time-series data. Panel data was chosen in this study because panel data is able to consider individual heterogeneity in an exponential manner, the number of observations becomes large so that the data is more informative, more varied, and the correlation between data decreases, and a higher degree of freedom so that more efficient estimation results can be obtained. In addition, panel data can be used to minimize the bias that might be caused by the aggregation of individual data. In connection with that, the panel data regression does not have to meet the assumptions of normality, heteroscedasticity, and auto-correlation. The data analysis used is panel least square. The Chow, Hausman, and Lagrange test results to determine the Common Effect Model (CEM), Fixed Effect Model (FEM), and Random Effect Model (REM) regression models show that the Random Effect Model is the most appropriate for analysis.

Measurement

Cash Holdings (CH) are measured as cash plus cash equivalents divided by the following net assets. Net assets are total assets minus cash and cash equivalents. Earnings Quality (EQ) indicates information asymmetry. The higher the quality of income, the lower the information asymmetry. The proxy used to measure earnings quality is inverse of discretionary accruals (DACs) modified by John (Dechow et al., 1995). DAC shows the magnitude of the company's accrual policy. Audit Committee Expertise (ACE) is measured by the percentage of audit committees with accounting, economic and financial backgrounds shared by all members of the audit committee. The control variables used for the whole model are Return on Assets (ROA) obtained from net income after tax divided by total assets, debt equity ratio (DER) is total debt divided by total equity, total assets (TA)

ANALYSIS AND RESULTS

The mean of cash holding value of 7.8125% indicates that cash and cash equivalents have a relatively large proportion compared to assets other than cash and cash equivalents. A minimum value of 0.00888%, a maximum value of 65.4512% and a standard deviation of 86,586% shows (Table 1) the difference in the company's strategy of holding cash. The difference in the strategy of cash holding in this study is predicted to be caused by the information asymmetry reflected in the standard deviation of EQ and ACE.

Table 1
DESCRIPTIVE STATISTIC

	Mean	Median	Maximum	Minimum	Std. Dev.
CH	0.078125	0.050073	0.654512	8.88E-05	0.086586
EQ	13.66256	2.583811	26395.26	-29401.4	1335.234
ACE	0.757546	0.666667	1	0	0.239687
ROA	0.349028	0.035007	62.04412	-10.8894	3.499339
DER	1.201065	0.969365	22.02457	-73.5084	3.373561
TA	1.02E+13	2.46E+12	3.45E+14	2.48E+10	2.84E+13

The correlations in Table 2 for the variables CH, EQ, ACE, ROA, DER and TA prove that there are no strong correlations between these variables. The highest correlation occurs between the ACE and ROA variables, which is 0.0433 this proves that the results of testing model 1, model 2 and model 3 do not occur multicollinearity.

Table 2
THE CORRELATION BETWEEN INDEPENDENT VARIABLES

	EQ	ACE	ROA	DER	TA
EQ	1	0.036187	-0.0053	0.002748	-0.01901
ACE	0.036187	1	-0.0433	0.023505	0.019873
ROA	-0.0053	-0.0433	1	0.020653	0.017582
DER	0.002748	0.023505	0.020653	1	0.020038
TA	-0.01901	0.019873	0.017582	0.020038	1

The EQ variables in Table 3 for model 1, model 2 and model 3 showed t values statistically significant at the 1% level with a negative regression coefficient. These results prove that earnings quality has a negative effect on cash holdings. Model 2 and model 3 show the t-statistic value for the ACE variable is significant at the 5% level with the regression coefficient marked negative which means hypothesis 2 which states the audit committee expertise has a negative effect on the cash holding strategy proven. A statistical t value of 2.13283 for EQxACE shows that hypothesis 3 which states that the audit committee expertise strengthens the relationship between earnings quality and cash holding strategy is proven.

Table 3
THE RESULTS OF PANEL LEAST SQUARE

	Model 1		Model 2		Model 3	
Variable	**Coefficient**	**t-Statistic**	**Coefficient**	**t-Statistic**	**Coefficient**	**t-Statistic**
C	0.076305	13.28637	0.108607	7.532558	0.109395	7.593339
EQ	-4.61E-06	-2.67791*	-4.47E-06	-2.59915*	-2.24E-05*	-2.61045*
ACE			-0.04274	-2.44073**	-0.0441	-2.52186**
EQ*ACE					2.19E-05	2.13283**
ROA	0.002312	1.84E+00	0.002234	1.782523***	2.23E-03	1.784493***
DER	-2.70E-04	-0.36924	-0.00026	-0.35573	-0.00024	-0.32888
TA	1.38E-16	0.835894	1.46E-16	0.890016	1.47E-16	0.898302
	2.85E-16	1.558202	3.16E-16	1.712416***	0.108607	
R-squared		0.012271		0.018742		0.034639
Adjusted R-squared		0.007905		0.013315		0.028225
F-statistic		2.810689**		3.453358*		5.400265*
Prob(F-statistic)		0.024553		0.004256		0.000017
Chow test						
F statistic		6.215805*		6.131373*		6.125884*
Probability		0		0		0
Hausman test						
Chi-Sq. Statistic		4.88913		4.857606		5.497216
Probability		0.2989		0.4335		0.4818
Langrange test						
Breusch-Pagan		488.1837		479.5607		479.1425
Probability		0		0		0

***Significant at α = 10%; **Significant at α = 5%; * Significant at α = 1%

Model 1 : $CH = \beta_0 + \beta_1 EQ_{it} + \beta_4 ROA_{it} + \beta_5 DER_{it} + \beta_6 TA_{it} + \varepsilon$
Model 2 : $CH = \beta_0 + \beta_1 EQ_{it} + \beta_2 ACE_{it} + \beta_4 ROA_{it} + \beta_5 DER_{it} + \beta_6 TA_{it} + \varepsilon$
Model 3 : $CH = \beta_0 + \beta_1 EQ_{it} + \beta_2 ACE_{it} + \beta_3 EQ_{it} x ACE_{it} + \beta_4 ROA_{it} + \beta_5 DER_{it} + \beta_6 TA_{it} + \varepsilon$

DISCUSSION OF FINDING

Companies with poor earnings quality show inaccurate and less transparent information, causing ambiguity both internally and externally which causes information asymmetry (Sun et al., 2012 and Shin et al. 2018). High information asymmetry results in loss of funding support external and external costs are too expensive to encourage companies to hold internal cash for investment and maintain liquidity balance and investment interest. The results of this study indicate that when low information asymmetry is manifested in good quality financial reporting, management will choose a strategy to establish a low cash holding. The results of this study are in line with Shin et al. (2018) proves that information asymmetry and agency problems tend to coexist in companies with poor earnings quality. Greiner (2017) shows that aggressive revenue increases in management of real activities are associated with greater cash holdings, this show a relationship between earnings quality and cash holdings. Koo et al. (2017) show that high-quality reporting is associated with higher dividend payments, thus suggesting the possibility that earnings quality can have a negative impact on cash holdings. Sun et al. (2012) proves two opposite phenomena, that poor earnings quality has a negative impact on the value of a company's cash holdings and a positive impact on the level of cash reserves. Meanwhile, higher cash rates and lower value levels exist simultaneously and the two are inseparable from each other. Sun et al. (2012) argue that there are investor concerns about the use of discretionary corporate cash holdings when company managers provide poor quality. Farinha et al. (2018) found evidence that earnings quality has a negative effect on holding cash, but when the sample is grouped into companies that generate profits and losses, it fails to prove that earnings quality has a negative effect on holding cash. The inconsistency of the results can be interpreted that the loss company does not have the high opportunity costs associated when large cash holdings can compensate for the perception of low earnings quality.

Audit committee expertise has a negative effect on cash holding. These results are in line with agency theory. Audit committee expertise viewed from an educational background is a very important characteristic to ensure that the audit committee performs effectively (Benjamin & Karrahemi (2013), so that the presence of audit committee expertise reflects good governance practices. In the perspective of agency theory, the audit committee with the proportion of members those with higher financial expertise must be able to control access to free cash flow by management. The high proportion of audit committees with financial expertise shows that the audit committee can work effectively and can reduce agency problems so that management can optimize the use of cash and does not need to hold a lot of cash. Low information asymmetry gives confidence that the company has no problems with future cash flow. The results of this study are in line with the research of Carcello et al. (2006) which proves the relationship between audit committee accounting expertise and reduced earnings management. DeFond et al. (2005) found evidence that the market reacted positively when newly appointed members had audit and accounting expertise. Davidson et al. (2004) found that there was a positive relationship between members of the financial literacy audit committee and company performance. The results of previous studies provide additional evidence that the expertise audit committee can reduce information asymmetry to prevent agency problems.

The main task of the audit committee is to oversee the financial reporting and audit process so that its members must have the ability to understand the problem being examined (Aldamen et al., 2012). Financial expertise is very important for the effectiveness of the audit committee to improve the quality of financial reporting (Hamdan et al., 2013). The interaction of audit committee expertise with earnings quality (EQ*ACE) shows that audit committee expertise is an appropriate governance mechanism that can improve earnings quality that can reduce information asymmetry so as to encourage management to set low holding cash. CG within the agency's framework is expected to control moral hazards and adverse selection of managers. Audit committee members with accounting and financial backgrounds will assist in effective management monitoring and review of a company's financial statements. When the audit committee has members with the necessary expertise in accounting and finance, the audit committee will be effective in monitoring and there will be good financial reporting. This will also limit opportunistic management and protect the interests of shareholders and stakeholders thereby reducing agency problems and improving earnings quality (Badolato et al., 2014). Abbott et al. (2000) documented a significant negative relationship between the presence of audit committee members with financial expertise and the event of a restatement of financial statements, which meant that the inclusion of financial experts in the audit committee improved the quality of monitoring

CONCLUSION

The quality of the financial statements reflects the information asymmetry, inaccurate earnings quality cause internal and external ambiguity that encourages companies to have cash holding that is greater than the normal level because of the information asymmetry and external funding support is too expensive. The audit committee as an internal governance mechanism can reduce agency conflicts and information asymmetries, so encourage lower cash holdings the expertise in the audit committee shows better corporate governance must be able to limit management's access to free cash flow. Companies that have a high level of information asymmetry incur higher costs for external financing in the form of debt due to heavier agreements, or equity because the discount rate is loaded at high agency costs. This study proves that the accuracy of financial statements is reflected in the quality of earnings and monitoring the process of preparing financial statements by an expert audit committee reduces information asymmetry so as to reduce the level of cash holding. The study also found that the audit committee expertise was able to oversee financial reporting so as to produce earnings quality that could influence the need to cash holding.

FUTURE RESEARCH

Earnings quality in this study is only seen from discretionary accruals which only reflect the accuracy of earnings quality. Future researchers can use earnings quality based on an investor's perspective. The effectiveness of internal control is an important part that can create quality financial reports so that subsequent research can examine the effectiveness of internal control. In addition, further researchers can also interact with earnings quality, audit committee expertise and the effectiveness of internal control. Next studies should focus on certain industries, such as food and beverage, and banking.

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