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## The role of Free Cash Flow as a moderating factor in Intellectual Capital Disclosure which is influenced by the Audit Committee and Audit Quality

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**Abstract:** Intellectual Capital is all knowledge assets that can be differentiated between stakeholder resources and structural resources. This research aims to analyze the influence of the audit committee and audit quality on intellectual capital disclosure and to analyze whether there is a role for free cash flow as a moderating variable in the influence of the audit committee and audit quality on the company's intellectual capital disclosure. This research uses a population of banking companies listed on the Indonesian capital market (BEI). This research sample consists of 30 banking companies whose data can be used for this research with a research period of 5 (five) years, from 2017-2022 where the total analysis data units that can be processed for this research amount to a total of 150 analysis data units. This existing data was processed with the help of statistical tools SPSS software version 26.00. By using multiple regression analysis to test the hypothesis in this research, the following research results can be produced: (1) The Audit Committee has a significant effect on Intellectual Capital disclosure; (2) Audit quality has a significant effect on Intellectual Capital disclosure; (3) Free Cash Flow moderates the relationship between the Audit Committee regarding Intellectual Capital disclosure; (4) Free Cash Flow moderates the relationship between Audit Quality and Intellectual Capital disclosure. Limitations in the research include that the audit committee is only assessed from the number of committees in the company so that in further research the audit committee can be assessed from the number of meetings held. Further research is recommended to expand sectors other than banking to be used as research samples, such as the energy sector or other sectors in the Indonesian capital market.

**Keyword:** Audit Committee, Audit Quality, Intellectual Capital Disclosure, Free Cash Flow.

### INTRODUCTION

The development of digitalization today makes companies increasingly aware of the importance of systematically managing external communications which is closely related to

intellectual capital (IC). Several studies have been conducted regarding investors and analysts as well as capital market experts, the demand for information can be demonstrated by substantial differences between the various types of information found in company annual reports and several types of information requested by the existing market (Eccles et al., 2018). In general, companies, investors and analysts ask for more reliable or reliable information. This can be exemplified as follows: managerial quality, experience, expertise, customer relations, integrity and competence. Basically, these things are factors that are directly related to the disclosure of intellectual capital of a company in Indonesia.

The existing agency problem is one of the problems that often arises in the disclosure of intellectual capital. From another point of view, this agency problem arises because company management tries to maximize its interests by minimizing costs. Minimizing agency costs is by reporting relevant accounting results to the company owner so that it can add to the reputation of a company manager. Disclosure of the intellectual model at the level or levels in the company's annual reporting and financial reports is very closely related to the responsibility to ensure that the financial reporting is made by the company. The Audit Committee is responsible for ensuring that the financial reports prepared by company management provide a true picture. The effective and efficient functioning of a company audit committee will result in better control over the company, so that agency conflicts that occur within the company due to the desire of company management to improve their own welfare can be minimized.

Intellectual Capital is a process of creating value that depends on the use of intangible assets which can include the following: science and technology, system design and implementation, licensing and intellectual property rights as well as knowledge about marketing and branding. One part of the disclosure of Intellectual Capital\_IC is the existence of Human Capital which is a combination of skills, innovation, knowledge and ability of a person in carrying out their role so that they can create added value in improving company performance, both financial performance and non-financial performance, thereby increasing the value of the company. HC is one of several very important factors in increasing a company's competitive advantage to be able to compete in the era of digitalization for every company related to information systems and technology systems today. This makes HC play a role in increasing the potential and motivation of an employee so that his or her skills can be utilized optimally and can make them superior compared to other competing companies.

Apart from the Human Capital element, there is a second component, namely Employee Capital, which can play a role in assessing how much added value is created from the funds that have been spent by the company. This can be seen from the existence of Capital Employees who generate higher income than other competing companies. This means that companies are better at utilizing their capital to be competitive in terms of human resources. The third component of Intellectual Capital disclosure is Structural Capital, one of the elements which is technology and facilities and infrastructure that support employees to carry out company operational activities so that they can maintain their economic position and be able to compete with other competing companies. The greater the value of Human Capital (HC) in increasing the company's added value, the smaller the value of Structural capital (SC).

The disclosure of intellectual capital (IC) in the annual report is closely related to the responsibility of the audit committee which acts as one of the committees in the company. The Audit Committee plays a supervisory role in the company which is responsible for ensuring that the financial reports prepared by the company management provide a picture of the company's true and actual financial performance. The function of an audit committee can effectively improve control and supervision of the company in a better direction. This is intended so that agency conflicts that arise from the desire of company management to improve their own welfare can be immediately minimized.



- $\alpha$  : Constant
- X1 : Audit Committee
- X2 : Audit Quality
- X3 : Free Cash Flow
- $\beta_1 - \beta_4$  : Regression Coefficient
- $\varepsilon$  : Error term

**Operational Variable**

<b>Table 1 Operational Definition of Research Variables</b>			
Variable	Indicator	Formula	Scale
Intellectual Capital Disclosure (Y) (Dependen Variabel)	The disclosure classification consists of 30 items which are divided into three components, namely 1. Human Capital, 2. Relational Capital, 3. Organizational Capital.	$IFAC = \frac{\sum X_{yit}}{nit} \times 100\%$  (Febrina et al., (2013)	Rasio
Audit Committee (X1) (Independent Variable)	Number of Audit Committees in Banking Companies	KA = Total Audit Committee owned  Nuning Mulatsih et al., (2019)	Nominal
Audit Quality (X2) (Independent Variable)	If the company uses big-4 KAP audit services it will be given code 1 and if the company does not use big-4 KAP audit services then it will be given code 0	Value 1 = Big 4 affiliated KAP Value 0 = KAP that is not affiliated with the Big 4  Vannesa Fonda Sudjipto et all (2020)	Dummy
Free Cash Flow (X3) (Moderating Variable)	Free Cash Flow represents cash remaining from business operational activities that can be used for dividend payments, expansion, or debt repayment	Free Cash Flow = Net profit + Depreciation/Amortization – Changes in Working Capital – Capital Expenditures  Ross et.al (2015)	Ratio

**Hypothesis:**

H1: The Audit Committee influences Intellectual Capital Disclosure

H2: Audit quality influences Intellectual Capital Disclosure

H3: Free Cash Flow strengthens the influence of the Audit Committee on Intellectual Capital Disclosure

H4: Free Cash Flow strengthens the influence of Audit Quality on Intellectual Capital Disclosure

**RESULTS AND DISCUSSION**

**Statistic Descriptive**

Descriptive statistics provide an overview or description of data seen from the average value (mean), standard deviation, maximum and minimum values. The statistical description of each variable in the study is presented in the following table:

**Table 2 Statistic Descriptive**

	N	Minimum	Maximum	Mean	Std. Deviation
ICDI	159	0,1532	0,3453	0,24321	0,04332
KOM_AUD	159	1	3	1,32122	0,02214
KUA_AUD	159	0	1	0,63422	0,01213
FCF	159	0,3231	4,3223	3,15752	0,08221

Based on table 2, Intellectual Capital Disclosure (ICDI) for all companies has a minimum value of 0.1532, a maximum value of 0.3453, an average value of 0.24321, and a

standard deviation of 0.034332. The company's Audit Committee has a minimum value of 1, a maximum value of 3, an average value of 1.32122 and a standard deviation of 0.02214. Audit Quality has a minimum value of 0, a maximum value of 1, an average value of 0.63422 and a standard deviation of 0.01213. Free Cash Flow has a minimum value of 0.3231, a maximum value of 4.3223, an average value of 3.15752, and a standard deviation of 0.08221.

**Normality Test**

Berikut merupakan hasil uji normalitas menggunakan Kolmogorov-Smirnov

**Table 3. Normality Test**

One-Sample Kolmogorov-Smirnov Test		
		Unstandardized Residual
N		159
Normal Parameters <sup>a,b</sup>	Mean	.0000000
	Std. Deviation	.94524092
Most Extreme Differences	Absolute	.223
	Positive	.132
	Negative	-.223
Test Statistic		.223
Asymp. Sig. (2-tailed)		.837a
a. Test distribution is Normal.		
b. Calculated from data.		

Based on the research results, it shows that the probability is 0.837 above 5% so it can be concluded that the data is normally distributed

**Multicollinearity Test**

The following are the results of the multicollinearity test

**Table 4. Multicollinearity test**

Coefficients <sup>a</sup>								
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	5.931	1.263		5.280	.000		
	KOM_AUD	2.983	.120	1.602	5.451	.000	.709	3.391
	KUA_AUD	3.432	.324	.234	3.432	.000	.747	3.543
	FCF	2.868	.280	1.038	2.918	.000	.793	3.521

The results of the multicollinearity test show that there is no VIF value more than 10, so it can be concluded that the model in this study is free from multicollinearity problems.

**Hypothesis Test**

**Table 5 Hypothesis Test**

Research Method	Model 1		Model 2	
Variable	Coefficient	Prob.	Coefficient	Prob.
Audit Committee	0.0342	0.000	0.0232	0.008
Audit Quality	0.3236	0.041	0.00321	0.013
Audit Committee*Free Cash Flow			0.00123	0.022
Audit Quality*Free Cash Flow			0.8876	0.047
Total Sample	120		120	
R2	0.321		0.333	
Prob.	0.000		0.000	

Based on the research results above, the first model testing the influence of the audit committee on intellectual capital disclosure shows that there is an influence between the audit committee on Intellectual Capital where the significance value is 0.000 below 5%, meaning the first hypothesis is accepted and then there is the influence of Audit Quality on Intellectual Capital disclosure where the significance is equal to 0.041 is below 5%, meaning that the second hypothesis is accepted and the second model tests the role of Free Cash Flow as a moderating influence of the audit committee on Intellectual Capital disclosure. The results of this research indicate that there is moderation between Free Cash Flow and the influence of the Audit Committee on Intellectual Capital Disclosure where the probability is below 5%, meaning the third hypothesis. Then this research tests the role of Free Cash Flow as a moderating influence of Audit Quality on Intellectual Capital disclosure. Where the probability is below 5%, meaning the fourth hypothesis is accepted

### **The Influence of the Audit Committee on Intellectual Capital Disclosure**

Based on the research results, it shows that the Audit Committee has a positive and significant influence on Intellectual Capital Disclosure. These results support the theory of Li, et.al (2012) and Haji (2015) which shows that the number of financial experts on the audit committee has a positive relationship with Intellectual Capital disclosure. In general, the board of commissioners forms committees under them in accordance with the company's needs and applicable laws and regulations. This committee is intended to assist the board of commissioners in carrying out their responsibilities effectively so that the results support the Agency Theory.

### **The Influence of the Audit Quality on Intellectual Capital Disclosure**

Sample companies audited by the Big 4 present more ICD information compared to companies that are not audited by the Big 4. This is relevant to the statement by Whiting & Woodcock, (2011) which states that companies audited by the Big 4 present more ICD information. compared to companies that are not audited by the Big 4. Big 4 audit firms tend to encourage companies to disclose more information for several reasons: first, because they safeguard their reputation and second, to ensure customer care. These results are in line with research by Haniffa & Cooke, (2002), and Ousama et al., (2012) which found a positive and insignificant effect. Of the total 14 sample companies, 6 companies were audited by the Big 4. The results of this research are positive, which means that companies that use Big 4 audit services have a high level of disclosure compared to companies that do not use Big 4 audit services.

### **Free Cash Flow moderates the influence of the Audit Committee on Intellectual Capital Disclosure.**

Based on the research results, it shows that there is a role of Free Cash Flow as a moderating influence of the Audit Committee on Intellectual Capital Disclosure. This supports the theory of Bateset et al. (2009) where there is the role of Free Cash Flow as a moderating influence of the Audit Committee on Intellectual Capital Disclosure. This is because First, cash is a support when a company faces an unexpected liquidity shortage. Second, based on agency theory, hoarding large amounts of cash is considered an opportunistic behavior by corporate management taking personal advantage of minority shareholders.

## **Free Cash Flow moderates the influence of the Audit Quality on Intellectual Capital Disclosure.**

Based on the research results, it shows that there is a role of Free Cash Flow as a moderating influence of the Audit Quality on Intellectual Capital Disclosure. This supports the theory of Bates et al. (2009) where there is the role of Free Cash Flow as a moderating influence of the Audit Quality on Intellectual Capital Disclosure. This is because First, cash is a support when a company faces an unexpected liquidity shortage. Second, based on agency theory, The more information that is disclosed is a sign that the company has a high level of transparency and this will attract investors' interest in investing in the company concerned.

## **CONCLUSION**

Based on the research results, it shows that the Audit Committee has a positive and significant influence on Intellectual Capital Disclosure, then Audit Quality has a positive and significant influence on Intellectual Capital Disclosure. These results also show the role of Free Cash Flow as a moderating influence of the Audit Committee on Intellectual Capital Disclosures and these results show the role of Free Cash Flow as a moderating influence of Audit Quality on Intellectual Capital Disclosures. It can be concluded that this research supports agency theory.

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