

Audit Committee Characteristics and Firm Performance: A Case of Top Performing, PN17 and GN3 Public Listed Companies

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Abstract

Purpose: The purpose of this study is to examine the extent of audit committee and firm performance among top performing, PN17 and GN3 companies

Design/methodology/approach: research design for this study is statistical analysis. Data were obtained from annual report of the year 2020 consisting of 50 samples; 30 top performing companies and 20 from PN17 and GN3 companies

Findings: This study found no significant relationship between audit committee characteristics and firm performance among top performing, PN17 and GN3 companies.

Research limitations/implications: There is a limitation in the number of samples which is this study only used 50 samples. This study does not implement cross-longitudinal where it might narrow the findings.

Practical implications: To enhance the literature on corporate governance and provide insightful information the regulator.

Originality/value: This study will provide an understanding on audit committee effectiveness in public listed companies.

Paper type: Research paper

Keywords: Audit committee, Firm performance, Practice Note 17, Guidance Note 3

Introduction

The Practice Note 17 and Guidance Note 3 of Bursa Malaysia, abbreviated as PN17 and GN3, are a classification system for firms in the main and ACE markets that are suffering from financial difficulties (Bursa, 2021). Financial difficulties can be caused by a variety of factors, including a lack of resources, insufficient market demand, or incompetent leadership. The board of directors especially an audit committee is one of the groups responsible in overseeing the organisation and its direction. Numerous prior studies have established that the audit committee (AC) has significant influence on the business's outcome and direction. The AC's important position in organisation structure continues to garner increased public and regulatory interest.

AC are a mediator between the board of directors, auditors, and senior management. Beasley et al. (2009) emphasised several characteristics of an independent audit committee, including skilled professionals with authority, independence, and candour who ensure accurate financial reporting to enable stakeholders to make prudent, intelligent, and appropriate decisions.

Independent audit committees are crucial because they aid the board of directors in promoting transparency, preventing, and managing unethical business behaviour, and supervising the financial reporting process (Beasley et al., 2009). A well-functioning AC is chaired by a few members designated by the board of directors, conducts task established by the board of directors and ensures that external audit companies provide transparent financial statement. AC monitoring function is crucial in affecting the firm's performance (Rahman et al., 2019). Numerous studies have been undertaken in established and developing countries alike to determine the AC effect on corporate outcome especially on its performance. Several studies present different results on the effect of AC on corporate performance, which varies according to the culture and institutions of each country. The audit committee is a widely discussed topic in the accounting and auditing literature. The objective is to ascertain whether there is a significant correlation between AC characteristics and the firm performance among top performing, PN17 and GN3.

Literature Review

The importance of AC has shown during previous corporate scandals. Their apparent significance is demonstrated by their inclusion and expansion of functions in a several corporate governance practice (Zraiq & Fadzil, 2018). The audit committee's organisation varies according to the committee's objectives, functions, and obligations. Al-Thuneibat (2006) defined AC as board of directors that focus on financial information produce by the organisation. The AC's principal aim is to improve the quality of audits and to provide constructive criticism to the directors and senior executives. The importance of independent and competent AC has increased in recent years as a result of the regulator's desire for effective corporate accountability, but also due to the concerns about the organisation financial position. According to agency theory, well-run businesses outperform their less well-run competitors. The audit committee's non-executive members lacked conflicts of interest and acted to maximise the shareholders wealth (Muhammad, et al., 2016).

However, resource dependence theory revealed that a director with a higher share of directors may have more experience managing the business more successfully, resulting in enhanced corporate performance (Zhou et al., 2018). In general, the audit committee was formed as to analysing and assessing financial issues (Islam et al., 2010). Additionally, the investor put a high degree of trust in this committee to ensure the organisation follows all the international financial reporting standards. Guizani (2013) asserts that audit committee members with a strong stake are expected to have a full awareness of organisational operations and a higher level of technical skills, indicating a more dependable perspective.

Hypotheses Development

Audit Committee Expertise and Firm Performance

Alzeban (2020) revealed that the AC independent and the inclusion of people with accounting and auditing knowledge had a significant effect on business performance. This highlights how an audit committee's strong financial and accounting expertise can result in more effective monitoring of the business, ultimately improving the firm's performance. This was verified by Naiker and Sharma (2009), who discovered a correlation between AC expertise in external audits and increased corporate performance. This is because financial understanding facilitates effective governance, which enhances shareholder wealth through enhanced supervision of management and accounting regulations (Mir & Souad, 2008). According to Jaime and Micheal (2013), the audit committee's financial competency is crucial because it is responsible for the financial reporting process. Financially astute audit committees may provide significant benefits to the client, as their financial expertise increases their likelihood of detecting any

manipulation (Jaime & Micheal, 2013). Abernathy et al. (2014) perform additional research and discovered that academic knowledge in accounting is related to fewer financial reporting delays. Additionally, it demonstrates that the AC literacy in accounting enhances the AC's efficacy, which is consistent with Rashidah and Fairuzana's (2006) findings from a Malaysian context. However, Cohen et al. (2002) and Carcello et al. (2011) revealed no causal influence of AC experience and financial performance. As a result, H1 was developed:

H1: There is significant relationship between AC expertise and firm performance of top performing, PN17 and GN3 companies.

Audit Committee Size and Firm Performance

According to Zhou et al. (2018), firms with larger boards of directors performed better, while those with more independent board members performed worse, and the AC's primary function was to advise rather than monitor corporate performance. According to Saleh et al. (2007), a larger AC is more likely to have a diverse range of competencies, which aids in monitoring. Mir and Souad (2008) followed up on this finding, stating that larger audit committees boost business performance. Al-Mamun et al. (2014), on the other hand, discovered a contradict relationship between AC size and company performance. This is also supported by Aldamen et al. (2012), who examined the audit committee's impact on firm performance during the crisis and discovered that smaller AC with greater competencies linked with better firm performance. Afza and Nazir (2014) assert that increasing the size of the AC may result in inefficiencies and increased decision-making time. As a result, H2 is created:

H2: There is significant relationship between AC size and firm performance of top performing, PN17 and GN3 companies.

Audit Committee Meeting Frequency and Firm Performance

Zraiq and Fadzil (2018) discovered an effect of AC meetings, size on organisation performance as measured by Return on Asset (ROA) and Earnings per share (EPS), which is consistent with Sultana's (2015) finding that high AC meeting frequency is related to good corporate direction and performance. Adel and Maissa (2013) discover a connection of AC meetings and corporate success in Tunisia. However, Evans et al. (2002) learned that high AC meetings results in poor corporate performance. This could be a result of the rising cost of holding several meetings, as well as the reversal of previous sessions' decisions. According to Saleh et al. (2007), AC that meet less frequently are less likely to perform successfully in their monitoring job. These findings corroborate prior research demonstrating that an active AC is associated with fewer discretionary current accruals (Xie, et al., 2003). In other findings, Abbott et al. (2004), Al-Mamun et al. (2014), and Aanu et al. (2014) discovered that meeting frequency of AC members have no effect on business performance. As a result, H3 was developed:

H3: There is significant relationship between AC meeting frequency and firm performance of top performing, PN17 and GN3 companies.

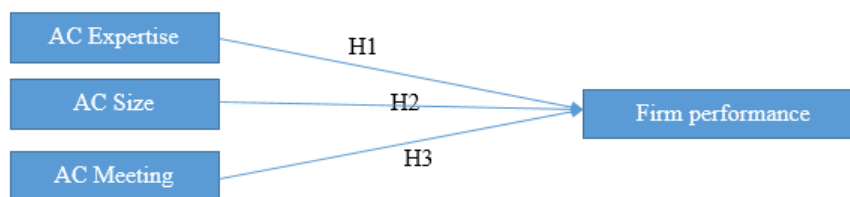


Figure 1: Conceptual Framework

Research Method

Type of Research and Sample Selection

Statistical analysis is the type of research for this study. Secondary data was used in this investigation. Annual report for the year 2020 were selected as the data collection for this study. The sample for this study is fifty (50) companies comprises of thirty (30) top performing companies based on market capitalisation and twenty (20) companies form PN17 and GN3 obtained from Bursa Malaysia. This is taken to determine whether AC characteristics are having influence in firm performance. The sampling technique used is purposive sample selection.

Measurement of Variables

AC expertise were measure by the percentage of committee who having accounting or finance related background (Hamdan et al., 2013). AC size is total number of audit committee member whereas AC meetings is measured by the number of meetings frequency held by the AC (Commeey et al. 2020). The dependent variable firm performance was measured by return on equity (ROE), earnings per share (EPS) and price to earnings (P/E). This measurement is similar to the student done by Kabakci (2008), Salim and Yadav (2012), Khan (2012) and Toraman et al. (2013) which use ROE and EPS as measurement for firm performance.

Findings

This study begins with descriptive analysis and further explain the findings on AC affecting firm performance.

Descriptive Analysis

Table 1: Descriptive Analysis

		Audit Committee Expertise	Audit Committee Size	Audit Committee Meetings	Return on Equity	Earnings Per Share	Price to Earnings
N	Valid	50	50	50	50	50	50
Mean		56.35	3.68	6.60	0.97	28.32	29.62
Median		50	3.50	5.00	10.24	13	11.03
Std. Deviation		24.46	0.94	3.17	121.56	108.96	59.09
Variance		598.1	0.88	10.04	14777.57	11872.99	3491.85
Minimum		20	3	3	-775	-28	-91.37
Maximum		100	8	17	184.25	769	243.31

Based on the Table 1, in average half of the AC member are having academic qualification in accounting, having an accounting professional membership and have a working experience as an auditor or an accounting with a score of 56.35%. Minimum percentage score of audit committee composition is 20% showing that there is still audit committee consist of only one committee member who has related academic background and expertise in accounting and this study also found some public listed companies mainly top performing companies are having all its audit committee member from account related academic and expertise background. Standard deviation and variance score for audit committee expertise is 24.47 and 598.10 respectively. This study found that in average, audit committee size is 3.68 which is barely

above the minimum requirement of audit committee. Minimum score is 3 and there is one company that have 8 board of directors that become audit committee. Standard deviation and variance score for audit committee size is 0.94 and 0.88 for the audit committee meetings, average score is 6.60 indicate that in average the audit committee held 6 times in a year. Minimum number of meetings is 3, which is surprising because minimum number of meeting required to be held by audit committee is 4 and maximum is 17 meetings in a year. Average score for ROE, EPS and P/E is 0.97, 28.32 and 29.61 respectively.

Regression Analysis

Table 2: Regression Analysis

Dependent Variable	R	R Square	Adjusted R Square
ROE	.167a	0.028	-0.035
EPS	.108a	0.012	-0.053
P/E	.386a	0.149	0.094

a Predictors: (Constant), Audit Committee Meetings, Audit Committee Expertise, Audit Committee Size

This analysis performed to determine impact of AC size, AC meetings and AC expertise over firm performance which is indicated by ROE, EPS and P/E. For ROE, R² values of 0.028 shown that AC meeting, size and expertise contributing to the ROE by 2.8%, while 97.2% were from the other variable that were not tested in this study. For EPS, R² values of 0.012 indicate that independent variables contributing to the EPS by 1.2%, while 98.8% can be attributed by other factors. This result is similar found with P/E that shows R² values of 0.149 lead that independent variable contributing to the EPS by 14.9%, while 85.1% were from the other variable that were not tested in this study. This indicate that the relationship between independent variables with ROE, EPS and P/E are moderately low.

Table 3: Co-efficient of AC Expertise, AC Size and AC Meetings with ROE.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-87.459	85.725		-1.020	0.313
	Audit Committee Expertise	0.479	0.726	0.096	0.661	0.512
	Audit Committee Size	9.436	19.759	0.073	0.478	0.635
	Audit Committee Meetings	4.043	5.856	0.105	0.690	0.493

a. Dependent Variable: Return on Equity

Table 3 shows the co-efficient of AC meetings, AC expertise and AC size with ROE. The t-values for AC meetings, AC expertise and AC size are positive but there is no significant relationship between all independent variables and ROE at 0.512, 0.635 and 0.493.

Table 4: Co-efficient of AC Expertise, AC Size and AC Meetings with EPS.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	83.176	77.483		1.073	0.289
	Audit Committee Expertise	-0.166	0.656	-0.037	-0.253	0.801
	Audit Committee Size	-10.967	17.859	-0.094	-0.614	0.542
	Audit Committee Meetings	-0.780	5.293	-0.023	-0.147	0.884

a. Dependent Variable: Earnings Per Share

Table 4 shows the co-efficient of AC meetings, AC expertise and AC size with EPS. The t-values for AC meetings, AC expertise and AC size are all negative but there is no significant relationship between all independent variables and EPS at 0.801, 0.542 and 0.884.

Table 5: Co-efficient of AC Expertise, AC Size and AC Meetings with P/E.

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	-57.274	38.990		-1.469	0.149
	Audit Committee Expertise	0.600	0.330	0.249	1.820	0.075
	Audit Committee Size	4.817	8.987	0.076	0.536	0.595
	Audit Committee Meetings	5.353	2.664	0.287	2.010	0.050

a. Dependent Variable: Price to Earnings

Table 5 shows the co-efficient of AC meetings, audit committee expertise and AC size with P/E. The t-values for AC meetings, AC expertise and AC size are all positive and it is found that AC expertise and AC meetings were significant with P/E at 0.075 and 0.05 and AC size are not significant with P/E at 0.595.

Based on the three co-efficient table above, it can be concluded that AC meetings, AC expertise and AC size are not significant with firm performance (only P/E were found to be significant with AC expertise and meetings). This result is supporting the null hypotheses and similar with the study conducted by Cohen et al. (2002), Abbott et al. (2004), Carcello et al. (2011) Al-Mamun et al. (2014) and Aanu et al. (2014) that found no significant relationship between AC expertise and AC meetings. This might indicate that the audit committee might only focus the company monitoring but it did not have significant influence over firm performance.

Discussion and Conclusion

The study's objective is to establish a link between AC characteristics and corporate performance. The study's basic hypothesis is that the AC may influence firm performance, particularly for Malaysian publicly traded corporations. Our findings refute the assertion that

the AC has a material impact on corporate performance. This most likely suggests that the firm's financial problems are not the result of the AC's monitoring influence.

Limitations and Suggestions for Future Research

This study used a small sample size of 50 publicly traded firms in Malaysia, including high-performing, PN17, and GN3 enterprises. The outcome may be more favourable if the study is able to get a large sample size. Additionally, this study is limited to a single population in Malaysia, whereas longitudinal research will provide a more thorough analysis and findings.

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