

Conference Paper

The Influence of the Audit Committee and the Remuneration Committee on Company Performance

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Abstract

This research aims to analyze the impact of the size of the audit committee and remuneration committee on company performance using the Kompas 100 Index for the 2013–2015 period. Company performance is measured using the proxies of return on assets (ROA) and net profit margin (NPM). The research used leverage and company size as the control variables and the purposive sampling technique as the sampling method. In addition, the model used in this research was the panel data model, with the fixed effect model being used for the ROA proxy and the random effect model being used for the NPM proxy. The results showed that audit committee size and remuneration committee size have no significant effect on ROA and NPM.

Keywords: company performance, audit committee size, remuneration committee

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Received: 25 February 2018

Accepted: 26 May 2018

Published: 26 June 2018

Publishing services provided by
Knowledge E

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Selection and Peer-review under the responsibility of the ICIFEB Conference Committee.

1. Introduction

The weakening of corporate governance is a potential cause of a decrease in the capital inflows of a country because of increased capital outflows. It also has implications for the decline in stock prices on the stock exchange of the country through the less-developed capital market, which potentially lowers the currency exchange rate [7].

As the center of the endurance and the success of the company, the board of commissioners plays a very crucial role in performing corporate governance. The board of commissioners itself has the task to supervise the implementation of a management mechanism and give direction to the company management [15]. To implement the tasks so that they impact company performance, the board of commissioners is mandated to form an audit committee, nomination committee, remuneration committee, risk policy committee and corporate governance committee [5].

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The establishment of the audit committee is based on the Capital Market Supervisory Agency and Financial Institution (Badan Pengawas Pasar Modal-Laporan Keuangan) (BAPEPAM-LK) Circular Letter No. SE-03/PM/2000, which recommends an appeal to public companies to establish an audit committee. This Circular Letter explains that the audit committee has a task to assist the board of commissioners by providing professional and independent opinions to improve the quality of company performance and to reduce the occurrence of irregularities in the management of the company. Furthermore, the remuneration committee is to be established based on the Financial Services Authority (Otoritas Jasa Keuangan) (OJK) Regulation No. 34/POJK.04/2014 regarding the nomination and remuneration committees. The remuneration committee is responsible for assisting the functions and duties of the board of commissioners with respect to the remuneration of members of the board of directors and board of commissioners. The London Stock Exchange (2010 cited in Cintya, 2010), in its *A Guide to Listing on the London Stock Exchange*, states that a company needs to appoint new, independent directors in order to establish the audit committee and remuneration committee as they can give important suggestions, such as ideas for changes to company structure.

From the background of the problem that was previously presented, the intention of the author in conducting this research is to analyze how effective the board of commissioners and audit committee are in carrying out their respective operational duties. Furthermore, the purpose of this research is to determine the impact of the audit committee and remuneration committee on company performance.

2. Literature Review

2.1. Corporate governance

The implementation of corporate governance practices in a company is one of the most important processes for maintaining the long-term business sustainability of the company, as it is intended to meet the interests of the shareholders and stakeholders. Considering this issue, a company understands the need to implement good corporate governance (GCG; Link Net, n.d.). GCG is a set of rules or systems that regulate and control the company to create added value for the stakeholders that is related to the rights and obligations of the interested parties. This definition is based on the outcomes of a meeting of the Forum for Corporate Governance in Indonesia (FCGI). Through the implementation of the GCG principles compiled by the National Committee

on Governance Policy (2006), the principles are expected to assist the realization of fair business competition that is free from monopoly practices and has a high degree of sensitivity to all business activities.

2.2. Audit committee

The audit committee, which is established by the board of commissioners, is a committee that works professionally and independently. The audit committee has a duty to assist and strengthen the functions of the board of commissioners/board of supervisors in carrying out the oversight function over several corporate activities, including the financial-reporting process, risk management and the implementation of the audit and corporate governance [23]. According to the FCGI (cited in Surya and Yustiavandra, 2006) and YPPMI Institute (cited in Surya and Yustiavandra, 2006), the responsibilities of the audit committee include three areas: financial reporting, corporate governance and corporate control.

The purpose of establishing an audit committee, according to State-owned Enterprise (*Badan Usaha Milik Negara*; BUMN) Ministerial Decree No. 117 of 2002, is to assist the commissioners and supervisory boards in ensuring that internal control systems and the implementation of the duties of the external auditors and internal auditors have been effective. However, BAPEPAM-LK in its 2003 Circular Letter states that the purpose of establishing an audit committee is to assist the board of commissioners in improving the quality of information presented in the financial statements, creating a highly disciplined climate and controls that can reduce the opportunities for potential deviations by the management of the company, improving the effectiveness of the internal and external audit functions and identifying all things that require attention.

2.3. Remuneration committee

The remuneration committee is the one that is formed by, and therefore is liable to, the board of commissioners. The remuneration committee is responsible for performing the functions and duties of the board of commissioners regarding the remuneration for members of the boards of directors and commissioners, according to OJK Regulation No. 34/POJK/04 of 2014. The committee is composed of independent non-executive directors. This is to ensure effectiveness in performing supervision [3, 17]. The remuneration committee is responsible for designing and implementing the executive salary packages, bonus schemes and other incentive payments, including stock

options and long-term incentive plans. If the chief executive officer (CEO) becomes a member of the remuneration committee, it will affect the committee's ability to act as an independent arbitrary [3]. The remuneration committee is expected to measure, assess, evaluate and create a correlation between the amount of a CEO's salary and the company's performance, so that the proper remuneration rate for the directors/executives can be determined.

Moreover, Deloitte (2004) adds that another goal of forming a remuneration committee is to raise the transparency of the remuneration-administrating practices, to increase responsibilities of the shareholders and to commend the remuneration practice to the executives for the sake of effectiveness in terms of the shareholders' final approval. In addition, Eisenhardt (1989) concludes that remuneration is positively correlated with the wealth of the shareholder. The existence of a remuneration agreement urges the management to focus more on optimizing the shareholders' wealth. Therefore, to be able to make the best and the most important decisions for the company's sustainability, and to positively affect the company's performance, a remuneration agreement certainly helps the management to govern the company. A remuneration agreement can be used to reduce agency costs, which is intended to align the interests of the executives with those of the shareholders [11, 19]. Core et al. (2003) conclude that there is a relationship in the remuneration between CEO and shareholders, which will minimize agency costs and therefore improve the company performance.

2.4. Company performance

The company's performance is a measurement of the success of the management in governing the financial resources of the company, particularly with respect to investment management in an effort to provide value to the shareholders [10]. Company performance is also a measurement of the extent to which the company is effective in governing its owned assets in accordance with profit-making. A better performance shows that the profit a company makes is growing stably.

Return on assets (ROA) is a measure of the company's ability to make a profit from the number of owned assets [14]. If a company has a higher ROA percentage, this indicates that its operations are more efficient, and if has a lower ROA percentage, its operations are less efficient. Net profit margin (NPM) is a ratio used to demonstrate a company's ability to produce a net profit after taxes [18]. The bigger the NPM, the more productive a company's performance is predicted to be, which, in turn, will increase

the investors' trust in investing capital. The net income after tax shows the ability of the manager to set aside a certain margin as a reasonable component to be distributed to investors due to them being a party who has provided capital for a risk [18].

2.5. Development of hypotheses

The existence of an independent audit committee is a sign of a company's commitment to a fair governance practice [33]. Furthermore, Klein (2002) argues that the inclusion of independent members in an audit committee can minimize the chance of a company producing a fraudulent financial report. In accordance with this statement, McMullen (1996) concludes that establishing an audit committee lessens the emergence of problems on a company's financial report. Ultimately, the audit committee's role has a positive effect on the productivity of a company.

The inclusion of independent expert directors in the composition of a company's audit committee implies that it has the ability to improve performance significantly [4]. In addition, Bedard et al. (2004) explain that the expertise and experience possessed by an audit committee directly correlates with the effectiveness of its function. This is because the main task of the audit committee is to supervise the process for the presentation of the financial report and to audit the company, so the members of the committee must be adequately proficient in comprehending the problems to be discussed and researched. Furthermore, Felo et al. (2003) conclude that there is a positive relationship between the financial knowledge held by audit committee members and their working effectiveness. In particular, this applies to their role in ensuring that the process for the presentation of the financial report is well qualified and adheres to the applicable rules. The Public Oversight Board (1993) explains that low proficiency and a lack of relevant experience result in an inability and failure of the audit committee members to comprehend their roles and responsibilities in a company. The minimum number of members for an audit committee is three persons, and is limited to the non-executive directors of a company [3].

Based on the aforementioned conclusions, the hypothesis that will be verified in this research is:

H₁: An audit committee and remuneration committee have positive impacts on company performance.

3. Methodology

3.1. Populations and samples of the research

The research populations comprise public companies on the Indonesian Stock Exchange. The samples consist of companies listed on the Kompas 100 Index that have high liquidity, a high market-capitalization value and company stocks with good performances. The period used in this research is from 2013 to 2015. The sampling criteria used are for two successive periods in the same year, and if the criteria were not fulfilled by a company, then the company was removed from the research samples.

3.2. Data collection and data-measurement techniques

The data used in the research is unbalanced panel data, and the sampling method used is purposive sampling, which is defined as a sampling technique that is determined using certain criteria (Singarimbun and Effendi, 1995). This method was selected because it represents the sample and is based on conformity between the sample characteristics and the sampling criteria:

1. Audit committee is measured using the number of audit committee members the company has.
2. Remuneration committee is measured using a dummy variable, which is given a value of 1 if the company has a remuneration committee and 0 if the company does not have a remuneration committee.
3. Company performance is measured using the proxies of ROA and NPM.
4. Leverage is a financial ratio that compares the company's total debts and total equity.
5. Firm size is determined based on the amount of total assets, which is subjected to natural logarithms.

3.3. Methods and data analysis

To test the hypothesis in this study, the researchers used the following regression model:

$$KIN = \alpha + \beta_1 UKA_{i,t} + \beta_2 KR_{i,t} + \beta_3 LEV_{i,t} + \beta_4 FS_{i,t} + \epsilon_{i,t}$$

where:

KIN = Company performance (NPM and ROA)

UKA = Audit committee measurement

KR = Remuneration committee measurement

LEV = Leverage

FS = Firm Size

α = Constant

$\beta_1 - \beta_4$ = Regression coefficients

ε = Error

4. Results

4.1. Classic assumption test

4.1.1. Multicollinearity test

In this study, the researchers only used panel data to conduct a multicollinearity test. Using the Pearson correlation, there is no correlation coefficient value between variables that exceeds 0.90. From these results for this study, it can be concluded that multicollinearity is not detected in this sample.

4.2. Results of panel data regression tests

4.2.1. Chow test

The purpose of using this test is to identify whether the most appropriate model for the panel data regression for the ROA proxy of company performance is the common effect model or the fixed effect model. The Chow test results for the common effect model give a chi-square value of 348.3492 and a probability value of 0.00. Since the probability value is less than 0.05, it can be concluded that H_0 is rejected and H_1 is accepted. Therefore, in this study, the common effect model is not a good model to use on the panel data regression. The Chow test results for the fixed effect model give a chi-square value of 217.1197 with a probability value of 0.00. Because the value is less than 0.05, H_0 is rejected and H_1 is accepted. Therefore, it can be concluded that the fixed effect model is not a good model to use for the panel data regression model

for the ROA proxy, but is more appropriate than the common effect model, so the fixed effect model was chosen.

4.2.2. Hausman test

The Hausman test was used to determine the most appropriate model for the panel data regression for the NPM proxy of company performance, either the fixed effect model or random effect model. The results of the Hausman test for the fixed effect model are a chi-square value of 16.2799 and a probability value of 0.0027. Since the probability value is smaller than 0.05, it can be concluded that the fixed effect model is not a good model for panel data regression. The results of Hausman test for the random effect model are a chi-square value of 8.6223 and a probability value of 0.0713. Because the probability value is greater than 0.05, this shows that the random effect model is a good model for panel data regression.

4.3. Results of the regression test and discussion

The following regression equation identifies the effect of the independent variables, which are audit committee size and remuneration committee, and the effect of the control variables, which are leverage and firm size, on the dependent variable of ROA:

$$\text{ROA} = 141.3001 - 0.6458 \text{ UKA} - 1.1795 \text{ KR} - 0.4454 \text{ LEV} - 8.0303 \text{ FS}.$$

The researchers interpret the results of the previous regression equation as follows:

1. The equation generated a constant value (β) equal to 141.3001, which means if the variables UKA, KR, LEV and FS are 0, then the ROA value is 141.3001.
2. The UKA regression coefficient is -0.6458, indicating that for every 1-unit increase in UKA, assuming that the KR, LEV and FS variables are constant, there will be a decrease in ROA of 0.6458 units.
3. The KR regression coefficient is -1.1795, indicating that for every 1-unit increase in KR unit, assuming that the UKA, LEV and FS variables are constant, there will be a decrease in ROA of 1.1795 units.
4. The LEV regression coefficient is -0.4454, indicating that for each 1-unit increase in LEV, assuming that the UKA, KR and FS variables are constant, there will be a decrease in ROA of 0.4454 units.

5. The FS regression coefficient is -8.0303 , indicating that for every 1-unit increase in FS, assuming that the UKA, KR and LEV variables are constant, there will be a decrease in ROA of 8.0303 units.

The following regression equation shows the effect of the independent variables, which are audit committee size and remuneration committee, and the effect of the control variables, which are leverage and firm size, on the dependent variable for NPM:

$$\text{NPM} = 176.154 + 1.5119 \text{ UKA} - 5.5302 \text{ KR} - 1.1617 \text{ LEV} - 10.044 \text{ FS}.$$

Furthermore, the interpretation of the previous NPM regression equation is as follows:

1. In the equation, the value of constant (β) is 176.154, which means that if the UKA, KR, LEV and FS variables are 0, then the NPM value is 176.154.
2. The UKA regression coefficient is 1.5119, indicating that for every 1-unit increase in UKA, assuming that the KR, LEV and FS variables are constant, there will be an increase in NPM of 1.5119 units.
3. The KR regression coefficient is -5.5302 , indicating that for every 1-unit increase in KR, assuming that the UKA, LEV and FS variables are constant, there will be a decrease in NPM of 5.5302 units.
4. The LEV regression coefficient is -1.1617 , indicating that for each 1-unit increase in LEV, assuming that the UKA, KR and FS variables are constant, there will be a decrease in NPM of 1.1617 units.
5. The FS regression coefficient is -10.044 , indicating that for every 1-unit increase in FS, assuming that the UKA, KR and LEV variables are constant, there will be a decrease in NPM of 10.044 unit.

4.4. Hypothesis test results

The partial test hypotheses compiled for this research are:

H_0 : The independent variables have no significant effect on company performance.

H_a : The independent variables have a significant effect on company performance.

The results of the partial test previously described will determine the influence and the direction of the influence of the independent variables on the dependent variable. The results of the *t*-test for the hypothesis (partial) will then form the basis used to determine whether or not the hypothesis is accepted. H_0 is rejected if the probability value is less than 0.05, and if the probability value is greater than 0.05, H_0 is accepted.

4.4.1. Influence of audit committee size on company performance

The value for the audit committee size coefficient (for company performance proxied by ROA) is -0.6458 , and the probability value of 0.6213 is greater than 0.05 . The coefficient value for the audit committee size (for company performance proxied by NPM) is 1.5112 and the probability value of 0.6852 is greater than 0.05 . This indicates that the audit committee size has no significant effect on the performance of the company, whether proxied by ROA or NPM. This result is in line with the research conducted by Rimardhani et al. (2016), Lestari (2015) and Yunizar and Rahardjo (2014).

The results of Rimardhani et al.'s (2016) research illustrate that the number of audit committees cannot guarantee the effective operation of an audit committee with respect to the supervision of company performance. Establishing an audit committee solely on the basis of regulatory compliance indicates that the company only follows the rules. In practice, the role of the audit committee in carrying out supervisory and control functions is proven to be less than optimal. In addition, the tasks of maintaining the quality of the company's financial statements and assisting the board of commissioners are not fully achieved through the existence of an audit committee. This is primarily with respect to the supervision of the process for presenting financial-reporting information; an audit committee seems to only conduct a review of the company's financial and accounting information, but is not directly involved in the process of solving financial problems that occur in the company.

4.4.2. Influence of remuneration committee on company performance

The value of the remuneration committee coefficient (for company performance proxied by ROA) is -1.1795 and the probability value of 0.3798 is greater than 0.05 . The value of the remuneration committee coefficient (for company performance proxied

by NPM) is -5.5302 and the probability value of 0.1503 is greater than 0.05 . This means that the remuneration committee has no significant influence on the performance of the company, whether proxied by ROA or NPM. This result is in line with the research of Renaldo and Sudana (2015) who state that the remuneration committee has no significant influence on the performance of a company. This is because a remuneration committee only exists in a company as the result of an aim to meet the regulations. Thus, the performance of the remuneration committee cannot be maximized. In addition, many companies do not have a remuneration committee, which indicates that there are still many companies that have not realized the importance of the remuneration committee.

4.4.3. Effect of leverage control variables and company size on company performance

The leverage coefficient value (for company performance proxied by ROA) is 0.4454 and the probability value of 0.4589 is greater than 0.05 . The leverage coefficient value (for company performance proxied by NPM) is -1.1617 and the probability value of 0.4983 is greater than 0.05 . This indicates that leverage has no significant effect on company performance, whether proxied by ROA or NPM. This result is similar to that of the research conducted by Syari (2014) and Sesoningtyas (2012) who both observe that leverage has no significant effect on company performance. This is because the addition of working capital to debt capital does not affect the proliferation or decline in company performance.

The value of the company size coefficient (for company performance proxied by ROA) is -8.0303 and the probability value of 0.0003 is smaller than 0.005 . This indicates that company size has a significant negative effect on company performance proxied by ROA. This result is in line with research conducted by Isbanah (2015) who states that as the size of the company gets larger, beyond a certain point, this will result in a decline in company performance due to a too-large-sized company not being supported by good corporate management.

The value of the company size coefficient (for company performance proxied by NPM) is -10.0348 and probability value of 0.1074 is bigger than 0.005 . This indicates that company size has a significant negative effect on company performance proxied by NPM. This result is in line with research conducted by Isbanah (2015), Talebria et al. (2010) and Ratnasari (2016). Isbanah (2015) explains that the size of the company is not a guarantee of good performance, which is reflected in earnings. This is as expected

because the company has not been able to maximize its assets to achieve the desired profit. Therefore, it can be concluded that the size of the company cannot be used as a parameter to determine the probability of the company generating profit.

4.5. Coefficient of determination

The regression result for ROA has an adjusted R-square value of 0.8401. Therefore, it can be concluded that 84 percent of the ROA variable can be explained by the variation of the independent variables studied (audit committee size and remuneration committee size) and the control variables (leverage and company size). While the remaining 16 percent is explained by other factors outside the variables used in this research. Furthermore, the regression result for NPM has an adjusted R-square value of 0.0181. From these values, it can be concluded that 65.5 percent of the NPM variable can be explained by the variation of the independent variables in the study (audit committee size and remuneration committee size) and the control variables (leverage and company size). While the remaining 34.5 percent is explained by other factors outside the variables used in this research.

5. Conclusions, Implications and Suggestions

The conclusions that can be drawn from this research are that (1) the size of the audit committee does not significantly affect the performance of the company, whether it is inspected using ROA or NPM; (2) the remuneration committee has no significant effect on the performance of the company, whether it is inspected using ROA or NPM; (3) this helps to maintain the existence of the company on an ongoing basis; and (4) companies are expected to be able to evaluate the performance of their audit committees and remuneration committees, and maximize their performance bias.

In addition, the implications of this research are that this will help companies to (1) maintain the existence of the company on an ongoing basis and (2) be able to evaluate the performance of audit committees and remuneration committees, and to maximize their performance.

The researchers also provide suggestions for further research, which are (1) adding company performance proxies, not only from a financial perspective but also from a market perspective, to vary the results; (2) adding other independent variables, such as those relating to the board of directors and board of commissioners, which have a direct role in the management of the company, so that the results obtained relating

to the effect on the company's performance will be more accurate; and (3) expanding the study period so that the results obtained are more accurate.

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