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The impact of audit committee characteristics on corporate voluntary disclosure

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Abstract

The purpose of this study is to investigate the influence of audit committee characteristics on corporate voluntary disclosure of 146 Malaysian listed firms for the year 2009. Based on content analysis of disclosure, the empirical results of multiple regressions reveal that audit committee independence, size and multiple directorships of audit committee members are positively associated with corporate voluntary disclosure. Frequency of meetings and financial expertise of audit committee members are not significantly associated with corporate voluntary disclosure. The results offer evidence to policy makers, investors and accounting professionals on the extent to which audit committee characteristics associated with such committee effectiveness in monitoring corporate reporting processes.

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1. Introduction

Audit committee (AC) is considered as one of the crucial and influential participants of corporate governance as it assists the board of directors in discharging its responsibilities in overseeing corporate management (Bedard & Gendron, 2010; Li, Mangena, & Pike, 2012). In this respect, it is argued that AC plays a key role in monitoring

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management disclosure practices' and internal control (Dhaliwal, Naiker & Navissi, 2010; Persons, 2009). Hence, effective AC results in the enhancement of financial reporting process and thus reducing information asymmetry between management and stakeholders (Dhaliwal et al., 2010; Li et al., 2012). Accordingly, AC maintains and enhances public confidence in the credibility and the objectivity of the financial reporting through improving the disclosure practices of published information (Bedard & Gendron, 2010; Kelton & Yang, 2008).

Corporate voluntary disclosure is regarded as a mechanism to reduce information asymmetry between firm and outside investors (Akhtaruddin & Haron, 2010; Jiang, Habib, & Hu, 2011), and hence lowers agency costs which leads to improve corporate reporting transparency (Akhtaruddin & Haron, 2010). Furthermore, it is believed that transparency and adequate disclosure are also important in order to ensure the protection of minority shareholder's rights (Jiang et al., 2011). This is because voluntary disclosure expresses the transparency and accountability of management in conducting business (Akhtaruddin & Haron, 2010; Li et al., 2012).

Prior studies, including Malaysian ones, on the association between corporate governance and corporate voluntary disclosure have mainly focused on board and ownership structure (Akhtaruddin & Haron, 2010; Allegrini & Greco, 2011; Barako, Hancock, & Izan, 2006; Haniffa & Cooke, 2005; Haniffa & Cooke, 2002; Mohd Ghazali & Weetman, 2006). In addition, a number of empirical studies has shown that AC characteristics influence financial reporting quality and disclosure practices in Malaysian companies (Abdullah, Mohamad-Yusof, & Mohamad-Nor, 2010; Akhtaruddin & Haron, 2010). However, there are still limited empirical studies examining the role of AC in enhancing corporate voluntary disclosure. In this context, Akhtaruddin and Haron (2010) and Bedard and Gendron (2010) have suggested that an effective AC is needed to support a more transparent disclosure. Therefore, the aim of this study is to investigate the association between AC characteristics and corporate voluntary disclosure of Malaysian listed firms. This study has special significance in the context of Malaysia because of ownership concentration structure which makes Malaysia a unique corporate governance environment. Moreover, there is a lack of research in this field in Malaysia (Mohd Ghazali & Weetman, 2006).

2. Literature review and hypotheses development

2.1. Audit committee characteristics

AC is an oversight committee under the main board of directors. The board of directors has delegated the responsibility of corporate reporting process to the AC (Bedard & Gendron, 2010; Li et al., 2012). The Malaysian Code on Corporate Governance (2007) views ACs as the ultimate monitor of the corporate reporting process. Thus, AC is regarded as the monitoring device that reduces information asymmetry (Akhtaruddin & Haron, 2010; Barako et al., 2006), and consequently mitigates agency costs (Bedard & Gendron, 2010). Akhtaruddin and Haron (2010) and Barako et al., (2006) have indicated that AC is considered as a means of monitoring and improving corporate disclosure processes including voluntary disclosure.

Literature on AC has suggested that AC effectiveness essentially functions on AC characteristics (Akhtaruddin & Haron, 2010; Bedard & Gendron, 2010; Dhaliwal et al., 2010; Li et al., 2012; Persons, 2009). Hence, the right combination of skills and experience are critical in supporting the AC's ability to carry out its responsibilities effectively. Therefore, hypotheses are developed to investigate the effect of AC characteristics (independence, financial expertise, size, frequency of meetings and directorship of AC members) on corporate voluntary disclosure.

2.1.2 AC independence

Based on agency theory, Fama and Jensen (1983) have argued that the effective monitoring of management's behavior is more likely to be influenced by the presence of independent directors. This is because the independent directors on AC have no economic or personal relationship with management and hence they are more likely to work independently and objectively from management influence (Bedard & Gendron, 2010). Therefore, independent directors on AC have more opportunity to control and reduce management's opportunities to withhold information for their own benefits (Allegrini & Greco, 2011). Hence, an AC with independent directors will insure

the quality and transparency of financial reporting process, and which in turn reduces information asymmetry (Allegrini & Greco, 2011; Li et al., 2012). It therefore appears reasonable to argue that effective monitoring by independent directors on AC is thought to further motivate management to provide accurate and additional information in quick information processing (Haniffa and Cooke, 2002). Akhtaruddin and Haron (2010) and Patelli and Prencipe (2007) have found that AC independence is associated with more voluntary disclosure. It is therefore hypothesized that; H₁: There is a positive association between the level of voluntary disclosure and AC independence.

2.1.3 AC financial expertise

In order to effectively monitor corporate reporting process, AC members should be financially literate, so that they are able to understand and interpret financial statements (Dhaliwal et al., 2010). Financial expertise leads AC members to identify and ask knowledgeable questions that challenge management and external audit to a greater extent of financial reporting quality (Bedard & Gendron, 2010). This in turn will enhance transparency of corporate reporting and hence mitigate agency problem associated with flow of information. Previous studies have found a positive relation between AC financial expertise and financial reporting quality (Kelton & Yang, 2008; Kent, Routledge, & Stewart, 2010), and level of voluntary disclosure (Akhtaruddin & Haron, 2010). Therefore, the following hypothesis is tested; H₂: There is a positive relationship between the level of voluntary disclosure and AC financial expertise.

2.1.4 AC meeting frequency

Karamanou and Vafeas (2005) have argued that AC that meets more frequently is more likely to effectively accomplish its monitoring role. Greco (2011) has argued that meeting frequency of AC would allow the members to express judgment about the firm's accounting choice of principles, disclosures and estimates. In this case, regular meetings of AC would make it informed and knowledgeable about relevant accounting and auditing issues (Allegrini & Greco, 2011). For this reason, a more active AC, i.e. one that meets frequently during the year, would provide its members with greater opportunities for discussing and evaluating the issues placed before them concerning the company's financial reporting practices (Li et al., 2012). Empirically, Allegrini and Greco (2011) and Li et al., (2012) have found that at least four meetings a year for AC members are significantly related to the level of voluntary disclosure and intellectual capital disclosure, respectively. Therefore, the following hypothesis is indicated; H₃: There is a positive relationship between the level of voluntary disclosure and frequency of AC meeting.

2.1.5 AC size

Resource dependency theory argues that larger ACs are willing to devote greater resources and authority to effectively carry out their responsibilities (Allegrini & Greco, 2011). More directors on AC are more likely to bring diversity of views, expertise, experiences and skills to ensure effective monitoring (Bedard & Gendron, 2010). Hence, a higher number of AC members is likely to help such committee to uncover and resolve potential issues in corporate reporting process (Li et al., 2012). This indicates that, AC size is an integral factor for AC to adequately oversee corporate disclosure practices (Persons, 2009). Persons (2009) has found empirical evidence that many directors on AC appear to enhance the level of voluntary disclosure. Therefore, the following hypothesis is stated that; H₄: There is a positive relationship between the level of voluntary disclosure and AC size.

2.1.6 Multiple directorships of AC members

Fama and Jensen (1983) have argued that outside directors with directorships are perceived to be valuable

because they are concerned about their reputation damage, litigation risks and possible loss of future board opportunities and therefore will be motivated to perform their monitoring role effectively. Multiple directorships provide directors with important information regarding new policies, trade and practices among firms that could lead to better performance (Haniffa & Cooke, 2002). In addition, they expose directors to different management styles and monitoring behavior and allow directors to seek advice from others (Haniffa & Cooke, 2005). For this context, it can be argued that for a director of AC who is attached to different firms as a board member, manager, or any committee member might gain additional contextual background for conducting their monitoring responsibilities and this may affect financial reporting outcomes. Consistently, Haniffa and Cooke (2005) have reported that multiple directorships of AC members enhance the corporate disclosure practices. Therefore, the following hypotheses is tested; H₅: There is a positive relationship between the level of voluntary disclosure and directors with multiple directorships on AC

3. Research design

3.1. Sample selection

Data for this study were collected from the annual reports of companies that were listed on Bursa Malaysia as at the end of 2009. As on December 31, 2009, there were 964 listed on Bursa Malaysia. After removing finance firms and firms with incomplete data, the final population was 500. According to Tabachnick and Fidell (2007) the 146 top market capitalizations were identified as appropriate sample for the population. The annual reports of sample companies for the financial year 2009 were downloaded from the Bursa Malaysia website.

3.2. Voluntary disclosure measure

This study applies the 86 voluntary disclosure item checklist developed by Akhtaruddin and Haron (2010) and Mohd Ghazali and Weetman (2006). This checklist consists of (28 items) strategic information, (18 items) non-financial information and (40 items) financial information. A company is awarded 1 if an item included in the disclosure checklist is disclosed and 0 if it is not disclosed. Finally, the total score is divided by 86 to get voluntary disclosure score.

3.3. Model

Multiple regression analysis is employed to examine the relationship between corporate voluntary disclosure and the AC characteristics and control variables. Multiple regression assumptions including normality, multicollinearity and heteroskedasticity were met. The following regression model is estimated for this study:

$$\text{VDSCORE} = \beta_0 + \beta_1\text{ACIND} + \beta_2\text{ACFEXP} + \beta_3\text{ACMET} + \beta_4\text{ACSIZ} + \beta_5\text{MDAC} + \beta_6\text{FSIZ} + \beta_7\text{ROA} + \beta_8\text{LEVERG} + \varepsilon$$

Where VDSCORE is sum of all disclosure scores awarded to the company divided by maximum possible potential score applicable to the company, ACIND is the proportion of independent directors on the audit committee to the total audit, ACFEXP is the proportion of financial expertise on the audit committee to the total audit members, ACMET is the number of audit committee meetings for the year, ACSIZ is total number of directors on the audit, MDAC is the proportion of directors on audit committee with at least one directorship in other firms to the total audit committee members, FSIZ is natural log of total assets, ROA is defined as net income after tax divided by total assets, and LEVERG is ratio of total liabilities to total assets.

4. Empirical results

4.1. Descriptive analysis

Panel A of Table 1 presents the descriptive statistics of corporate voluntary disclosure for the overall index and categories. The mean disclosure score for overall items is 58.91% (ranging 45.35% to 79.07%). As for categories of voluntary disclosure, firms appear to voluntarily disclose more strategic information at 75.29% than both financial information and non-financial information at 52.65% and 47.33%, respectively.

Table 1. Descriptive statistics for dependent and independent variables

	Mean	Min	Max	SD
Panel A- dependent variables				
Overall voluntary disclosure	58.91	45.35	79.07	8.18
Strategic information	75.29	53.57	1.00	8.73
Non-financial information	47.33	16.67	1.00	16.76
Financial information	52.65	32.50	80.00	8.90
Panel B –independent variables				
Audit committee independence	0.84	0.42	1.00	0.16
Audit committee financial expertise	0.56	0.16	1.00	0.23
Frequency meeting of audit committee	5.10	3.00	15.00	1.57
Audit committee size	3.38	2.00	6.00	0.65
Multiple directorships of audit committee members	0.38	0.00	1.00	0.28
Firm size	14.62	11.96	18.80	1.16
Profitability	0.07	-0.20	0.52	0.08
Leverage	0.22	0.00	0.71	0.17

Panel B of Table 1 presents the descriptive statistics of the independent variables. The mean proportion of independent AC members is 84%, indicating majority of firms are composed ACs with independent directors. The mean of AC directors with financial expertise is 56%. On average, frequency of meetings of AC members is 5. The results show that AC size is ranging from two to six members with mean of approximately 3 members. The results also show that 38% of the ACs in the sample firms have members with at least one directorship in other firms. In terms of control variables, the mean size of the firm is 14.62 and the average profitability is 7%, whilst the average leverage is 22%.

4.2. Multiple regression results

The regression results of the association between AC characteristics and voluntary disclosure are presented in Table 2. In respect to AC characteristics variables, the results show that AC independence (ACIND) is significantly and positively associated with corporate voluntary disclosure at the 5%. Thus, the H_1 is supported. This is consistent with the findings from Akhtaruddin and Haron (2010) and Persons (2009) on voluntary disclosure. This finding is in the line with the notion that independent directors on AC enhance AC effectiveness. In this respect, it can be argued that AC independence effectively monitors and oversees the information disclosed in the annual reports and hence enhances voluntary discourse.

Table 2. Multiple regression results

Variable	Coefficient	t-test	P-value
(Constant)		0.336	0.737
ACIND	0.147	2.121	0.036**
ACFEXP	0.081	1.090	0.277
ACMET	-0.021	-0.289	0.773
ACSIZ	0.188	2.680	0.008***
MDAC	0.194	2.628	0.010**
FSIZ	0.448	5.121	0.000***

ROA	0.262	3.395	0.001***
LEVRG	-0.038	-0.540	0.590
R ²	0.384		
Adjusted R ²	0.348		
F	10.686		
Sig.	.000		

***Significant at 1%, **Significant at 5%

AC with financial expertise directors is insignificantly associated with voluntary disclosure, thus hypothesis H₂ is not supported. This result supports Persons's (2009) finding indicating insignificant association with corporate voluntary disclosure. However, the results do not support the prior studies reporting a positive association with financial reporting quality (Kent et al., 2010), and corporate voluntary disclosure (Akhtaruddin & Haron, 2010). It may well be that the corporate disclosure practices might require domain knowledge of accounting, auditing and finance to effectively evaluate and assess disclosed information.

The frequency of meetings of AC members is not significantly associated with corporate voluntary disclosure, thus H₃ is not supported. This indicates that AC activity does not enhance monitoring role of such committee over corporate disclosure practices.

AC size is positively and significantly associated with corporate voluntary disclosure at the level of 1%. Therefore, hypothesis H₄ is supported. This is consistent with the previous studies that have found AC size to be associated with financial reporting quality (Dhaliwal et al., 2010) and increased level of voluntary disclosure (Persons, 2009). The result suggests that AC size is an important factor in enhancing corporate voluntary disclosure in order to reduce information asymmetry associated with agency problems.

Finally, the result for AC members with multiple directorships is positive and significant with corporate voluntary disclosure at 5%. Thus, hypothesis H₅ is supported. The significant result, for AC members with multiple directorships, is consistent with (Haniffa & Cooke, 2005; Yang & Krishnan, 2005) and suggests that greater corporate voluntary disclosure is more likely when AC members hold directorships in other firms. This indicates that multiple directorships enhance AC's efficiency in monitoring management disclosure practices and therefore the ability to effectively oversee corporate disclosure processes.

In terms of the control variables, the statistical result shows that large companies have a significant influence on voluntary disclosure. The statistical result also shows that profitable firms enhance corporate voluntary disclosure. Finally, firm size shows an insignificant association with corporate voluntary disclosure.

5. Conclusion

This study examines the role of AC in enhancing corporate voluntary disclosure in the annual reports of Malaysian listed firms. Specifically, this paper investigates the association between AC characteristics and corporate voluntary disclosure. The empirical results indicate that AC independence, size and multiple directorships of AC members have significant effect on corporate voluntary disclosure. Financial expertise and frequency meeting of AC directors have no significant impact on corporate voluntary disclosure. Nevertheless, the results are consistent with the idea that AC plays a key role in overseeing corporate reporting processes including voluntary disclosure practices. The effectiveness of AC is contingent on AC characteristics namely, independency, size and multiple directorship of the committees' members. In line with the vigorous initiatives to improve AC effectiveness in corporate reporting transparency, the study provides insights into the role of AC in overseeing corporate reporting processes. This study demonstrates that agency theory complements resources dependency theory in enhancing audit committee effectiveness. Findings of this study are of interest to investors, policy makers and accounting professionals as they provide a useful basis for assessing and enhancing AC characteristics being associated with such committee effectiveness, which is important to improve corporate disclosure practices. The findings also add to the existing literature by contributing to the understanding of the role of AC in corporate disclosure practices. However, all the results are based on Malaysian stock market, and hence there may be limitations in extending to other countries. Future research could examine other characteristics of AC such as gender and tenure of directors and nationality of directors. Interaction of AC characteristics could also be examined.

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