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Board Profile and Audit Committee's Activity: Evidence from Malaysian Government-Linked Companies

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ABSTRACT

Recent corporate failure has led to a great call for an audit committee to increase its monitoring roles. Hence, this study aims to examine the relationship of board profile particularly on board size, board independence and board diligence towards audit committee activity. This activity is proxied by the frequency of audit committee meetings held during the year. This study uses data from the annual report of 66 firm-year observation samples of Government-Linked Companies (GLCs) for the year 2007 to 2009. The regression result shows that board independence has positive significant relationship with the activity of audit committee. A positive significant relationship was also found between board diligence and audit committee activity. However, there is insignificant relationship between board size and the activity of audit committee. Generally, this study concludes that increasing in board independence and board diligence; it should increase the performance of audit committee in GLC.
KEYWORDS: Audit Committee Activity, Board Composition, GLC; Corporate Governance, Agency Theory.

INTRODUCTION

Recent corporate failure has led to a great call for an audit committee to increase its monitoring roles. A best practice in an audit committee is perceived as a sign of improving corporate governance. The success of this committee in discharging its duties is depending on their working relationship with board of directors and other corporate governance participants [2]. As one of the crucial elements for corporate governance mechanism, the occurrence of audit committee meetings is indicated as a proxy of real monitoring and control levels. This professional meeting creates pressure to the company in improving their transparency [4]. Although the committee is a crucial corporate governance element, but prior researches in Malaysia have shown that there were very limited studies had been conducted to examine the factors which influenced the audit committee's activity. Surprisingly, there was a large body of academic literature in previous studies that examined the role of audit committee impact on earning management [5-7], firm performance [8], and voluntary disclosure [1, 3]. Hence, this study is undertaken to address the gap in existing literatures by examining the relationship between the board profile; particularly on board size, board independence and board diligence towards the audit committee's activity. The remainder of the paper is organized by reviewing the past literature, configuring the research methodology and presenting the findings of the result and the conclusion of the study.

LITERATURE REVIEW

Audit Committee Activity

In an agency theory perspective, monitoring mechanisms are important to overcome the possible conflict of interest between a director (an agent) and shareholders (principal) [9]. Audit committee is one of the monitoring mechanisms to ensure the transparency of financial reporting and corporate accountability [1]. They meet regularly with the company's external auditors and internal financial managers to review the financial statement, audit process as well as internal accounting control [7]. To be effective, the committee must be very active. This can be evaluated from its level of activity such as the duties it has performed, occurrences of its meetings as well as its size [10]. Hence, the effectiveness of its monitoring roles is strengthened by having more frequent meeting with external auditor and management.

Board Size and Audit Committee Activity

Empirical researches have documented mixed evidence on the role of board size. In [3] has suggested that in relation to voluntary disclosure, larger boards should not be detrimental to outside shareholders. In contrast, in

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[11] states that small boards are closely monitor management that could contribute higher firm performance. According to [6], well-functioning of board monitoring is not only depending on board composition, but it also depends on the subcommittee of the board. One of the subcommittee is the audit committee [12]. Larger boards provide more diversity for the selection of audit committee members to perform its monitoring roles [13]. Nevertheless, they found that the board size is insignificant to the audit committee's activity. Thus, it is hypothesized that:

H1: There is insignificant relationship between board size and audit committee activity.

Board Independence and Audit Committee Activity

Recent evidence suggests that a higher proportion of independent non-executive directors (INED) is associated with greater firm performance [14-16]. These findings support the agency theory in which they are the active monitor of manager. There is also a study [7] reported that board independence has negative relationship with abnormal accruals, where these boards are effective in monitoring the corporate financial accounting process. A positive significant between proportion of INED and audit committee activity was found in [13]. The researchers confirmed that the increase proportion of INED in the board means that there will be more of them in the audit committee, and therefore improve on the performance of audit committee. Therefore, next hypothesis is:

H2: There is a significant positive relationship between board independence and audit committee activity.

Board Diligence and Audit Committee Activity

In [17] reported less board meeting leads better performance of GLCs. It indicates that limit less board meeting could reduce unnecessary cost, thus has positive impact on firm's performance. In addition, another study [6] provides evidence that frequent board meeting serve as effective monitor to reduce the earning management. Another study [13] discovered that there was a significant positive association between board meeting and the activity level of audit committee. This is due to the audit committee is also the subcommittee of the main board. Therefore, an active board meeting positively influence the audit committee activity. Thus, this is hypothesized that:

H3: There is a significant positive relationship between board diligence and audit committee activity.

RESEARCH METHODOLOGY

Samples and Variable Measurement

GLC that obtained from Ministry of Finance (MOF) website are selected as the sample for this study. The period of this study is 3 years, which from 2007 to 2009. The final samples are 66 firm-year observations after excluding finance sectors because of different regulatory requirements. An annual report of a company is the main source of information for this study. Data of all variables were collected from the annual report. The data for firm size is extracted from Osiris to be the controlled variable.

Variables Measurement

The measurement of this study is adapted based on [13]. It shows the measurement of the variables. The independent variables consist of board size, board diligence and proportion of INED on board. Whereas, audit committee activity has become the dependent variable of this study and firm size is used as a controlled variable. The variables measurement of the study is shown in Table 1.

Table 1: Variables measurement

Variables Acronym	Definition	Variables measurement
Dependent variable		
ACACT	Audit committee activity	Frequency of audit committee meeting
Independent variables		
BSIZE	Board size	Number of directors on the board
BMEET	Board diligence	Number of board meeting held in a year
INED	Board independence	Proportion of INED divided by total number of director
Control variable		
LFSIZE	Firm size	Natural log of turnover

Research Model

Multiple linear regression is used to test the relationship between the dependent variables; namely the audit committee activity and the independent variables that are board size, board diligence and board independence. The following model is developed to test the hypotheses as follows.

$$ACACT = \beta_0 + \beta_1 BSIZE + \beta_2 BMEET + \beta_3 INED + \beta_4 LFSIZE + \epsilon \quad (1)$$

where

ACTACT	=	Audit committee activity
BSIZE	=	Board size
BMEET	=	Board diligence
BINED	=	Proportion of INED on board
LFSIZE	=	Firm size
ϵ	=	Error term

RESULTS AND DISCUSSION

Several tests have been undertaken to check the existence of any statistical problems such as test of multicollinearity on correlation matrix, as well as variance inflation factor (VIF) and normality test which based on Kolmogorov-Smirnov. The regression analysis is used to test the relationship between independent variables and dependent variable. The Adjusted R- Square statistic in Table 2 is 0.309, indicates that 30.9% of the total variation in audit committee activity can be explained by the changes of independent variables. The remaining is due to the randomness and other variables that are not included in the model. Overall, the model is significant at 1% based on the p-value.

Table 2: Model summary

Model	R	R Square	Sig.	Std. Error of the Estimate	F	Sig.
1	.592[a]	.350	.309	1.965	8.617	0.000[b]
a. Predictors: (constant) LFSIZE, INED, BMEET, BSIZE						

Table 3 shows the regression result for this study. The findings of this study are consistent with [13] that examine the determinants of audit committee activity in United Kingdom (UK) listed companies. Table 3 shows the value of board independence coefficient is positively related to the activity of audit committee with significant at 10% level. Thus, it implies that the proportion of INED is likely to increase the activity level of audit committee. It also shows the coefficient of board diligence is positive significant with the audit committee activity at 1% level, indicating that when boards meet more often, the activity of audit committee is increased. Hence, the findings confirm that board independence and board diligence are more effective monitor of audit committee activity, thus it improves the performance of audit committee. Meanwhile, board size and firm size are proven to be insignificant with the activity of audit committee, suggesting that these variables do not influence the activity of audit committee among GLC.

Table 3: Regression result

Model		Standardized Coefficients Beta	t	Sig.
1	(Constant)		.607	.546
	BSIZE	.017	.151	.880
	INED	.230	2.258	.027
	BMEET	.526	5.033	.000
	LFSIZE	.039	.352	.726

CONCLUSION

The objective of the study is to examine the relationship between board profile particularly on board size, board independence and board diligence towards audit committee activity. The findings provide evidence of Malaysia case, where the board independence and the board diligence have indicates positive significant relationship with the activity of audit committee. Surprisingly, insignificant relationship was revealed between the board size and the firm size on the activity of audit committee. The results of this study are consistent with [13] that examine the influence of audit committee activity in the UK environment. Generally, this study concludes that increasing in board independence and board diligence; it should increase the performance of audit committee in GLC. It is hoped that the findings may help regulators to enhance the effectiveness of audit committee in monitoring of GLC. Among the limitations of this study are samples limited to GLC, coverage data is from 2007 to 2009 and adjusted R square is low. To add the findings of this study, future research should extends the samples to all Malaysian public listed companies (PLCs), longer period of study, adding more variables or using other proxies of audit committee activity.

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