Impact of Audit Committees on the Financial Performance: Evidence from Jordan

Suleman Ali Eyal Awwad, Nik Mohd Norfadzilah, Faruk Abdullah

Abstract: This study examines the effects of the correlation between corporate governance mechanisms (audit committees) on the financial performance in the Jordanian companies, the sample comprises of 115 companies, 690 observations, listed in ASE for the period from (2010-2015), thus our goal is the correlation between the audit committees and financial performance to financial data analysis quality test and effect on the earnings. The results of this research expose a strong relationship both the audit committees and performance, and the results of this study have significant inclusion that supports encouraging the enforcement of the principles of governance and controlling the behavior of these committees, the reliability of statements, financial information, and reports issued by companies can be enhanced. The current study bridges the previous literature gap by providing empirical evidence on the quality and efficiency of audit committees in Jordan as an emerging economy and its impact on financial performance.

***Keywords*: Corporate Governance, Audit Committee, Financial Performance, Earnings Quality.**

I. INTRODUCTION

The basis of this research it seeks to achieve is to study the effect of governance and its mechanisms in Jordanian companies on financial performance. The motivation behind this research comes from the global concern for the quality of corporate governance and mechanisms (Abbadi, Hijazi, & Al-Rahahleh, 2016; Pucheta-Martínez & De Fuentes, 2007). The bankruptcy and corruption that suffered many companies in the world have affected the economy in general, which led to huge losses in the whole world and resulted in a global financial crisis (Shahwan, 2015). This made the parties concerned to issue administrative and supervisory instructions and increase interest in governance in order to help protect companies from this fraud and collapse (Barr-Pulliam, 2017; Pucheta-Martínez & De Fuentes, 2007; Alsufy, 2019). Moreover, to enhance transparency in the corporate data and financial statements that are presented to beneficiaries and investors in increasing oversight, by recommendations to get better the financial services provided. And therefore, the quality of reports and all financial information is a description of all financial work carried out by companies that can be used by the competent authorities and decision-makers in the event that they are reliable, clear and accurate and there is no manipulation (Barr-Pulliam, 2017; Devi et al., 2013). According to (Bansal & Sharma, 2016) the audit committees that are established in companies by fully independent boards of directors are part of the main and important governance mechanisms that are relied upon in companies to protect these companies from fraud and corruption and protect shareholders' money and all their rights and preserve the companies' reputation against other companies internally, externally and in front of Investors, it is considered one of the effective supervisory bodies if it operates sincerely and efficiently (Phan, Lai & Tran, 2020; Al-Najjar, 2010). Therefore, interest increased by the competent authorities in the audit committees in recent years after all the crashes that struck the international companies previously (Aanu, Odianonsen & Foyeke, 2014; Zraiq & Fadzil, 2018).

Revised Manuscript Received on June 22, 2020.
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II. LITERATURE REVIEW

These committees aim to maintain companies and protect them from fraud and develop systems, laws, and regulations that maintain corporate profitability and the quality of financial reports. These committees rely on a series of characteristics that must be within these committees in order to obtain a review committee with strong and effective activity, these characteristics are the size, experience, and finance, members' knowledge, degree of independence, and recurring meetings (Ahmed Haji, 2015; Mohammed, 2018). According to (Kwon & Wild, 1994); (Guthrie & Turnbull, 1995) credibility and integrity in the financial statements and reports issued by companies mainly depend on a strong emerging audit committee that works efficiently and effectively. According to the Jordanian Law of Governance of (2007) which includes companies, banks, and private institutions, which stipulates that "an audit committee shall be formed in every company or bank listed on the Amman Financial Market, provided that the members of this committee is not less than three independent non-executives and they have experience and practical skill and are efficient and effective, and this committee must meet to work with no less than four meetings per year". Therefore, and based on (Owens-Jackson, Robinson, & Shelton, 2009) the relationship between the existence of an effective, fully independent, and impartial audit committee in the company was examined, the possibility of fraud and misleading financial statements, and factors affecting the potential for fraud in the financial statements, it has been found that the audit independent does not always necessarily curb fraud in financial statements, they are inversely related (Felo, Krishnamurthy, & Solieri, 2003).

He also found, (Abed, Al-Attar & Suwaidan, 2012; Chaudhry, Roomi & Aftab, 2020) the existence of funding or supervisory expertise for the committee is of non-statistical significance.

So (Ahmed Haji, 2015) discussed the impact of effective and independent committees and the impact of their recommendations on the earnings, found that a relation powerful the audit committee and the earnings, and information in the event that the committee is independent and has the financial experience and they meet periodically. According to (Bromilow & Berlin, 2005) a guide of audit committees, includes an action plan for committee meetings, so that these meetings are at least (4) meetings during the year (Farouk & Hassan, 2014; Ziaee, 2014). Therefore, we assume that:

H1: Audit Committees size will be positively correlated for financial performance.

H2: Audit Committees independence will be positively correlated for financial performance.

H3: Audit Committees expertise is a positive relationship with financial performance.

H4: Audit Committees meetings are a positive link with financial performance.

On the other hand, (Kalbers & Fogarty, 1993; Rittenberg & Nair, 1993) it stipulated that the effective audit committee would fulfill its responsibilities. Based on the, (Bhasin, 2012; Olaoye, Olaoye & Adebayo, 2019; Nelson & Shukeri, 2011; Spira, 2007) the audit committee is considered one of the main and important committees that oversees the financial statements and reports of the company. However, (Klein, 2002) stated that an independent audit committee might protect the benefit of shareholders. Also, the audit committee can is protected companies from tampering with earnings (Bédard, Chtourou, & Courteau, 2004).

III. AGENCY THEORY

This Agency theory explaining the conflict between management and stakeholders, this theory states that this type of ownership can improve the role of management oversight in a company (Alsufy, 2019; Bouaine & Hrichi, 2019; Phan, Lai & Tran, 2020). Based on agency theory, agency problems arise when there are high conflicts and differences between the interests of both owners and managers. There must be great attention to the benefit of the shareholders, and that the goals of the company should be the well-being of the shareholders (Eisenhardt, 1989). A large body of literature examines earnings management using the agency's theoretical framework, where administrations are assumed to exhibit opportunistic behavior (Ghazali, Shafie, & Sanusi, 2015). As such, based on previous studies and the current study, it is supposed to be corporate governance mechanisms deterrent and maintains a wealth of shareholders (Abbadi et al., 2016; Abed, Al-Attar, & Suwaidan, 2012).

IV. METHODOLOGY

A. Study sample

The sample for this study is from the industrial and service companies listed in the Jordanian markets (ASE) for the period from 2010 to 2015, and the financial and banking sector was excluded due to the existence of a law related to it and the failure to publish all information, and some companies that contain incomplete information. Total companies listed in the Jordan 130 companies in 2015. The final sample for examination and analysis became 115 companies and 690 observations.

B. Variables Measurement

Table- I: Measurement

C. Regression Model

Dependent Variables		
Audit Committee Size	AC-SIZE	Members of the audit committee is three or more
Audit Committee Independence	AC-INDEP	Members non-executive
Audit Committee Expertise	AC-EXP	Experience in finance and accounting work
Audit Committee Meeting	AC-MEET	Four meetings per year or more
Independent Variable		
Financial Performance	Return on Assets (ROA)	Net income by total assets
	Return on Equity (ROE)	Net income by total equity

This study seeks to know the effect of audit committees on the performance of listed companies in Jordan, and multiple regression techniques are an appropriate tool for data analysis.

$$1\text{- } FP\,(ROA)_{it} = \beta_0 + \beta_1 ACSI_{it} + \beta_2 ACIN_{it} + \beta_3 ACEX_{it} + \beta_4 ACME_{it} + \varepsilon_{it}$$

$$2\text{- } FP\,(ROE)_{it} = \beta_0 + \beta_1 ACSI_{it} + \beta_2 ACIN_{it} + \beta_3 ACEX_{it} + \beta_4 ACME_{it} + \varepsilon_{it}$$

Where:

FP_{it} Is the Financial Performance, $ACSI_{it}$ is the Audit Committee Size, $ACIN_{it}$ is the Audit Committee Independence, $ACEX_{it}$ is the Audit Committee Expertise, $ACME_{it}$ is the Audit Committee Meetings, β_0 constant value, $\beta_1, \beta_2, \beta_3, \beta_4$ the slopes, ε_{it} is the error term, t the time series, and i the cross-sectional.

V. ANALYSIS AND DISCUSSION

In Table (2), results provide descriptive statistics of the variables used in this study and analysis of the relationship of the audit committee and the financial performance of 115 companies listed in Jordan during the period (2010-2015).

The average is the most commonly used standard of a central trend. Both mean and standard deviation are basic descriptive statistics for time scale and percentage scale.

As shown in Table 2 below, the return on equity has been the highest average (M = 7.620, SD = 1.251); while the return on assets record (M = -0.054, SD = 2.564). While both independent variables were recorded mean (AC.SIZE); (AC.IND); (AC.EXP); (AC.MEET); (0.185, 0.063, 0.354, 0.249) respectively. Also shows as Standard Deviation, Skewness, and Kurtosis.

The results in Table 5, the associated for AC and ROA are as follows: H1 predicted that AC-SIZE is positively related to financial performance (ROA).

Table- II: Descriptive Statistic

	ROA	ROE	AC.SIZE	AC.IND	AC.EXP	AC.MEET
Mean	-0.054	7.620	0.185	0.063	0.354	0.249
Median	0.046	9.354	0.125	0.055	0.245	0.131
Max	8.254	9.365	0.956	0.756	0.875	0.559
Min	-1.879	4.256	0.144	0.045	0.012	0.055
Std. Dev	2.564	1.251	0.257	0.352	0.361	0.085
Skewness	1.879	-0.295	1.755	0.735	0.390	3.645
Kurtosis	4.547	1.875	6.326	2.362	2.341	8.148
Observ	690 / 115 Companies					

Note: AC SIZE= Audit Committee Size; AC IND= Audit Committee Independence; AC EXP= Audit Committee Expertise; AC MEET= Audit Committee Meeting; ROA= Return on Asset; ROE= Return on Equity

Table- III: Correlation Coefficients

Variables	ROA	ROE	AC.SIZE	AC.IND	AC.EXP	AC.MEET
Return on Asset	1					
Return on Equity	.331	1				
AC Size	.358	.278	1			
AC Independence	.339	.278	.445	1		
AC Meeting	.251	.225	.313	.234	1	
AC Financial Expertise	.290	.215	.363	.323	.211	1

As shown in Table 3, the correlations between all variables less than values of .90 or more, which suggests not highly correlated, that is not causing any issue. A result in Table 4, following the examination of the correlation matrix, Variance Inflated Factor (VIF) and tolerance value to detect multicollinearity problems. If the VIF more than 10 and tolerance less than 0.20 mean that multicollinearity is a concern. Based on the result shown in Table 4 multicollinearity is not an issue, because VIF less than 10, tolerance more than 0.20.

Table- IV: VIF and Tolerance

Variables	N	VIF	Tolerance
AC Size	115	1.512	0.661
AC Independence	115	1.420	0.704
AC Meeting	115	1.135	0.881
AC Expertise	115	1.221	0.819

Also, the result indicated that AC-SIZE had significant relationship with return on asset (t = 5.321; p = 0.015), does support the H1.Similarly, H2 predicted that AC-IND is positively related to financial performance (ROA). Also in Table 5, insignificant positive relation for AC-IND and return on asset (t = 0.845; p = 0.251) indicating not support H2. Also, Result indicated that H3 and H4, AC-EXP, AC-MEET is positively related to financial performance (ROA), (t = 2.700; p = 0.010), (t = 3.340; p = 0.031) respectively. The results of the relationship of audit committees characteristic and return on equity (ROE) as shown in Table 6 are as follows: Results indicated that H1 AC-SIZE had a significant related for return on equity (t = -4.312; p = 0.012).

Similarly, H2 AC-IND is relation positive by financial performance (ROE), (t = 0.564; p = 0.025). Also, Result indicated that H3 AC-EXP is positively related to financial performance (ROE), (t = 2.526; p = 0.013), and H4 AC-MEET is relation positive by financial performance (ROE) but insignificant, (t = 3.235; p = 0.231).

committees are highly efficient and effective and are bound by the terms of governance, the performance of companies (ROA and ROE) is of high quality.

	Table- V: Model 1 (ROA as DV)				
Hyp	Variables	S-Error	T-value	P-Value	Decision
H1	Audit Committee Size	0.062	5.321	0.015	Sig Positive
H2	Audit Committee Independent	0.036	0.845	0.251	In Sig Positive
H3	Audit Committee Expert	0.052	2.700	0.010	Sig Positive
H4	Audit Committee Meetings	0.042	2.340	0.031	Sig Positive
Number of Observation		690			
Number of group		115			
F-statistic		4.310			
R2		0.526			
DW		1.370			

	Table- IV: Model 2 (ROE as DV)				
Hyp	Variables	S-Error	T-value	P-Value	Decision
H1	Audit Committee Size	0.022	-4.312	0.012	Sig Negative
H2	Audit Committee Independent	0.060	0.564	0.025	Sig Positive
H3	Audit Committee Expert	0.033	2.526	0.013	Sig Positive
H4	Audit Committee Meetings	0.071	3.235	0.231	In Sig Positive
Number of Observation		690			
Number of group		115			
F-statistic		5.510			
R2		0.681			
DW		1.420			

Also, based in Tables 5 and 6, there is no autocorrelation issue through the DW value is (1.370); (1.420) respectively. Here it can be seen that R-squared is (0.526); (0.681), and F-statistic is (4.310); (5.510).

VI. CONCLUSION

Corporate governance mechanisms have received great attention from shareholders, investors and monitors, especially after the scandals and collapses that many companies in the world have experienced in the past few years. Therefore, this study took into consideration the relations for (audit committee and financial performance) for Jordanian companies, with a sample of 115 companies from 2010 to 2015. Based on the previous discussion, statistical analyzes, and the results of this study, it can be seen that the size of the audit committee and financial experience and meetings it significantly affects ROA. But the independence of the committee, the insignificant effect on the ROA. Also, in the current study, the result of size is a significant negative impact on the ROE. As for the committee's meetings, there is no significant effect on the ROE. In general, and based on this study, the audit committee has an important effect on the financial performance of companies, as whenever these

Thus, it contributes to bridging the literature gap and this study can be used to make administrative and financial decisions for investors and shareholders. Finally, future research can analyze the correlation between audit committee in mitigating fraud, corruption, and earnings management

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