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# AUDIT COMMITTEE ATTRIBUTES AND VOLUNTARY ETHICS DISCLOSURE IN MALAYSIAN PUBLIC LISTED COMPANIES

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### *Abstract*

In corporate world, ethics is important principles as to avoid misconduct within organisation. There are many issues related to ethics in the organisation such as the level of disclosure in following the ethical code of conduct. Audit committee should play an important role in encouraging companies to practice a good voluntary ethics disclosure. This study examine the influence of audit committee attributes towards voluntary ethics disclosure in Malaysian Public Listed Companies. Particularly, focus on audit committee's size, time commitment, competency, independence, experience and frequency of audit committee meeting. The voluntary ethics disclosure is measured using a specific index adapted from previous study. Data were obtained from the annual reports of 260 companies for the year 2017. The study reveals that audit committee's competency found to have a significant positive relationship with voluntary ethics disclosure. This indicates that higher proportion of competent audit committee members tend to increase the voluntary ethics disclosure. However, the experience of audit committee members has a significant negative relationship with voluntary ethics disclosure. This indicates that the more experience gained through duration served by the audit committee, the lower the voluntary ethics disclosure.

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**Keywords:** Audit committee, voluntary disclosure, ethics disclosure, public listed companies, annual report.

## **1. Introduction**

Ethics refer to the behavior and deeds that can differentiate between good behaviour and bad behaviour (David & Resnik, 2013). It consists of morally behavior, legally behavior, right conduct, bad conduct and either good values or bad values (Duska, 2007). In corporate world, ethics act as principle that helps people in the company to follow the code of conducts set by the company. It is important to have ethics designated by the regulations to avoid any misconduct within the company (Othman et al., 2014). Meanwhile, Ethics disclosure is considered as a voluntary disclosure set by some companies to strengthen up their corporate governance (Sullivan & Shkolnikov, 2006). It is crucial for the company to practice a good voluntary disclosure by disclosing reliable and relevant information to the users. Thus, in achieving this goal, audit committee must play an important role in encouraging companies to practice a good ethics. The audit committee is an operating committee that responsible in monitoring the financial reporting and disclosure of the company (ING Groep, 2016). As stated in the Malaysian Code of Corporate Governance (MCCG), that every company should apply the ethical practices in conducting the business activities. Thus, by having right audit committee attributes are crucial as it influences the audit committee in carrying out their monitoring roles rather than just maintaining their presence. Therefore, this study is conducted to determine the influence of audit committee attributes towards the voluntary ethics disclosure.

## **2. Problem Statement**

Ethics is the mechanism that helps the company to avoid any misconduct in the company such as fraud cases. Fraud is an action to gain something using unethical behaviour. In previous scandals, giant company such as Enron has collapsed due to the unethical behaviour of their management. These frauds constitute a major reason for the lack of stakeholders trust on corporation (Sweiti & Attayah, 2013). Fraud incidents and any other unethical conducts could be due to the lack of internal controls and inefficient monitoring role of audit committee members. As stated by American Institute of Certified Public Accountants (2005), the audit committee should make sure their internal control might overcome any appropriate risk area to avoid from risk to happen. This is important as the good corporate governance may attract the investors to invest in the company (Hussain, 2012). However, the responsibility might not properly performed by some audit committees. It will become obstacles to the company if the audit committees are not well selected. The work performed may not be competent and it might affect the company's decision making. Hence, the audit committee attributes are important to determine on how the audit committee will carry out the governance duties and responsibilities, specifically on ethics disclosure.

## **3. Research Questions**

Research question to be solved in this study:

Is there any significant relationship between the audit committee attributes, specifically the audit committee size, commitment, competency, independence, experience and frequency of meetings towards the voluntary ethics disclosure?

## **4. Purpose of the Study**

The main objective of this study is to determine the relationship between audit committee attributes and the voluntary ethics disclosure. In particular, it focus on audit committee size, commitment, competency, independence, experience and frequency of audit committee meetings as the audit committee attributes.

### **4.1. Agency Theory**

Agency theory is used in this study to explain the relationship between audit committee attributes and the voluntary ethics disclosure. According to Jensen and Meckling (1976), agency theory identifies the agency relationship between principal and agent. Shareholder as the principal is responsible in providing capital to the company whereas, the management act as agent are responsible in maximizing shareholders' wealth. The separation of ownership from control implies that the principal (shareholder) cannot exercise full control over managerial action. Therefore, the management is required to control agency costs resulting from the separation of ownership and control (Fama & Jensen, 1983). The shareholder and audit committee engage to one another through a contract, which the management will provide services to the shareholders. Meanwhile, the audit committee on the other hand is responsible to provide services of monitoring on the corporate governance of the company. This is to ensure the shareholder is receiving reliable information in providing good decision-making (ICAEW, 2005). Wong (2012), stated that the management is expected to achieve every business through professional and ethical practices together with the competent of their employees. Thus, the agency theory is seems to be relevant to explain the audit committee as monitoring mechanism in reducing the agency cost.

### **4.2. Audit committee attributes and voluntary ethics disclosure**

Akhtaruddin and Haron (2010) indicates that audit committee is considered a means of monitoring and improving corporate disclosure processes which includes the voluntary disclosure. Consistent with agency theory, the role of audit committee to protect the interest of shareholders will leads to the influence of the voluntary ethics disclosures. Audit committee will help to monitor the activities of managers to ensure that the managers act in the best interest of shareholders. Thus, the agency cost can be reduced. Tjager et al. (2003) stated that the audit committee plays an important role in monitoring corporate governance of the company. Therefore, the individuals elected as an audit committee members need to meet specific criteria. The role of the audit committee as a key corporate governance system is a considerable interest in recent years. Kalbers and Fogarty (1993), stated that qualification of individuals selected as audit committee members plays an important role in the success of audit committee in performing its duty in supervising the information disclosed by the management.

According to Baxter and Cotter (2009), the larger the size of audit committee, the more they can share their different expertise and skills in improving firm's performance. Setiany et al. (2017) in his empirical evidence found that there is a positive relationship between audit committee size and voluntary financial disclosure, which indicates that the higher the audit committee size, the higher will be the voluntary financial disclosure of the company. While according to Persons (2009), a smaller board of

directors is less favourable to an ethics code adoption. Hackman (1990) argued that the massive size of an audit committee might result in poor communication and decision-making process as there would be arguments or debates among the committee members. However, other study by Lin et al. (2008), stated that small or large number of audit committee is not necessary to determine whether the audit committee will affect the ethics disclosure of the company. Thus, our first hypothesis is formulated as follows:

H<sub>1</sub>: There is a significant relationship between audit committee size and voluntary ethics disclosure.

Setiany et al. (2017) stated that time commitment of audit committee can be measured by the number of current positions held by the committee member within or outside organization. If the audit committee holds more than two or three positions within or outside organization, it can be categorized as not committed. This is consistent with Persons (2009) and Othman et al. (2014) who found that there is a negative relationship between audit committee commitment and voluntary ethics disclosure. It indicates that the more positions held by the audit committee, the more adverse impacts towards the effectiveness and efficiency of audit committee roles. As the time commitment of audit committee is higher, the effectiveness of audit committee responsibility towards the company will become lower (Morck et al., 1988). Other than that, study by Pamudji and Trihartati (2010) stated that the effectiveness of audit committee members might not influence the company's voluntary financial disclosure as the time commitment of audit committee members are not an important factor. Thus, our second hypothesis is formulated as follows:

H<sub>2</sub>: There is a significant relationship between audit committee commitment and voluntary ethics disclosure.

According to Aldamen et al. (2012), competent audit committee with financial expertise is crucial in overseeing the financial reporting process of the companies. This might be true as the competency of audit committee may encourage to reduce the probability of financial fraud (Owens-Jackson et al., 2009). Furthermore, for efficient monitoring role of audit committee, at least one of the audit committee should have an education background in accounting or finance, and the other members should be able to read and understand the financial statements (Othman et al., 2014). Besides, Xie et al. (2003), stated that the audit committee members with financial expertise will lead to small discretionary accruals. However, in contrast, study by Hussain (2012), found that the accounting expert's role is not considerably related in management practice. Thus, our third hypothesis is formulated as follows:

H<sub>3</sub>: There is significant relationship between competencies of audit committee and voluntary ethics disclosure.

Independence of audit committee is a situation where the audit committees are free from influence by inside or outside party of the company who have interest towards the organizations. The audit committee members with a high level of independence may encourage themselves to be more transparent in making disclosure. Persons (2005) states that the audit committee independence might influence the effectiveness of financial reporting process as it may reduce the fraud incident. This is consistent with Abbott and Parker (2000), who found that there is a negative relationship between audit committee independence and financial misstatement. It shows that the more independent the audit committee the lower will be the financial fraud. Furthermore, related with reporting disclosure, Barako et al. (2006) documented that there is a negative relationship between the presence of outside directors on the board and disclosure quality. However, study

by Bronson et al. (2006) found that there is no significant relationship between the audit committee independence and the audit committee effectiveness. Thus, our fourth hypothesis is formulated as follows:

H<sub>4</sub>: There is a significant relationship of audit committee independence and voluntary ethics disclosure.

Yew (2013) stated that the average number of the audit committee experience could be measured by how long they are in the organisation over the incorporated life of the company. According to McDaniel et al. (2002), to be one of the audit committee members, having a long duration in the company is another crucial attribute as it promotes and encourage the committee in enhancing the quality of financial reporting process. Other than that, experience in accounting and finance are viewed as the more significant elements of an effective audit committee (Kalbers & Fogarty, 1993). This is to ensure that there is quality, reliability and credibility in the oversight function of the audit committee (Agoglia et al., 2011). Other than that, Huang and Hilary (2017) stated that higher board tenure give negative impact towards the firm performance. It also supported by Fracassi and Tate (2012), stated that the board committee who have higher working tenure with the company could decrease the firm value. Thus, our fifth hypothesis is formulated as follows:

H<sub>5</sub>: There is a significant relationship between audit committee experience and voluntary ethics disclosure.

The frequency of audit committee meeting can be measured by the number of audit committee meetings in a year. When the frequency of meeting is high, there will be more signals of information provided by the audit committee (Eng & Mak, 2003). Empirical evidence by Raghunandan et al. (2001) explained that an audit committee will be able to carry out their duties on the current accounting and auditing issues when they are frequently met. It helps them to be well-informed, more motivated and well-educated. According to Persons (2009), the more frequent audit committee meeting, the more effective an organization will be as they were well-monitored and volunteer in providing ethics disclosure. In addition, Xie et al. (2003) also stated that the frequency of meetings and discretionary accruals shown a negative relationship. Besides, Greco (2011) and, Karamanou and Vafeas (2005) argued that, with the more frequent meeting, the audit committee would provide an ethical codes judgment and successfully achieve its monitoring role. Thus, the following hypothesis is formulated:

H<sub>6</sub>: There is a significant relationship between the frequency of audit committee meeting and voluntary ethics disclosure.

## **5. Research Methods**

### **5.1. Sample and data collection**

The sample of the study is obtained from the public listed companies of Bursa Malaysia for the year 2017. A total of 260 Malaysian public listed companies were randomly selected using the random number generator of MS Excel to ensure a representative from all industrial sectors. Data on voluntary ethics disclosure is extracted using the content analysis method from the annual report of 2017. The annual report is selected as medium of reporting as it would be the most likely to be viewed by the stakeholders and interested party on ethics disclosures.

## 5.2. Measurement of independent variables

**Table 01.** Measurement of Independent Variables

No	Independent variables	Measurement
1	Audit Committee Size	Total number of audit committee members
2	Audit Committee Commitment	The proportion audit committee members who concurrently hold equal or more than 3 positions total of audit committee members
3	Audit Committee Competency	The proportion of audit committee with professional accounting qualification.
4	Audit Committee Independence	Proportion of independent audit committees of total audit committee
5	Audit Committee Experience	The average year of tenure as audit committee member
6	Audit Committee Meeting	Number of audit committee meetings in a year

## 5.3. Measurement of Voluntary Ethics Disclosure

Based on Table 01, voluntary ethics disclosure is assessed and adopted based on ethics disclosure index developed by Persons (2009) and Salin and Ismail (2015). There are a total of 18 aspect of ethics disclosures adopted from Persons (2009) and another 8 aspects from Salin and Ismail (2015). Thus, this study has combined 26 voluntary ethics disclosure items based of Persons (2009) and Salin and Ismail (2015). Dichotomous method is used for each disclosure item, which is '1' will be given if the company disclosed such information and "0" for non-disclosure. Accordingly, the maximum score will be 26 if all the 26 items are complied.

## 5.4. Data analysis

Linear multiple regression analysis is conducted to test the relationship between the independent variables and the voluntary ethics disclosure. The assumptions underlying regression model are tested for multicollinearity based on the correlation matrix. Multicollinearity problem exist when the coefficient correlation between two variables is greater than 0.8 (Field, 2013). Normality tests based on Kolmogrov-Smirnov (K-S) test is also conducted with significance level of less than 0.05 indicates that the distribution of the data is not normal (De Vaus, 2002). The empirical models used to test the hypotheses are as follows:

$$VED = \beta_0 + \beta_1 ACSize + \beta_2 ACCom + \beta_3 ACComp + \beta_4 ACInd + \beta_5 ACExp + \beta_6 ACMMeet + e$$

Where,

VED	=	Voluntary Ethics Disclosure
ACSize	=	Audit Committee Size
ACComm	=	Audit Committee Commitment
ACComp	=	Audit Committee Competency
ACInd	=	Audit Committee Independence
ACExp	=	Audit Committee Experience
ACMeet	=	Audit Committee Meetings
e	=	Error term

## 6. Findings

### 6.1. Descriptive Analysis

**Table 02.** Descriptive statistics for dependent and independent variables

Variables	Min	Max	Mean	Std. Deviation	K-S Test
VED	9.000	26.000	19.581	3.817	0.001
ACSize	2.000	6.000	3.346	0.599	0.000
ACComm	0.000	1.000	0.850	0.234	0.000
ACComp	0.200	1.000	0.455	0.187	0.000
ACInd	0.500	1.000	0.893	0.145	0.000
ACExp	0.000	27.000	7.369	4.511	0.000
ACMeet	2.000	21.000	5.231	1.736	0.000

From the descriptive analysis in Table 02, it shows that majority of the companies have at least three members of audit committee with mean score of 3.346. This is complying with Bursa Malaysia Listing Requirement that requires the size of audit committee should not less than three members. Similarly, for audit committee competency, with minimum score of 0.2, it shows all companies in the sample complied with the listing requirement to have at least one audit committee with accounting professional qualification. Furthermore, as for the voluntary ethics disclosure, with the mean score of 19.581, it shows that, on average the sample companies have disclosed at least 19 items out of 26 items of the ethics disclosure index.

As for the normality test, it shows that all variables are not normally distributed based on Kolmogorov-Smirnov (K-S) test shown in Table 02. Variables that are not normally distributed are transformed to normal scores (Young, 1998) before conducting regression analysis since one of the requirements of linear is for the data to be normally distributed (Field, 2013). The advantage of using normal scores is that the result from the test would have exact statistical properties as the significance level can be determined. Besides, both F and t-test, and the regression coefficients from the transformation are more meaningful for interpretation.

### 6.2. Correlation Analysis

Table 03 represent the statistical result of correlation coefficient analysis between independent variables. From the result, it shows that none of the coefficients exceed 0.8 coefficient. Thus, it is confirmed that there is no existence of strong multicollinearity among the variables.

**Table 03.** Correlation Analysis

Variables	ACSize	ACComm	ACComp	ACInd	ACExp	ACMeet
ACSize	1	-0.105	-0.105	-0.197	-0.142	0.138
ACComm		1	0.132	0.257	0.016	-0.037
ACComp			1	0.009	-0.065	-0.065
ACInd				1	-0.096	0.016
ACExp					1	-0.132
ACMeet						1

### **6.1. Multiple Regression Analysis**

Result of multiple regression on the relationship between audit committee attributes and the voluntary ethics disclosure is presented in Table 04. The estimated regression indicates that the audit committee competency and voluntary ethics disclosure is statistically significant as the p-value is less than 0.05. Thus, H<sub>3</sub> is accepted. It shows that competent audit committee might influence the voluntary ethics disclosure. This is consistent with Krishnan and Lee (2009), stated that, it is important for audit committee to have an accounting background in order to perform their duties comprehensively and maximise the ability to detect fraud As stated by Owens-Jackson et al. (2009), the competency of audit committee will reduce the probability to gain financial fraud. Therefore, it is proven that competent audit committee members may promote voluntary ethics disclosure.

Furthermore, the results also show that audit committee experience has significant negative influence towards voluntary ethics disclosure. Thus, H<sub>5</sub> is supported which indicates that the higher the year of tenure of audit committee, the lower would be the voluntary ethics disclosure. This is in line with Huang and Hilary (2017), stated that higher board tenure gives negative impact towards the firm performance. It also supported by Fracassi and Tate (2012), that the board committee who have higher working tenure with the company might decrease the firm value. It may affect the voluntary ethics disclosure as the audit committee may take for granted due to the opportunities they possessed. For instant, the familiarity with company's business and the management because of their longer duration served for the company.

However, no such relationship observed for audit committee size, audit committee commitment, audit committee independence and audit committee meetings. Thus, H<sub>1</sub>, H<sub>2</sub>, H<sub>4</sub> and H<sub>6</sub> are not supported. This indicates that audit committee size does not have significant influence towards voluntary ethics disclosure. The result for audit committee size is consistent with Lin, Xiao and Tang (2008), which stated that small or large number of audit committee is not necessary to determine whether the audit committee will affect the ethics disclosure of the company. In addition, the result also evidence that the audit committee commitment does not have significant relationship with voluntary ethics disclosure. The result indicates that multiple positions of audit committee will not affect the voluntary ethics disclosure. This is consistent with is with Setiany et al. (2017) that found no significant relationship between the audit committee commitment and voluntary financial disclosure.

Similarly, the relationship between audit committee independence and voluntary ethics disclosure is found to be insignificant. It shows that even the audit committee is independent and efficient; it will not lead to voluntary ethics disclosure. According to Linck et al. (2009) independent directors perform little role in monitoring because of lack of real independence, time and enough information and presence of them have no significant impact on management decision. The case might be the same for the independent audit committee as they may not fully independent and may be close friends for non independent audit committee, directors or people in the board. Lastly, the finding for audit committee frequency of meetings is consistent with Rahman and Ali (2006) and Saleh et al. (2007) that found no evidence of relationship between the frequency of audit committee meetings and the decreasing number of discretionary accruals. It shows that frequency of meetings will not ensure to reduce unethical practice or encourage ethical disclosures.



**Table 04.** Multiple Regression Result

Variables	Coefficients	t-statistics	Sig. t
Constant		-0.074	0.941
ACSize	0.018	0.274	0.784
ACComm	0.083	1.319	0.188
ACComp	0.127	2.010	0.045
ACInd	-0.029	-0.454	0.650
ACExp	-0.176	-2.822	0.005
ACMeet	0.099	1.612	0.108

$R^2 = 0.065$ ., F-statistic = 2.950, p = 0.08

## 7. Conclusion

This study attempts to investigate the relationship between audit committee attributes and voluntary ethics disclosure. The voluntary ethics disclosure is measured using a specific index adapted from previous study based on Persons (2009) and Salin and Ismail (2015). Data were obtained from the annual reports of 260 companies for the year 2017. The finding indicates that audit committee's competency has significant influence towards voluntary ethics disclosure. It indicates that higher proportion of competent audit committee members tend to increase the voluntary ethics disclosure. In addition, we also found that the experience of audit committee members has significant negative relationship with voluntary ethics disclosure. The results show that the more experience gained through duration served by the audit committee, the lower the voluntary ethics disclosure. However, there is no significant relationship is observed between audit committee size, audit committee commitment, independence of audit committee and frequency of audit committee meetings towards voluntary ethics disclosure.

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