CORPORATE REPORTING QUALITY, AUDIT COMMITTEE AND QUALITY OF AUDIT[1]

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Abstract

The study investigates the effectiveness of audit committee in terms of the quality of reporting. Specifically, the study examines the relationship between quality of reporting of companies listed on the Bursa Malaysia and some elements of corporate governance namely the external audit and the audit committee. Characteristics of audit committee being examined include financial literacy, multiple directorships, independence of audit committee, and activeness of the committee. Good quality corporate reporting provides credible information of company performance to users for economic decisions. The quality of corporate reporting is determined based on the selection criteria for the National Annual Corporate Report Award 2002. The sample consists of fifty-four companies with good annual reports and fifty-four companies with poor annual reports. Using logistic regression, results show that only multiple directorships of audit committee members is significantly related to quality of reporting

Keywords: *audit committee, corporate reporting, independence, financial literacy and multiple directorships.*

Introduction

Companies incorporated in Malaysia under the Companies Act 1965 are required to furnish their shareholders with a formal public document that is called the corporate annual report (CAR). Companies use corporate reporting to disseminate information about their past and future activities as well as outcome of those activities (Crowther, 2000). Such a document represents a measure of accountability on the part of the board of directors for the information contained, therein, details of the prospects and accomplishments of the board over the reporting period (Abdul Rahman, 1999). In total, the content of annual reports should be of a quality that is useful to users of the reports and meets the information needs of those users. The content and presentation of such information are important because they affect the credibility of the report and in turn, influence the confidence of investors and other stakeholders in the company (Chow and Wong-Boren, 1987; and Jensen and Meckling, 1976). The quality of information in an annual report takes on a more vital dimension for Malaysian companies listed on the Bursa Malaysia when users are no longer confined to the domestic group but are expected to be drawn from the international community.

In cognizance of the need to produce quality CARs, the Bursa Malaysia, together with the Malaysian Institute of Management (MIM), the Malaysian Institute of Certified Public Accountants (MICPA), and the Malaysian Institute of Accountants (MIA) initiated the National Annual Corporate Report Award (NACRA) in 1990 (Lam, 1999). The award has set a competitive standard in order to promote greater and more effective communications by organizations through publication of timely, informative, factual and reader-friendly annual reports by companies incorporated in Malaysia (Lee, 1994). For the 2002 award, for instance, only 78 out of the 848 companies listed on the Bursa Malaysia (i.e. 9%) met the NACRA standards at the preliminary screening although the award has been given for more than 10 years (Khor, 2002).

Two corporate governance mechanisms, audit committees and external audit, have been the vanguard of corporate reporting. This is formally acknowledged in the Code of Corporate Governance (The Code) adopted for all listed companies in Malaysia effective from January 2002 (FCCG, 2001). Since an audit committee assists boards of directors in complying with various reporting rules and regulations, the presence of an independent and qualified audit committee will promote the dissemination of high quality information (Song and Windram, 2000). In Malaysia, Ruzaidah and Takiah (2004) have shown that the quality of CARs is significantly related to certain characteristics of audit committee including financial literacy, frequency of meeting and multiple directorships of committee members. Ruzaidah and Takiah (2004), however, do not examine the extent the external audit, being an external mechanism of corporate governance, has contributed to promoting the quality of CARs. Although Lily and Takiah (2003) have shown that the quality of reporting of listed companies in Malaysia is related to the size of audit firms, results are in the opposite direction. This unexpected result could be due to the problem of imbalanced number of sample of Big5 and non-Big5 clients. This study, therefore, addresses the issue of whether companies selected for the NACRA award have better monitoring mechanisms compared to those not selected for the award. This study attempts to extend the Ruzaidah and Takiah (2004) study in three ways. Firstly, this study includes independence of audit committee which is found to be an important characteristic that is positively related to high quality information (Song and Windram, 2000; Blue Ribbon Committee, 1999; Cadbury Committee, 1992; and Treadway Commission, 1987). This variable has not been addressed in the Ruzaidah and Takiah (2004) study in evaluating the effectiveness of audit committees. Secondly, this study attempts to examine the monitoring role of external auditors in enhancing the quality of corporate reporting. Thirdly, this study also examines the interaction between audit committee independence and audit quality in relation to quality of corporate reporting.

The remainder of the paper is structured as follows. The next section surveys the literature on quality of annual reports in order to formulate the hypotheses of the study. This is followed by the research method used then the results are reported and discussed in the fifth section. In the final section some conclusions are drawn taking into consideration the limitations of the study and further research opportunities.

Literature Review and Hypotheses Development

Corporate Annual Reports (CARs)

Judd and Timms (1991) view CARs as communication tools which provide links between the management of corporations and its various stakeholders including customers, shareholders, employees, suppliers, media and the government. Although the annual report is primarily addressed to the shareholders, its reach is beyond the members only. Hence, it is essential that the quality of CARs be maintained in order to ensure some measure of credibility on the information contained therein. Bartlett and Jones (1997) observe that over the period from 1970 to 1990, total mandatory contents of CARs have increased rapidly as a result of changing demands from several regulatory bodies. In Malaysia, the quality of the information in an annual report takes on a more important dimension in view of the implementation of the Code of Corporate Governance effective 1 January 2002, which amongst other things, require directors to disclose how the company complies with, what the Code identifies, as "best practices" of corporate governance and to explain for any non-compliance.

Many perspectives have been used in researching CARs (Stanton and Stanton, 2002). The accountability perspective views corporations as reacting to concerns of external parties (Keasey and Wright, 1993). Accountability involves monitoring, evaluation and control of organizational agents (in this case, the management) to ensure they behave in the interests of both shareholders and that of other stakeholders (Keasey and Wright, 1993). Studies of modern day capital market which examine the relationship between corporate information and share prices conclude that regulated reports provide new and relevant information to investors (Kothari, 2001).

Audit Committee

Audit committee is a committee of the board with at least one non-officer member of the board of directors to appoint/select the auditor, arrange the details of the audit and oversee the financial reporting process (Crawford, 1987). Hence, it is an important element of the monitoring mechanism of company management. Prior literature on the effectiveness of audit committee associated the existence of audit committee with the quality of corporate financial reporting (e.g. Beasley, 1996; McMullen and Raghunandan, 1996; McMullen, 1996; Song and Windram, 2000). However, the results were mixed. For instance, in Beasley (1996), McMullen and Raghunandan (1996), McMullen (1996), and Song and Windram (2000) studies, the existence of audit committee reduces reporting problems. In Menon and Williams (1994), however, the existence of audit committee has no significant relationship with the reporting problem. Menon and Williams (1994) suggest that the existence of audit committee is more for cosmetic reason and does not provide an assurance for unbiased and effective management. In Malaysia, very few studies have examined the effectiveness of the committee although an audit committee has been made compulsory for all listed companies since 1994. The effectiveness of audit committee has been examined based on the perception of internal auditors (Shamsul and Al Murisi, 1997).

In more recent studies, Norman, Mohid and Takiah (2006) assess the effectiveness of some audit committee characteristics to monitor management behavior with respect to their incentives to manage earnings. The study finds that the presence of a fully independent audit committee reduces earnings management practices. The interaction between the proportion of audit committee members with accounting knowledge and frequency of meeting is significantly related to earnings management practices. Mohid, Norman and Takiah (2004) find that characteristics of audit committee differ significantly between financially distressed and non-distressed companies. The evidence suggests that independence, activeness and financial literacy of audit committee each have positive associations with the financial performance of companies. Results suggest that distressed companies should give more emphasis and attention to these characteristics for better financial performance. In those studies, four audit committee variables are identified to have potential influence on the effectiveness of audit committee. These characteristics include financial literacy of audit committee members, activeness of the committee, number of directorship positions held by members, and independence of the committee. Ruzaidah and Takiah (2004) find that the quality of CARs of Bursa Malaysia listed companies is significantly related to certain characteristics of audit committee, particularly frequency of the committee meeting and financial literacy of the members. In the study, the relationship between CARs and external audit is not addressed. This study extends the Ruzaidah and Takiah (2004) study by introducing the audit quality variable to see the relationship with the quality of CARs and interactions with audit committee independence in enhancing the quality of reporting. It is expected that the audit committee plays an enhanced role in the corporate governance process, in particular, in ensuring that companies produce good CARs. The following sections discuss the hypotheses developed to test the above-mentioned relationships between audit committee characteristics and quality of corporate reporting.

Financial Literacy

The need for a high degree of financial literacy is necessary for an audit committee to effectively oversee a corporation's financial controls and reporting. The role of an audit committee in overseeing accountability of the management covers a wide scope to include the overall process of corporate reporting. This role requires the audit committee to have accounting knowledge in order to acquire an in-depth understanding of corporate reporting and, hence, improve compliance with regulatory requirements. The need to comprehend the overall financial and non-financial contents of corporate reports is greater considering that listed companies are operating as conglomerates with some having complex group structures and therefore, presenting technically advanced financial reporting contents. Knowledge and experience in the areas of accounting, auditing and or finance are found to have reduced fraud in corporate financial reporting (Song and Windram, 2000). A formal recognition of this requirement was recently made in the U.S. with the passing of the Sarbanes-Oxley Act 2002 which requires each public listed company to disclose whether or not it has a financial expert in the audit committee.

The Blue Ribbon Committee[2] (1999) raised the issue of the background and experience of audit committee that can affect their effectiveness. The Committee suggests that audit committee members should be financially literate. In Malaysia, members of audit committees are required to have a sufficient understanding of financial reporting issues (FCCG, 2001). The Listing Requirements of Bursa Malaysia recently suggest that audit committees should have at least one member registered with the local accounting professional body, the Malaysian Institute of Accountants (MIA), or at least three years experience after passing a professional examination and must be a member of one of the specified accounting associations (Shamser and Zulkarnain, 2001). Ruzaidah and Takiah (2004) find that, in Malaysia, public listed companies with financially literate audit committees have a higher ability to produce good annual reports. They argue that audit committee members who have the knowledge in the areas of accounting, auditing, and finance are capable of meeting their responsibilities of monitoring internal control and financial reporting.

The focus of discussions is that financial reporting quality is better when financial experts are part of the committee (McDaniel, Martin and Maines, 2002; and Collier, 1993). The absence of financial experts in the audit committee has led the company to have financial problems (McMullen and Raghunandan, 1996). They found firms with financial problems are unlikely to have audit committee members with financial expertise. The lack of knowledge in financial reporting and internal control among audit committee members are perceived by external auditors as the hindrance for effective interactions between external auditors and audit committees (Kalbers, 1992). Also, the expertise among members of the audit committee is expected to minimize the manipulation of financial reporting by the management or other interested parties in the companies (Ruzaidah and Takiah, 2004). The market reacts positively to the appointment of audit committee with financial expertise. This is because members of the committee equipped with financial experience and training are able to understand earnings management and act accordingly (Xie, Davidson and DaDolt, 2003). Hence, it is expected that the higher the number of audit committee with financial literacy, the better the quality of corporate reporting. We hypothesize that:

H1: Financial literacy of audit committee is positively associated with the quality of corporate reporting

Frequency of Meeting

The effectiveness of audit committee depends on the extent the committee is able to resolve issues and problems faced by the company and to improve their monitoring function of company activities (Abbott, Park and Parker, 2000). A more active audit committee is expected to provide an effective monitoring mechanism. The more frequent the audit committee meets, the more opportunity it has to discuss current issues faced by the company. Evidence shows that companies with less audit committee meetings are often found to have problems of reporting (McMullen and Raghunandan, 1996). There is evidence that inactive audit committee is associated with non-compliance with regulatory requirements and accounting standards (Menon and Williams, 1994). Menon and Williams (1994) find that an audit committee, which holds fewer meetings than the minimum of two per year as suggested by the American Bar Association, is less likely to pursue their duties diligently. Kalbers and Fogarty (1993) reinforce this notion by positing that audit committee effectiveness is a function of audit committee members' desire to carry out their duties.

Since the level of audit committee activity reflects good governance, it should enhance the reliability of financial reporting. The Code of Corporate states that the provision of an institutionalized forum (audit committee) encourages the external auditor to raise potentially troublesome issues at a relatively early stage. As a best practice, audit committee meeting should be conducted at least once a year without the presence of executive board members. However, the total number of meetings depends on the company's terms of reference and the complexity of the company's operations. At least three or four meetings should be planned to coincide with the audit cycle and the timing of published annual reports in addition to other meetings held in response to circumstances that arise during the financial year (FCCG, 2001).

Consistent with this argument, Abbott, Parker and Peters (2004) found a lower likelihood of prior period financial statement restatements (a proxy for low quality reporting) in firms with more active audit committees. A study by Anderson, Mansi and Reeb (2004) indicates that the costs of debt decreases when the frequency of audit committee meeting increases. Xie et al. (2003) find the number of audit meeting is negatively related to discretionary accruals. The finding suggests as the frequency of meeting increases, discretionary accruals (earnings management) decreases.[3] In Malaysia, Ruzaidah and Takiah (2004) also find that the good reporting companies meet more often than the poor reporting companies. The more frequent audit committees meet, the better the quality of financial reporting because they can monitor the management activities more promptly and effectively in the meeting (Ruzaidah and Takiah, 2004). These studies regard the frequency of meeting as a proxy for audit committee activity. Although the number of meetings may not provide any indication about the extent of work accomplished during the meeting, it is noted that audit committee without any meeting or with small number of meetings is less likely to be a good monitor (Menon and Williams, 1994). Hence we hypothesize that:

H2: Frequency of audit committee meeting is positively associated with quality of corporate reporting.

Multiple Directorships

Multiple directorships refers to the number of director positions held by audit committee members. Shivdasani (1993) and Song and Windram (2000) argue that multiple directorships may cause limitations of time and commitment for audit committee members from performing effectively. Audit committee members who hold director posts of too many companies may have limited time fulfilling their responsibilities (Lipton and Lorch, 1992; Core, Holthausen and Larker, 1999).

However, there are studies which show that multiple directorships may enhance the contribution of audit committee members towards discharging their duties effectively. For example, audit committees with multiple directorships demand a more extensive audit to protect their reputation capital (Boo and Sharma, 2008), hence, contributing to better reporting quality. Kiel and Nicholson (2003) find multiple directorship is positively associated market capitalization and performance of Australian listed companies. Multiple directorships enrich audit committee members with experience and knowledge of management of companies of different business background. The experience from managing other companies exposes audit committee members to economic trends and aspects of international business besides providing the opportunity to compare management policies and practices.

In Malaysia, the importance of experience of audit committee members gained through director positions in other companies is evident in the Ruzaidah and Takiah (2004) study. They argue that multiple directorships would enhance audit committee expertise and enable them to monitor the companies to produce high quality reporting. Among Malaysian corporations, multiple directorships of audit committee members is also found to have significant positive relationships with corporate social reporting practices (Haniffa and Cooke, 2005) and corporate performance (Haniffa and Hudaib, 2006). This suggests that audit committee with multiple directorships provides an effective monitoring mechanism.

Given that studies on multiple directorships of audit committee of Malaysian corporations have have shown positive results, this study hypothesizes:

H3: Multiple directorships of audit committee members is positively associated with the quality of corporate reporting

Independence

Independence is an essential factor for an audit committee to ensure that management is to be held accountable to shareholders (Blue Ribbon Committee, 1999; Cadbury Committee, 1992; and Treadway Commission 1987). In order to maintain the independence of audit committee, the Code of Corporate Governance states that the majority of audit committee members must be independent and the chairman should be an independent non-executive director. An independent audit committee enhances the effectiveness of monitoring function. It serves as a reinforcing agent to the independence of internal and external auditors. It is posited that the more independent the audit committee, the higher the degree of oversight and the more likely that members act objectively in evaluating the propriety of the company accounting, internal control and reporting practices. The Blue Ribbon Committee's (1999) recommendation that audit committees consists entirely of non-employee directors assumes that outside independent audit committee members are better monitors of management. Similarly in Malaysia, Section 344A (2) of the Bursa Malaysia Listing Requirement requires audit committee to consist of a minimum of three members, a majority of which must be non-executive directors. In this manner, the monitoring function on behalf of shareholders is enhanced as the independence of the committee increases because it serves as a reinforcing agent to the independence of internal as well as external auditors.

The audit committee independence is significantly related to financial reporting practices in which the occurrence of financial statement frauds is more likely to happen in firms with less audit committee independence (Beasley, Carcello, Hermanson and Lapides, 2000). It is also evident that auditors who give financially distressed firms a going concern report are less likely to be dismissed when such firms have an independent audit committee (Carcello and Neal, 2000). A membership of CEO with a duality role in the audit committee has caused the committee to become less independent (Vicnair, Hickman and Carnes, 1993). This indicates that an independent audit committee is able to help companies sustain the continuity of business although when they are faced with financial difficulties. This is because independent audit committee members are more effective in controlling earnings (Klein, 2002). They are expected to propose certain action plans to mitigate the problem. Hence, the following hypothesis is developed.

H4: Independence of audit committees is positively associated with the quality of corporate reporting

External Audit

As the external audit has been the traditional bastion of assurance of the quality of financial reports contained in CARs, this study will examine the relationship between quality of CARs and external audit as well as audit committee. Traditionally, the external auditor is associated with the provision of an assurance of the reliability of financial statements prepared by the board of directors to shareholders (Mautz and Sharaf, 1961). The information asymmetry between the management and shareholders has resulted in agency problems (Fama, 1980). An external audit is seen to be a controlling mechanism used by the company to address agency problems (Jensen and Meckling, 1976; Watts and Zimmerman, 1983). The external audit helps reduce the gap from the separation of ownership and control of an entity (Fama and Jensen, 1983). Any manipulation of accounting information can be reduced through an audit (Jensen and Meckling, 1976). Within the framework of corporate governance, the external auditors have a considerable influence over the accountability of management and the integrity of financial reports contained in corporate annual reports (Watts and Zimmerman, 1983; Goodwin and Seow, 2000). The Code lays down the primary responsibility of external auditors is to publicly report to shareholders. It has been argued that large audit firms are more likely to report misstatements and non-compliance. This is because large audit firms are able to provide high quality audit services (DeAngelo, 1981 and Krishnan, 2003). Since the external audit has been the traditional source of assurance of quality of information placed in CARs, it is expected that high quality audit will produce high quality CARs. It is hypothesized therefore that:

H5: The quality of audit is positively associated with the quality of corporate reporting

Interactions between Independence of Audit Committee and External Auditors

External auditors, through their interactions with audit committees, are able to influence the company's internal control strength as well as reporting quality. Goodwin and Seow (2000) find that investors, auditors and directors all believe that a strong and effective audit committee assists external auditors to perform the audit. Under the Code of Corporate Governance (2001), the audit committee is expected to deal with the appointment and dismissal of external auditors. The Code spells out that it is the responsibility of the audit committee to discuss with the external auditors the nature and scope of audit before the audit starts and to review the findings of the audit subsequently. Such linkage is expected to produce an interaction effect between the external auditors and the audit committees. Gul, Lynn and Tsui (2002) provide evidence of the interacting effect of external audit on the relations between discretionary accruals and independence of board of directors, and between discretionary accruals and financial literacy of audit committee. The negative relationship between independence of board of directors and discretionary accruals is being weakened by the audit of non-Big5[4] (Klein, 2002). The finding suggests that negative relationships between discretionary accruals and independence of board of directors and the board financial literacy respectively are stronger for the companies audited by Big5. This is because the control by independent board of directors and financially literate audit committees becomes more important when the companies do not get quality audit (i.e. not audited by big audit firms). Hence, the following hypothesis is developed.

H6: The positive relationship between independent audit committee and quality of corporate reporting for companies audited by the Big5 is significantly stronger than that for companies audited by the non-Big5

Research Method

The following model is used to capture the relationship between quality reporting and its associated factors.

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_4 X_5 + \in$$

Where:

Y	=	Quality of corporate reporting
X_1	=	Financial literacy of audit committee members
X_2	=	Frequency of audit committee meeting
X_3	=	Multiple directorship of audit committee members
X_4	=	Independence of audit committee
X_5	=	External audit quality
X_4X_5	=	Interaction between independence of audit committee and external audit

Dependent Variables

Quality of reporting is the dependent variable of this study. This study uses the NACRA award for best reporting in annual reports as the proxy for reporting quality. The reporting quality is evaluated along several dimensions including timeliness of reporting, compliance with the regulatory, accounting and disclosure requirements, and non-qualification of audit report. Adjudicators of the award are experts in various fields drawn from the securities industry, accountancy profession, commerce, industry, and academia.

For the purpose of this study, companies that are short-listed for the reporting award, either at the preliminary or final stage, are considered to have good reporting. Companies that did not make it at either stage are categorized as companies with poor reporting. In this study, the nominal scale is used to measure the quality of company reporting with 1 for good quality reporting and 0 for poor quality reporting.

Independent Variables

Five independent variables of the study are financial literacy, frequency of audit committee meeting, multiple directorships, independence of audit committee, and external audit. Financial literacy of audit committee members is measured by the ratio of members who are MIA members. The MIA membership as defined in the Accountants Act 1967 is used to proxy financial literacy because of the recognition given by the profession. The membership requirement imposed by MIA assures that all MIA members must maintain a certain level of competency in order to retain their memberships with the Institute. Frequency of meeting is determined based on the actual number of audit committee meetings held in a year as stated in the annual reports of companies. Multiple directorships variable is measured by the number of director positions held by audit committee members in other companies, either as executive or non-executive directors. Independence of audit committee is operationalised by the ratio of non-executive directors to the total of audit committee members. Since the quality of audit is not directly observable, this study uses the size of audit firms, i.e. Big5 vs. non-Big5 to proxy the quality of audit (DeAngelo, 1981). A nominal scale of 1 is assigned for companies audited by the Big5 and 0 for those audited by the non-Big5.

Results of Analyses

Sample

This is a cross-sectional study of firms listed on Bursa Malaysia. The sample consists of 108 companies listed on the Bursa Malaysia for the year 2002. Fifty-four companies, as identified by the NACRA 2002 selection committee as having good financial reporting practice, were matched with fifty-four other listed firms not selected for the award, i.e. companies that do not meet the criteria set by NACRA. The matched pair sampling is used to select the high quality and low quality reporting on the basis of similarity in company size, financial year-end and industry classification to eliminate their possible effects on the quality of reporting (Buzby, 1975; and Beasley, 1996). The use of NACRA criteria of corporate reporting as the benchmark is consistent with the basis for Bursa Malaysia Listing Requirement. Bursa Malaysia listed companies are subject to rigorous disclosure requirements by the Securities Commission (SC) to protect shareholder decision-making. This regulatory environment enforces companies to comply with good reporting practices. Table 1 presents the distribution of sample by industry.

In order to ensure the matched-pair samples do not differ significantly in terms of size, a *t*-Wilcoxon test is done between total assets of good reporting companies and that of

Table 1: Distribution of Sample by Industry

Industry	No. of companies	%
Consumer products	8	7.4
Industrial products	22	20.4
Trading and services	28	25.9
Financial	20	18.5
Construction	10	9.3
Real Estate	8	7.4
Plantation	12	11.1
Total	108	100

poor reporting companies. The result shows no significant difference in size of assets between the mean of total assets of both groups of companies at $p<0.05$.

Descriptive Statistics

Table 2 shows the mean of variables of the two groups of good reporting and poor reporting companies. The table shows that good reporting companies have more accountant members in the audit committee. About 30% of good reporting companies have audit committee with less than 0.25 number of accountant member as opposed to only 20% for poor reporting companies. A majority of the poor reporting companies (i.e. about 74%) ensures their audit committee members consist of accountants between 0.25 to 0.50 percent as compared to only 65% for the good reporting companies.

The table also shows that poor reporting companies appear to meet less often than good reporting companies as 20% of the latter meet on average three times or less in a year and only 3.8% of the former meet with same frequency in a year. For the good reporting group, about 41% met more than five times a year compared to only 12.9% for the poor reporting. This indicates that, on average, good reporting companies meet more frequently than the poor reporting companies.

In terms of multiple directorships, Table 2 shows that members of audit committee of good reporting companies hold more directorship positions in other companies compared to poor reporting companies. On average, audit committee members of about 60% of poor reporting companies hold less than two director positions of other companies. Only about 11% of these companies hold an average of four director positions of other companies as compared to more than 20% of audit committee members of good reporting companies. In total, audit committee members of only about 40% of poor reporting companies hold more than two director posts compared to about 54% of good reporting companies audit committee members who hold the same number of director posts in other companies. This indicates that audit committee members of good reporting companies are more exposed to the knowledge and experience on the management of a number of other companies.

Table 2: Descriptive Statistics of Audit Committee Members for Good and Poor Reporting Companies

		Good Reporting Companies		Poor Reporting Companies	
		No	%	No	%
Financial literacy	<0.25	16	29.6	11	20.4
	0.25 -0.50	35	64.9	40	74.0
	>0.50	3	5.5	3	5.6
	Total	54	100.0	54	100.0
	Mean	0.2741		0.2944	
Frequency of Meeting	≤3	2	3.8	11	20.4
	4-5	30	55.4	36	66.7
	≥5	22	40.8	7	12.9
	Total	54	100.0	54	100.0
	Mean	4.278		4.296	
Multiple Directorships	<1.95	25	46.3	32	59.3
	1.96-3.66	18	33.3	16	29.6
	3.67-5.37	11	20.4	6	11.1
	Total	54	100.0	54	100.0
	Mean	2.352		1.729	
Independence	<0.40	2	3.8	7	13.0
	0.40-0.75	33	61.2	13	24.0
	>0.75	19	35.2	34	63.0
	Total	54	100.0	54	100.0
	Mean	0.6590		0.6815	
Quality of Audit	Big5	45	83.8	37	68.5
	Non-Big5	9	16.7	17	31.5
	Total	54	100.0	54	100.0
	Mean	0.69		0.83	

In terms of independence of audit committee, Table 2 shows that the ratio of independent members of audit committee of most good reporting companies (ie 61.2%) is 0.4 to 0.75. About 35.2% of these companies exhibit a high level of independence with 75% of the audit committee members being independent directors. Among the poor reporting companies, however, 63% of the audit committee consists of more than 0.75 independent members and only 24% of the companies with 0.4 to 0.75 independent members. The result seems to indicate that poor reporting companies maintain better independent members of audit committee than the good reporting companies.

With respect to quality of audit, Table 2 shows that about 83.8% of companies with good reporting obtain audit services from Big5 audit firms. Only about 68.5% of companies with poor reporting utilize the services Big5 audit firms. This indicates that good reporting companies choose audit services of the Big5 in order to receive high quality audit services and hence maintain a high quality corporate reporting for the companies. This result suggests the importance of the role of external audit in ensuring good quality CARs.

Tests of Data

The regression analysis requires an assumption that the data is normally distributed with no multicollinearity problems among variables (Garson, 2006). A test of normality assumption is performed by using both kurtosis and skewness of data. Results of the tests show that the values range between 0.087 to 2.07 for kurtosis and between -0.436 and 2.009 for skewness. Values of both kurtosis and skewness are low which suggests that the data is fairly normally distributed and allows the regression test to be carried out (Cooper and Schindler, 2001). The skewness and kurtosis tests show that the data is fairly normally distributed.

Test of correlation is used to test the degree of relationships between variables under study. The objective of the test is to see whether there are any multicollinearity problems among variables. The problem exists if independent variables are highly correlated among each other with correlation values exceeding 0.90 (Tabachnick and Fidell, 2001). High correlation among independent variables reduces the explanatory power of the variables on the dependent variable (Sharma, 1996). Results of the test are presented in Table 3 which shows that the correlation values among independent variables range between 0.003 and 0.308. Hence, multicollinearity problems do not exist in this study. This problem would affect the reliability of coefficient values.

Table 3: Analysis of Correlations between Variables

	Frequency of meeting	**Independence**	**Multiple directorships**	**Audit quality**	**Financial literacy**
Frequency of meeting	1	-0.053	0.039	0.144	0.065
Independence	-0.053	1	-0.005	0.170	0.057
Multple directorships	0.039	-0.005	1	-0.356(**)	0.115
Audit quality	0.144	0.170	-0.356(**)	1	0.003
Financial literacy	0.065	0.057	0.115	0.003	1

Tests of Hypotheses

This study uses the logistic stepwise regression analysis to test the model. This analysis is chosen because it is more suitable when the dependent variable is measured on a nominal scale (Hosmer and Lemeshow, 2000; Sharma, 1996). Results of the analysis are summarized in Table 4.

Table 4 shows that the value of Nagelkerke R^2 is 0.093, that is 9.3% of quality of reporting of companies can be explained by the variables under study. Results show only one independent variable, that is multiple directorships, has a significant positive relationship with quality of corporate reporting at $p=0.066$. This result supports hypothesis 3. The result shows that the higher the number of director positions held by audit committee

Table 4: Results of Logistic Stepwise Regression Analysis

Variables	Coefficient	Std. Error	Sig. *p*
Financial literacy	0.254	0.578	0.661
Frequency of meeting	-0.009	0.178	0.960
Independence	0.389	4.64	0.933
Multiple directorships	0.293	0.159	0.066
Audit quality	-0.228	2.67	0.932
Independence x Audit quality	-1.091	3.72	0.770
Constant	0.024	2.54	0.992

Nagelkerke Value $R^2 = 0.093$

members, the higher is the effectiveness of audit committee in fulfilling their responsibilities. This finding is in line with previous studies which argue that the higher the number of multiple directorships of audit committee members, the more effective are their controlling and monitoring roles (e.g. Boo and Sharma, 2008; Kiel and Nicholson, 2003; Ruzaidah and Takiah, 2004). As shown in Table 2, a higher percentage of the good reporting companies hold more directorship positions in other companies (i.e. 20.4% with 3.67-5.37 positions; 46.3% with <1.95 positions) than that of the poor reporting companies (i.e. 11.1% with 3.67-5.37 positions; 59.3% with <1.95 positions).

Results show that quality of corporate reporting is not significantly related to other independent variables under study including financial literacy, frequency of meeting, independence of audit committee, and audit quality respectively at $p<0.1$. It is noted that the relationships between quality of audit and quality of corporate reporting is negative. This relationship is in the direction opposite to that hypothesized. The negative relationship suggests that the higher the audit quality, the lower is the quality of corporate reporting. However, the relationship is not significant.

As mentioned earlier, poor reporting companies have more independent committee members compared to good reporting companies. However, the difference is not statistically significant (see Table 4). The insignificant relationship may be attributed to companies merely complying, in form rather than substance, with the Code of Best Practice of Corporate Governance. The Code prescribes that majority of audit committee members must be independent. Hence, compliance with the independence requirement may be perceived as having to fulfill the listing requirements of Bursa Malaysia. It is argued, therefore, that compliance with this best practice may not reflect the ability of audit committee to produce good corporate reporting which involves appreciation of some professional practices and applications of accounting standards.

The insignificant relationship between financial literacy and quality of corporate reporting is in the positive direction as predicted. This positive relationship indicates that audit committee members of good reporting companies are more financially literate than that of poor reporting companies. The insignificant relationship between the overall mean of financial literacy and quality of corporate reporting suggests that all companies listed in Bursa Malaysia comply with the minimum requirement as prescribed in the Code of Best

Practice of Corporate Governance with regard to the qualification of members. This is evident by the descriptive statistics in Table 2 above. Hence, the level of financial literacy makes no difference in the quality of reporting between good and poor reporting companies.

Similarly, results show no significant relationship between frequency of audit committee meetings and quality of reporting although the coefficient (see Table 2) indicates that audit committee of good reporting companies meet more frequently than the audit committee of poor reporting companies. As discussed below, the overall frequency of meeting is higher for the poor reporting companies than that of the good reporting companies but with an insignificant difference. Best practice, as described in the Code, prescribes that companies must hold an appropriate number of audit committee meetings a year but is not prescriptive on the number of meetings deemed appropriate. Hence, companies hold audit committee meetings at a pace or frequency they believe as necessary to review the company's quarterly as well as final financial statements.

In terms of the interaction between audit quality and audit committee independence, the study finds that such an interaction is not significantly related to corporate reporting. The result suggests that the quality of reporting does not depend on quality of audit which could be attributed to the nature of companies selected for poor reporting quality that do not include companies with qualified audit opinions. Hence, researchers are not able to measure the effect of audit quality on corporate reporting. The sample selection for poor reporting companies did not specifically distinguish poor reporting companies on the basis of qualified audit opinion. This limitation could possibly explain the lack of significant relationship between audit quality and corporate reporting quality. In addition, results also show that both financial literacy of audit committee members and frequency of committee meeting both do not have significant relationships with the quality of company reporting at $p<0.1$.

Additional Tests

T-tests of independent samples are carried out as further analysis in respect of the independent variables in order to provide more understanding of the study. Results of tests are presented in Table 5.

Table 5: Results of Independent Samples t-tests

Independent Variables	Mean difference	df	Sig. (2-tailed)
Financial literacy	0.0000	106.0	1.00
Frequency of meeting	-0.0185	103.6	0.933
Independence	-0.0225	103.8	0.411
Multiple directorship	0.623	103.5	0.*021*
Audit quality	-0.148	101.2	0.*073*

Results show no significant difference in the mean of three variables: financial literacy, frequency of meeting, and independence of audit committee, between companies with high quality corporate reporting and those with low quality corporate reporting. The results are consistent with results of the hypothesis testing. In terms of financial literacy, the result suggests that most companies meet the minimum requirement of at least one MIA member in the audit committee as specified in the Code of Good Practice of Corporate Governance. Hence, no difference is observed in financial literacy between both good and poor reporting companies.

Results also show that mean of frequency of meeting is also not significantly different between the two groups of companies although descriptive statistics in Table 2 indicates that higher percentage of good reporting companies meet more often (i.e. 40.8% meet more than five times a year) than poor reporting companies (i.e. 12.9% meet more than five times a year). The overall frequency of meeting may appear to be higher for the poor reporting companies than that of the good reporting companies but about 20.4% of the poor reporting companies meet less than three times a year. Considering that the Code requires audit committee to review the quarterly and final financial statements, the three meetings a year do not provide sufficient time for audit committee members to really understand and deliberate problems faced by the companies and provide strategic plans for overcoming the problems and improving the business. In terms of independence of audit committee, Table 5 shows that audit committee of poor reporting companies is more independent than that of good reporting companies but the difference is not significant.

However, those companies with high quality corporate reporting and those poor quality corporate reporting are significantly different in terms of number of director positions held by audit committee members and also in terms of audit quality. Results show that the mean of multiple directorships of good quality corporate companies is significantly higher than that of poor corporate reporting companies at $p=0.021$. This result is consistent with results of hypothesis testing which indicates a significant positive relationship between multiple directorships and quality of corporate reporting.

With regard to the quality of audit, results of the t-tests of independent samples in Table 5 show that audit quality of companies with good corporate reporting quality differ significantly from that of poor corporate reporting quality companies at $p=0.073$. The descriptive statistics in Table 2 indicate some variation in the quality of audit between good and poor reporting companies. The descriptive statistics show that Big5 audit firms dominate the audit of both the good and the poor corporate reporting groups of companies. However, results indicate that the percentage of companies with good corporate reporting that hire Big5 audit firms is higher (83.8%) than that of poor reporting companies that hire the Big5 (68.5%). Although the hypothesis on the positive association between quality of audit and quality of corporate reporting is not supported, results of the *t*-test of independent samples suggest that good quality corporate reporting companies tend to use high quality audit services compared to poor reporting companies.

Discussion and Conclusion

This study has shown that multiple directorships is the only important factor influencing the quality of corporate reporting. The result suggests that having more than one director position in other companies enhances audit committee contribution to the company reporting quality which is consistent with other studies (e.g. Boo and Sharma, 2008; Kiel and Nicholson, 2003; Ruzaidah and Takiah, 2004). Results of the study support the hypothesis. In addition, the study finds no significant relationships between three other variables, which are financial literacy, frequency of meetings and independence of committee members respectively, and quality of reporting. The finding on insignificant relationship between financial literacy and quality of corporate reporting appears to contradict the findings of Ruzaidah and Takiah (2004). In terms of audit committee independence, the result contradicts Beasley's (1996) findings, which suggest that, the independence of board of directors would influence companies to produce good reporting or to comply with regulatory requirements. These inconsistencies could be due to the higher level of compliance with best practice of corporate governance in terms of financial literacy, independence, and meeting frequency of audit committees.

The formation of audit committee is made mandatory by the Bursa Malaysia Listing Requirements to all listed companies. The ruling in the Code of Corporate Governance (FCCG, 2001) requires companies to meet minimum characteristics with respect to financial literacy, frequency of meetings and independence of committee members. In order to comply with the ruling, companies would therefore have at least one MIA member in the committee who is deemed to have financial literacy. Companies would also meet three to four times a year as suggested in the Code. The ruling also requires companies to ensure that the majority members of board are non-executive directors. As a result of this ruling, all listed companies would ensure that these specified minimum requirements are met in order for the companies to comply with the listing requirements. Hence, it is argued that in fulfilling these requirements, companies are more concerned with complying with the form of listing requirements rather than the impact of these requirements. It is argued that, since the compliance of these factors is merely for the purpose of window dressing, they may not contribute significantly to differences in the company performance, that is between good reporting and poor reporting. The result provides support to previous findings (Shamsul and Al Murisi, 1997) but contradicts the study by Collier (1993) which suggests that independence of audit committee is the most important factor in determining its effectiveness.

The findings of this study on the significant relationship between multiple-directorships and reporting quality and the significant difference of audit quality between companies with good reporting and those with poor reporting suggests the importance of these two variables. It is noted that these two variables are not part of Best Practices of the Code. Although companies are structurally in compliance with the Code's Best Practices to meet the listing requirements it is difficult to determine the extent of the quality of audit committee meeting and the real contribution of the committee members during meetings. Hence, further research needs to address this issue in evaluating the effectiveness of audit committee in monitoring the performance of companies in which they are serving and whether there is any optimal limit of multiple directorship as suggested by the Bursa Malaysia Listing Requirements.

The study focuses only on companies short-listed for NACRA, which is used as the proxy of good quality reporting and those not short-listed for NACRA as the proxy of poor quality reporting. This basis is used on the assumption that companies which do not submit application for the competition are classified as having poor corporate reporting. Owing to the nature of the sample, results may be applicable to NACRA companies and those selected as the matched pair sample only. Another limitation of this study is with respect to the measure of financial literacy which has resulted in members of audit committee who have attained a certain level of financial literacy through experience but are not members of MIA. These are not included in the sample. Future research may consider using a more comprehensive measure of financial literacy.

Notes

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2 Blue Ribbon Committee was set up in late 1998 to give recommendations on the role of audit committee in order to strengthen the monitoring role over the reporting process in the U.S. (Xie et al., 2003)

3 However, the frequency of meeting can also be interpreted as more problems encountered during the audit process. To the extent that this statement is true, it should be expected that the frequency of meeting is positively associated with earnings management.

4 The Big 5 includes the five largest audit firms which are Ernst and Young, Price Waterhouse, Coopers and Lybrand, KPMG, and Deloitte Touche.

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