



Role of Audit Committee on Corporate Governance - Experience and Expertise of audit committee has a significant influence and positive bearing on the financial performance of the companies

KEYWORDS

Corporate Governance, Audit Committee, Financial Performance, Experience and Expertise.

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ABSTRACT *The seeds of modern CG were probably sown by the Watergate scandal in the United States. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight the control failures that had allowed several major Corporations to make illegal political contributions and to bribe government officials. Audit Committee an organism devised to support the board of Directors that by virtue of delegation will aide in the examination, evaluation and permanent surveillance of the accounting and financial system of the corporation, constant verification of the independence criteria before the external auditor, as well as the follow-up of proceedings of internal systems of management controls. The effectiveness of audit committee are based on the characteristics of independence, financial expertise and diligence.*

Introduction

Corporate Governance (CG) assumes centre-stage when things go seriously wrong with companies. Until then, it is usually taken for granted, with boards and directors tucked away in salubrious isolation, institutions considered an unavoidable necessity not to be seen or heard in public except at the ritual annual meetings of shareholders. The seeds of modern CG were probably sown by the Watergate scandal in the United States. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight the control failures that had allowed several major Corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in USA that contained specific provisions regarding the establishment, maintenance and review of systems of internal control. It takes some major scams or high profile corporate failures to trigger reviews and reforms. This trend appears to be quite universal as can be seen from past international experience. The first decade of the new millennium has already witnessed some extraordinary upheavals in this field, such as the failures or serious financial distress of corporations like Enron, WorldCom, Vivendi International, Parmalat, Lehman Brothers, American International Group, Inc (AIG), and others, with even professional firms like Arthur Andersen not being spared.

The Indian experience has not been very dissimilar. The 1990's saw the failure of a number of company and several instances of mismanagement, with some well known corporate leaders and executives being hauled up for non-performance and / or non-compliance of legal requirements. A scam of severe magnitude, comparable to a scaled-down version of the Black Monday disaster of September 1987 on the New York Stock Exchange and other related markets, rocked the Indian Stock markets in 1992-93, exposing the inadequacies of procedural and regulatory controls in the country. The state controlled Unit Trust of India had to be bailed out twice in the last decade, impacting upon investors and the citizens at large. Numerous non-banking financial companies and even co-operative banks have come to grief, with quite a few heading towards liquidation or suspended animation. And as 2008 drew to a close, the much-admired IT major Satyam Com-

puters shook the country with what is probably the largest corporate fraud in India.

Audit Committee: An organism devised to support the board of Directors that by virtue of delegation will aide in the examination, evaluation and permanent surveillance of the accounting and financial system of the corporation, constant verification of the independence criteria before the external auditor, as well as the follow-up of proceedings of internal systems of management controls

AUDIT COMMITTEE ROLE AND RESPONSIBILITIES

AC is often referred to as one of the successes of CG. It is a subset of the corporate board of directors and has the responsibility of overseeing a firm's financial-reporting process (Klein, 2002) and enhancing the internal control procedures, external reporting and risk management of companies. It also plays an important role as a channel to facilitate communication between the board, external auditors and internal auditors.

NEED FOR CORPORATE GOVERNANCE

Corporate scandals in the United States (Enron Corp, WorldCom, and Tyco International) Europe (Polly Peck, Bank of Credit and Commerce International and Barings Bank) and India (Satyam) some of which have triggered the largest insolvencies in history—have caused a crisis of confidence in the corporate sector. As a result, CG has entered the vocabulary not only of financial economists but also of day traders, pension fund beneficiaries, employees of all ranks, chief executive officers, and prime ministers. During the wave of financial crises of 1997-98 in Asia, Russia, and Latin America, the behavior of the corporate sector affected entire economies. Deficiencies in CG endangered the stability of the global financial system. Improving CG is now recognized in most countries and policy circles to have first-order macroeconomic consequences and has become a main stream concern.

CORPORATE GOVERNANCE AND FIRM PERFORMANCE

Shareholders and managers have conflicting interests (Profit maximization V/s Wealth maximization) due to separation of ownership and control. As a result, managers have incentives and ability to maximize their own interests at the

expenses of share holders. These include manipulation of earnings, utilization of corporate resources in the form of a perquisites.

ROLE OF AUDITS

The audits can play a significant role in the corporate governance by minimizing the agency costs through a mechanism called check and balance and enhancing the financial reporting process through the quality auditing and assuring credibility of financial statements of the firm.

AUDIT COMMITTEE EFFECTIVENESS

Since the inception of the audit committees, their effectiveness has been a key and crucial issue. The effectiveness of audit committee are based on the characteristics of independence, financial expertise and diligence.

DATA SOURCE

The study depends on primary and secondary data for collecting relevant facts required for achieving its objectives. Primary data collection source includes structured questionnaire, with Likert's five point scale for collecting information on composition, power, diligence, meeting frequency of AC, the existing practices of AC, role in financial reporting, overall practice, factors affecting AC practices in India and possible measures for enhancing AC effectiveness. Secondary sources of data collection include Companies Annual Reports, Comptroller and Auditor General of India (C&AG) Reports, Periodicals, Internet, EBSCO database, INFLIBNET and IIMB library.

DATA ANALYSIS TOOLS

Statistical Package for Social Science (SPSS) is used to analyze the data. Some of the tools used for the data analysis are Descriptive Statistics such as, Frequency Distribution, Mean and Coefficient of variation (CV). And for testing the hypothesis, Correlation, Chi Square test, and Z test for portions, are used.

QUESTIONNAIRE SURVEY

Questionnaire survey method of data collection is quite popular method used in the social science field. It is being adopted by private individuals, research scholars, private and public organizations and even by Governments. In this method a questionnaire is sent (usually by post and through mail) to the persons concerned with a request to answer the questions and return the questionnaire.

STUDY POPULATION AND SAMPLE

The population of the current study consists of companies listed on BSE and NSE and the sample for the study consists of 111 fortune 500 companies listed on both BSE and NSE. As per the records there are 5568 companies listed on BSE and 1800 companies on NSE. The samples are selected by examining the fortune 500 companies in India listed on BSE/NSE in terms of their market capitalization as on March 2013. The respondents for the current study consist of Company Secretaries, Chief Financial Officers, Director Finance and Financial Advisors.

PRE TESTING AND THE PILOT STUDY

The aim of the pilot survey is to establish that the proposed questionnaire is understandable and clear to the members of the target population. The draft of the questionnaire was distributed among the members of Institute of Company Secretaries of India (ICSI), Chartered Accountants, Officers and Staff of Accountant General Office and Financial Executives of Central and State Government Public Sector Undertakings, working at Delhi, Mumbai, Kolkata,

Bengaluru and Chennai.

QUESTIONNAIRE SURVEY RESPONSES

Out of 527 mailed questionnaires, a total of 111 questionnaires were finally received in different period of times which were ranged from 1 day to 6 months.

OBJECTIVES OF THE STUDY

"The main objective of this research study is to explore the significant relationship that exists between Experience and Expertise of audit committee and the financial performance of the company's"

HYPOTHESIS OF THE STUDY

H0 : Experience and Expertise of audit committee has no influence on financial performance of the companies.

H1 : Experience and Expertise of audit committee has a significant influence and positive bearing on the financial performance of the companies

To test this Hypothesis, a correlation is run between two key performance variables, AC members experience in finance, accounting and auditing and companies financial performance (Sales Revenue, Profit before Tax, Profit after Tax, Net worth, Earnings Per Share, Market Price of Shares and Market Capitalisation)

Table showing the Experience and Effectiveness of AC Members

Factors	Sales Revenue	FBT	PAT	Networth	EPS	MPS	Market Capitalization
Correlation	0.04	0.09	0.09	0.01	-0.12	-0.01	-0.07
t	0.45	0.91	0.93	0.08	=1.21	=1.03	=0.75
Result	H0 accepted	H0 accepted	H0 accepted	H0 accepted	H0 accepted	H0 accepted	H0 accepted

accepted

Source: SPSS Output

Note: only the derived values are presented table above, ± values of t represent |t| value

From the above correlations table it is clear that there exists a very low positive correlation between Audit Committee members experience in financial, accounting and auditing and Companies financial performance such as Sales Revenue (+0.04), Profit Before Tax (+0.09), Profit After Tax (+0.09), Net worth (+0.01), and is very low negatively related with Earnings Per Shares (-0.12), Market Price of Shares (-0.01), Market Capitalization (-0.07). Further To test the level of significance existing 't' test is being carried out.

Result: A Close observation of the above summarized table shows that there is a positive correlation between members experience and expertise (control factor) on the sales revenue of the organization; which in turn influences its gross and net profitability and there by the rewards to the share holders, which is very much indicative that the governance practices followed by the organization (with the help of experienced and expertise audit committee) help in creating credibility among the stake holders and ensure they are responsive towards the initiatives of the organization; Contrarily it can also be seen that there is a very low negative correlation between the members experience and expertise and EPS and MPS adopting disclosure norms and providing for transparency to the activities initiated would expose them to the risk of losing strategic positions in the market place; which is reflected in terms of negative EPS, MPS and Market Capitalization On the

other hand, this has a positive bearing on the PBT, PAT, Net worth of Shares, Though for all the factors correlation expressed is positive (however low), there is a need for testing the significance of correlation existing; for which 't' statistic is used to testing at 5% level of significance. On evaluation, it can be found that, for all the factors tested derived value of "t" is less than that of the standard value at 5% level of significance, and H0 stands accepted; and it can be conclude that, the correlation existing between the experience and expertise is low and thereby the efficiency of the audit committee has very little bearing or most of the times insignificant bearing on enhancing the Internal Financial Performance Efficiency of the organization. Whereas, the presence of efficient audit committee in the organization, when ensures good disclosure of the material facts of the organization and its performance, can ensure positive response of the stakeholders and create positive image in the market; thereby such demand created in the equity market can lead to continuous increase in the value of PBT, PAT and net-worth. Hence, it can conclude that Experience/ Expertise and its induced efficiency among the audit committee has a very little influence on the (PBT, PAT and network)

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