

Economics and Business Review

Volume 2 (16) Number 1 2016

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Paper based publication

ISSN 2392-1641

POZNAŃ UNIVERSITY OF ECONOMICS AND BUSINESS PRESS
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Printed and bound in Poland by:
Poznań University of Economics and Business Print Shop

Circulation: 300 copies

Audit committee structure and earnings management in Asia Pacific¹

Qaiser Rafique Yasser,² Abdullah Al Mamun³

Abstract: The relationships between the audit committee structure and earnings management is quite complicated. They are not simply bivariate correlations. Rather, there may be mediating effects or moderating influences on these casual associations. Nonetheless, previous research has not investigated these complicated relationships in emerging markets with an advanced economy. This paper aims to examine the mediating impact of audit committee structure and earnings management in Australia, Malaysia, and Pakistan. The results suggest that audit committee size is positively associated with financial reporting quality. We also noted that, instead of adding value, audit committee independence is negatively associated with reporting quality. The results indicate that the audit committee is a less significant factor in corporate governance than suggested by many previous researchers and policy makers. This paper contributes to the literature on corporate governance and earnings management by introducing a framework for identifying and analyzing moderating variables that affect the relationship between the audit committee structure and earnings management.

Keywords: audit committee, earning management.

JEL codes: G34, M41.

Introduction

The audit committee is one of key governance devices to monitor management on behalf of shareholders and ensures a fair presentation of financial statements. A strong audit committee is expected to remedy weak governance systems that seem to prevail in emerging markets. The relationship between corporate governance, audit committee, shareholders and board of managers is important in formulating efficient financial and operating management practice. According

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to researchers [Bédard and Gendron 2010; Aldamen et al. 2012; Liao and Tsu 2013; Leong et al. 2015] corporate governance and audit committees play an important role mainly in improving the value of the companies and efficiency of their marketing activity.

Financial reporting is a very fundamental corporate responsibility and a core element of the communal system. This is because financial reporting serves as the major medium of communication between companies and stakeholders by reducing the level of information asymmetry between the directors, who have access to management information and other interested parties who are external to the company. Duchin, Matsusaka, and Ozbas [2010] have argued that the credibility and transparency of financial statements of a company depend on the effectiveness of the monitoring mechanism of the company and this has led researchers to examine corporate governance issues. Given these developments, several empirical researches [Chan and Li 2008; Bédard and Gendron 2010; Yasser, Entebang, and Mansor 2011; Erkens and Bonner 2013] have identified the role of the audit committee as being critical in ensuring the credibility of the financial statement [Abbott, Park, and Parker 2000]. Meanwhile, Bergstresser and Philippon [2006] stated that earnings management is a management action taken for profit making and this tends to reflect the interests of management rather than an actual picture of company performance.

Countries around the world are characterized by alternative corporate governance systems [Vera-Muñoz 2005], and there is considerable debate relating to how good, superior or effective these systems are. Lin, Li, and Yang [2006] suggest that such judgments are inherently subjective because of the sparse evidence on the relative performance of different corporate governance systems. A question of key interest is therefore: do differences in these systems lead to differences in earnings' management? Whilst existing studies have usually examined the audit committee characteristics of firms in one country or region, there is, to our knowledge, no study yet that has thoroughly analyzed the influence of cross-country audit committee characteristics on earnings management. In this study, we take a step towards filling this gap. We empirically analyzed the effect of audit committee structure on earnings management by examining a sample of matched industrial companies listed on the stock exchanges of three countries, namely Australia, Malaysia and Pakistan.

This paper makes several contributions to existing literature. First, the literature lacks comprehensible evidence on the impact of audit committee structure on financial reporting quality and a firm's performance due to the endogenous and heterogeneity issues [Adams, Hermalin, and Weisbach 2010; Liao and Tsu 2013]. Most of the studies on audit committees and financial reporting quality are from developed and European economies. However, this study compares the results of the audit committee structure on the financial performance and reporting quality from developed and developing countries. Secondly, our study falls under the literature that examines the consequences

of the regulatory changes introduced around the world to strengthen corporate governance and corporate transparency by using the sample of developing and developed countries.

The paper is divided into 4 sections. The first section is devoted to literature review. The second outlines the theoretical framework and hypotheses. Section three deals with the methodology used. The fourth section presents and discusses the results. The paper is closed with conclusions.

1. Literature review

Literature on audit committees suggests that the roles of regulatory and controlling authorities are mainly important in improving the firm's value. The good audit committee is focused on the protection of the rights of shareholders and plays an important role in the development of capital markets by protecting investor interests [Abdurrouf, Siddique, and Rahaman 2010]. The role of an audit committee is significant in implementing corporate governance principles.

Studies indicate that inclusion of independent or outside directors on the board improves disclosure quality [DeFond, Raghunandan, and Subramanyam 2002; Ajinkya, Bhojraj, and Sengupta 2005; Bergstresser and Philippon 2006; Duchin, Matsusaka, and Ozbas 2010; Liao and Tsu 2013], decreases the likelihood of financial statement fraud [Yang and Krishnan 2005; Abdullah, Mohamad-Yusof, and Mohamad-Nor 2010], curtails the magnitude of earnings' management [Klein 2002; Xie, Davidson, and DaDalt 2003; Peasnell, Pope, and Young 2005; Jaggi, Leung, and Gul 2009; Dimitropoulos and Asteriou 2010], lowers the incidence of related party transactions [Dahya, Dimitrov, and McConnell 2008], and enhances the firm's performance [Choi, Park, and Yoo 2007]. However, the evidence from Malaysia indicates that the independence of the board does not enhance reporting lucidity [Haniffa and Cooke 2002; Wan-Hussin 2009] and restrain corporate restatements [Abdullah, Siddique, and Rahaman 2010], which lends credibility to the view that the presence of independent non-executive directors are merely a box-ticking exercise, is ceremonial and is a form of window dressing.

Sarbanes-Oxley Act of 2002 (SOX) requires firms to have an audit committees comprised solely of an independent director who is not an affiliate of the firm and not accepting any compensation from the firm other than the director's fees. Many studies have uncovered empirical regularities that audit committee independence enhances the quality of financial reporting. In addition, Abbott, Park, and Parker [2000], Archambeault, DeZoort, and Hermanson [2008] and Persons [2009] show that audit committee independence reduce earnings' management, the likelihood of financial reporting restatement and financial reporting fraud. Furthermore, the likelihood that companies re-

ceive a true opinion of their current state is influenced by the number of outside directors in the audit committee [Carcello and Neal 2000; Vera-Muñoz 2005].

Krishnan [2005] documents that audit committees with independent directors are extensively less likely to be associated with the incidence of internal control problems over financial reporting quality. A study conducted by Pomeroy and Thornton [2008] opined that the independence of the audit committee has more impact in enhancing the audit quality through averting going concern reports and auditor resignations than it is in enhancing accruals quality and avoiding restatements. The audit committee meeting is the place for directors to discuss the financial reporting process and it is where the process of monitoring financial reporting occurs. An independent audit committee is unlikely to be effective unless the committee is also active [Haniffa and Cooke 2002].

The Blue Ribbon Committee on audit committees advocates that an audit committee is to meet at least four times per year for reliable reporting. The regulation on audit committees in Britain prescribes that the number of meetings required in a financial year should be not less than three, in view of the fact that the requirement for interim financial reporting is semi-annual. The Bédard and Gendron [2010] analysis shows that most of the studies on audit committee meeting and financial reporting quality that they reviewed do not find significant associations.

However, the studies of Xie, Davidson, and DaDalt [2003] and Li, Pike, and Haniffa [2008] show that audit committee meeting frequency is positively related to the level of corporate disclosure. In addition, Abbott, Park, and Parker [2000], Vafeas [2005] and Persons [2009] document that higher level of audit committee activity is significantly related to a lower incidence of financial restatement, or reporting a small earnings' increase, or fraudulent financial reporting.

Yang and Krishnan [2005] argue that by meeting frequently, the audit committee will remain informed and knowledgeable about accounting or auditing issues and can direct internal and external audit resources to address the matter in a timely fashion. During the audit committee meeting the problems encountered in the financial reporting process are identified, but if the frequency of the meetings is low the problems may not be rectified and resolved within a short period of time.

Previous researches have investigated the role of the size of audit committees as an effective mechanism for monitoring and controlling financial reporting. Additionally, Baxter and Cotter [2009] posited that a large board size is associated with delays and administrative bottlenecks.

However, other studies suggested that smaller boards may be less encumbered with bureaucratic problems. Anderson, Mansi, and Reeb [2004] stated that large boards can devote more time and resources to monitor the finan-

cial reporting process and the internal control systems. This implies that an increase in audit committee size enables members to distribute the workload and commit more time and resources to monitor the management and detect fraudulent behaviour.

2. Theoretical framework and hypothesis

Theoretical support for the formation of audit committees can be found in agency theory. According to agency theory, providers of finance, both equity holders and debt holders act as principals who seek to obtain maximum profit from management acting as their agent [Aldamen et al. 2012]. Assuming economic self-interest, there is the potential for opportunistic actions of the agent, which are to the detriment of the principal.

The audit committee serves many important corporate governance functions and provides advice on operational and regulatory matters [Yang and Krishnan 2005; Vera-Muñoz 2005]. It helps to alleviate agency problems by facilitating the timely release of unbiased accounting information by managers to shareholders and creditors, thus reducing information asymmetry between executive and non-executive directors [Klein 2002; Islam et al. 2010]. From an agency theory perspective, the composition of the audit committee is an important corporate governance mechanism because the presence of non-executive directors provides a way of monitoring the actions of managers (agents) and of ensuring that shareholder's (Principal's) interests are being safeguarded.

Due to the separation between ownership and management, the shareholders are unable to directly observe the actions of management [Bédard and Gendron 2010]. Therefore, a system of corporate governance controls is established on the shareholders' behalf to discourage managers from pursuing objectives that do not maximize the shareholder's wealth. These controls are aimed at either aligning managers' and shareholders' incentives or limiting the opportunistic activities of managers [Dellaportas et al. 2005]. Audit committees are one example of such a corporate governance control. Baxter and Cotter [2009] argued that audit committees will be voluntarily employed to improve the quality of information flows between principal and agent wherever there are high agency costs. Audit committees have been widely recommended as an important means of improving the quality of corporate financial reporting practices.

Kirk [2000] argues that the audit committee is to give unbiased reviews of financial information and audit committee independence can contribute to the financial reporting quality. Meanwhile, Beasley, and Salterio [2001] document that companies that have the incentive and ability to increase the strength of the audit committee will do it by including more independent directors in the committee than the minimum number as required by legislation.

In summary, whether the audit committee structure in Asia Pacific will be positively related to earnings' management or not is still an empirical question. We formally present the hypothesis in an alternative format as follows.
 H1: *The audit committee structure is positively associated with earnings' management.*

3. Research methodology

This research adopted a quantitative research method as it is the method to be used for historical data collection and descriptive studies. The longitudinal study approach had been selected under quantitative research methodology to study corporate financial records. Given data restrictions and allowing sufficient time for the revelation of irregularity, our sample covers 2011 to 2013. The top indexed companies from three Asia Pacific economies were selected because these are more likely to have the resources and motivation to take advantage of the opportunities to adopt good corporate governance practices. The sample of companies in the data represents a diversity of companies in terms of industries, growth prospects and ownership structure.

The top indexed companies taken from the Australian Stock Exchange (AXS), Kuala Lumpur Stock Exchange (KLSE) and Karachi Stock Exchange (KSE) in the proportions of 25%, 37.5% and 37.5% respectively in the total sample, as in Table 1 below.

Table 1. Sample selection

Country	Index	Companies	Percentage
Australia	Australia Stock Exchange (ASX-20)	60	25
Malaysia	Kuala Lumpur Stock Exchange (KLSE-30)	90	37.5
Pakistan	Karachi Stock Exchange (KSE-30)	90	37.5
Total Sample Companies (Three Years – 2011 to 2013)		240	100.0

Accounting measures have the limitation that they are somewhat open to manipulation by management, so multiple performance measures were used because of the inherent limitations in any single financial measurement [Boyd, Gove, and Hitt 2005]. Based on suggestions in previous research, multiple measures produce a more accurate description of performance [Rechner and Dalton 1991].

3.1. Variables and measures

The variables employed in this study are described in Table 2.

Table 2. Variable description

Governance Variables	
AC Chair Meeting (ACCM)	Total Meetings attended by the Audit Committee chairman in a year
AC Members (ACM)	Total Members in the Audit Committee
AC Ownership (ACO)	Percentage of ownership held by Audit Committee members
AC Chair (ACC)	Audit Committee Chairman Status, i.e., ED, NED, etc.
IND AC (INDA)	Total Independent Non-Executive Directors in the Audit Committee
NED AC (NEDA)	Total Non-Executive Members of the Audit Committee
Performance Variable	
Return on Equity (ROE)	Net Profit divided by Total Equity
Return on Assets (ROA)	Net Profit divided by Total Assets
Control Variables	
Firm Size (FSIZE)	Natural Logarithm of Total Assets
Board Size (BS)	Total Number of Board Members
Firm Age (FAGE)	Total number of years the company has been incorporated
Reporting Variables	
AR	Discretionary Revenues
Paaccr	Performance-adjusted Discretionary Accruals
Tcaccr	Total Current Accruals
AGGRE	Aggregate

3.2. Control variables

Yim [2013] argues that due to the effects of the learning curve and survival bias older firms are likely to be more efficient than younger ones. Thus a better performance should be expected. The older firms are characterized by both resource advantages and social burden. Given the possible influences of a firm's age on organizational performance, it was included as a control variable in Table 2.

Firm Size is the total assets stated on the company's balance sheet and the variable is included in order to check the firm's size [Ferris, Jayaraman, and Sabherwal 2013].

3.3. Performance variable

Return on assets (ROA) is included as the firm-specific performance variable. ROA defined as the profit generated by the firm in relation to its asset base. It is included as a measure to check the acquiring firm's operating performance [Yim 2013; Serfling 2014].

ROE was obtained by using net income divided by the average of owners' equity during a given year. This approach is used by Peng, Zhang, and Li [2007].

3.4. Proxies for financial reporting quality

There is no one universally recognized measure of financial reporting quality [Dechow et al. 2011]. This study exploits three measures that have been used in prior research as well as an aggregate measure for the following reasons. First, the construct we are interested in is financial reporting quality, which clearly is multi-dimensional. Thus, a single proxy is inadequate to cover all facets of financial reporting quality. Second, the use of multiple proxies increases the adequacy of our results. Third, using alternative measures mitigates the possibility that results using one particular proxy capture some factors other than financial reporting quality.

The first measure is performance-adjusted discretionary accruals as developed by Ashbaugh et al. [2003] and Chen et al. [2010].

$$PAaccr_{i,t} = \alpha_0 + \alpha_1 \left(\frac{1}{Assets_{i,t-1}} \right) + \alpha_2 \Delta Rev_{i,t} + \alpha_3 PPE_{i,t} + \alpha_4 ROA_{i,t} + \epsilon_{i,t}, \quad (1)$$

where:

$PAaccr_{i,t}$ – total accruals, measured as the change in non-cash current assets minus the change in current non-interest bearing liabilities, minus depreciation and amortization expense for firm i at year t , scaled by lagged total assets ($Assets_{i,t}$);

$\Delta Rev_{i,t}$ – the annual change in revenues scaled by lagged total assets;

$PPE_{i,t}$ – property, plant, and equipment for firm i at year t , scaled by lagged total assets;

$ROA_{i,t}$ – return on assets for firm i at year t .

The residuals from the regression model are discretionary accruals. In our tests, we use the absolute values of discretionary accruals as a proxy for financial reporting quality.

To calculate the second proxy, this study follows McNichols [2002] and Chen et al. [2010] and estimates discretionary revenues. Specifically, we used the following regression:

$$\Delta AR_{i,t} = \alpha_0 + \alpha_1 \Delta Rev_{i,t} + \epsilon_{i,t}, \quad (2)$$

where:

$\Delta AR_{i,t}$ – represents the annual change in accounts receivable,

$\Delta Rev_{i,t}$ – the annual change in revenues, each scaled by lagged total assets.

Discretionary revenues are the residuals from Equation (2) which are estimated separately for each industry-country group.

Our third proxy is based on the cross-sectional Dechow and Dichev [2002] model, as modified by McNichols [2002], and Francis et al. [2005]:

$$TCaccr_{i,t} = \alpha_0 + \alpha_1 OCF_{i,t-1} + \alpha_2 OCF_{i,t} + \alpha_3 OCF_{i,t+1} + \alpha_4 \Delta Rev_{i,t} + \alpha_5 PPE_{i,t} + \epsilon_{i,t} \quad (3)$$

where:

$TCaccr_i$ – total current accruals, measured as the change in non-cash current assets minus the change in current non-interest bearing liabilities, scaled by lagged total assets;

OCF – cash flow from operations, measured as the sum of net income, depreciation and amortization, and changes in current liabilities, minus changes in current assets, scaled by lagged total assets;

$\Delta Rev_{i,t}$ – the annual change in revenues scaled by lagged total assets;

$PPE_{i,t}$ – property, plant, and equipment, scaled by lagged total assets.

The residuals from Equation (3) represent the estimation errors in the current accruals that are not associated with operating cash flows and that cannot be explained by the change in revenue and the level of property, plant and equipment. Given the short longitudinal time frame in our study, we follow Boyd, Gove, and Hitt [2005], Srinidhi and Gul [2007] and Chen et al. [2010] and use the absolute value of this residual as a proxy for financial reporting quality.

Thus, higher values of $TCaccr$ represent higher financial reporting quality. Besides, to reduce measurement error in the financial reporting quality mechanism, and to present evidence based on general financial reporting metric, we aggregate these proxies into one aggregate score. Particularly, following Biddle, Hilary, and Verdi [2009] and Chen et al. [2010] we first normalize all proxies and then take the average of the three measures as our summary financial reporting quality statistic (AGGRE).

4. Results and discussion

4.1. Statistic analysis

Table 3 presents summary statistics on audit structure, firm performance and financial reporting quality. We see from the table that the firms in Australia are older than Pakistan and Malaysia. The minimum audit committee chairman at-

Table 3. Descriptive statistics

	Australia (N = 60)			Malaysia (N = 90)			Pakistan (N = 90)					
	Min.	Max.	Mean	S.D	Min.	Max.	Mean	S.D	Min.	Max.	Mean	S.D
AC Chair Meeting	3	10	0.93	0.14	3	11	0.96	0.14	1	9	0.73	0.26
AC Member	3	9	4.33	1.02	3	5	3.52	0.58	3	9	4.33	1.02
AC Ownership	0	0	0.00	0.00	0.0	15.8	0.17	1.67	0	3.67	0.11	0.98
AC Chair	0	1	0.77	0.43	0	1	0.96	0.21	0	1	0.72	0.43
IND AC	0	9	3.38	1.97	0.0	4.0	2.86	0.69	0	5	3.08	1.42
NED AC	3	9	4.32	1.03	2.0	5.0	3.47	0.62	3.0	9.0	4.32	1.03
Firm Size	3.7	5.9	4.81	0.59	3.1	5.7	4.55	0.63	3.7	5.9	3.50	0.47
Firm Age	11.0	196.0	93.7	53.1	3.0	72.0	34.13	14.88	6.0	155.0	73.5	42.10
Board Size	8.0	15.0	10.27	1.66	6.0	14.0	9.36	2.10	5.0	13.0	9.87	1.46
ROA	0.0	0.2	0.05	0.05	0.0	0.6	0.09	0.11	0.0	0.2	0.05	0.05
ROE	-0.1	0.4	0.13	0.09	-0.1	4.6	0.27	0.60	-0.1	0.4	0.13	0.09
AR	0.71	1.09	0.87	0.10	0.86	1.47	1.14	0.15	0.71	1.09	0.87	0.14
Paaccr	1.29	2.30	1.79	0.31	1.37	2.75	1.94	0.31	1.29	2.32	1.77	0.29
Teaccr	1.45	2.77	2.19	0.36	1.73	2.86	2.35	0.28	1.46	2.57	2.04	0.37
AGGRE	3.65	6.12	4.85	0.75	4.58	6.39	5.43	0.44	3.65	5.82	4.45	0.78

tendance is 3 times in Australia and Malaysia and once in Pakistan, whilst the maximum meeting attendance of the audit committee chair is 10, 11 and 9 respectively. The average numbers of board members are 9, 9 and 10 in Pakistan, Malaysia and Australia respectively.

The average size of the audit committee is 4.3 in Australia, 3.5 in Malaysia and 4.3 people in Pakistan, which is comparable to Yatim et al. [2006], but in Malaysia is slightly lower than Mohd-Saleh, Mohd Iskandar, and Rahmat [2007], who document an average size of 3.7 people as in Table 3.

4.2. Regression analysis

Table 4 indicates that the dependent variable AR is positively associated with the audit committee structure in Pakistan and Australia whilst the independent audit committee is negatively associated with AR in Malaysia. Non-executive members of audit committees are also negatively associated with the financial reporting quality in Pakistan. From the results of the coefficient analysis, the model of the study was found to be statistically significant at a level of 5% ($p < 0.05$). In this study the adjusted R^2 for AR dependent variable the model was 51%, 63.5% and 39.5%, which was adjusted to better fit the model in the population and the final adjusted R^2 became 43.3%, 59.4% and 32.7% respectively for Australia, Malaysia and Pakistan. The results also indicate that firm size is significantly negative with financial reporting measure 'AR' in Australia, Malaysia and Pakistan.

Our results show that a more active and larger audit committee is desirable in enhancing the quality of financial reporting and is consistent with the evidence provided by Kent, Routledge, and Stewart [2010]. The audit committee members are positively associated with earning management, which place emphasis on financial statement accuracy, control effectiveness and transparency [Islam et al. 2010]. However, Anderson, Mansi, and Reeb [2004] stated that large numbers on boards can devote more time and resources to monitor the financial reporting process and the internal control systems. This implies that an increase in audit committee size enables members to distribute the workload and commit more time and resources to monitor the management and detect fraudulent behaviour.

Table 4 signifies that firm size is negatively associated with financial reporting quality in Australia, Malaysia, and Pakistan. The results are in line with previous studies conducted by Abbott, Park, and Parker [2000], Davidson, Godwin-Stewart, and Kent [2005], Krishnan [2005], Rahman and Ali [2006]. However, Li, Pike, and Haniffa [2008], Persons [2009] and Islam et al. [2010] show that the audit committee size influences corporate disclosures. However most of the studies reviewed in their survey by Bédard and Gendron [2010] indicate that the size of the audit committee is not an important determinant of effectiveness and they caution that the incremental costs of poor communi-

cation, coordination, involvement and decision making associated with a larger audit committee might outweigh the benefits.

Since large companies are more exposed to public scrutiny [Alsaeed 2006] and are more complex [Craig and Diga 1998] than smaller companies they need to provide a better quality of financial reporting. Besides that, large companies also have greater resources and may be able to appoint prestigious external auditors and attract reputable non-executive directors [Song and Windram 2004], which in turn could help them in enhancing the quality of financial reporting and at the same time possess sufficient resources for collecting, analyzing and presenting an extensive amount of data at minimal cost [Alsaeed 2006].

Firm age is also negatively associated with financial reporting quality. This is based upon arguments that new companies may encounter difficulty in making changes to comply with the requirements [Abbott, Park, and Parker 2000], whereas old firms might have improved their financial reporting practices [Alsaeed 2006]. At the same time, younger companies are under pressure to boost earnings [Abbott, Park, and Parker 2000]. However, Baxter and Cotter [2009] found that board size is positively associated with audit committee independence, implying that firms with a large board are more likely to have effective audit committees and thus are more likely to demand high quality auditing services. Thus, our finding on board size is consistent with that in Klein [2002].

The size of the firm measured by the natural log of the total asset expectedly has a positive relationship and is statistically significant at 1% level of significance. This means that larger firms produce more reliable and qualitative information in their financial statements /higher quality financial reporting than the smaller firms. Our result implies that an increase in the size of the firm by one unit whilst other variables remain constant will increase the financial reporting quality.

Table 5 indicates that audit committee meetings having no impact on a firm's performance. This result is similar to previous studies that were conducted by Al-Matari et al. [2012], Al-Matari et al. [2012] and Mohd [2011] who found an insignificant relationship between audit committee meetings and ROA. One possible explanation for this insignificance is that the frequency of audit committee meetings and the firm's performance is that board meetings are not always useful as the limited time non-executive directors spend together is not spent on exchanging meaningful ideas amongst themselves and with management.

This study found a surprisingly insignificant association between audit committee size and a firm's performance, as apparent in Table 5. There is no significant association between audit committee size, ROA and ROE. This result is consistent with the previous studies of Mak and Li [2001], Wei [2007] in China, Ghabayen [2012] and Nuryanah and Islam [2011] in developing countries. The hypothesis H1 predicts that audit committee structure does not affect the earnings' management so the alternative hypothesis is rejected.

Table 4. Financial reporting variables

	Australia				Malaysia				Pakistan			
	AR	PAaccr	Tcaccr	AGGRE	AR	PAaccr	Tcaccr	AGGRE	AR	PAaccr	Tcaccr	AGGRE
AC Chair Meeting	0.39	-0.16	-0.26	-0.15	-0.51	-0.07	-0.26	-0.36	0.80	-0.76	-0.38	-0.42
AC Member	**1.11	0.92**	-0.64	0.84**	-0.17	0.11**	1.48**	1.02**	1.72	0.35**	0.92	0.29**
AC Ownership	0.20	0.32	0.18	1.36	0.19	-0.33	-1.35	-1.06	-0.99	1.37	1.55	1.49
AC Chair	0.20	1.38	1.00	1.09	1.12	-1.44	-0.48	-0.89	0.69	-0.01	-1.56	-0.86
IND AC	-0.78	-1.80	-1.95**	-1.84**	-2.25**	-2.67**	1.91	-2.29**	1.01	-0.34	0.19	0.26
NED AC	1.81	1.45	1.23	1.46	-0.21	-0.27**	-1.33**	-1.12**	-2.03	1.10	0.79	0.52
Firm Age	2.07**	3.39**	2.52**	2.93**	2.41**	-1.32	2.71**	1.96**	-0.38	-0.43	-1.42	-1.31
Board Size	1.24	1.88	1.95**	1.93**	2.79**	2.27**	1.49	1.61	-0.43	0.45	0.95	0.77
Firm Size	-6.75**	-6.01**	-3.59**	-5.14**	-9.25**	-9.36**	-4.98**	-6.50**	-6.31**	-7.63**	-5.6**	-6.05**
R ² (%)	51.0	49.5	33.9	43.4	63.5	62.4	42.8	49.3	39.5	50.1	43.1	44.2
Adj. R ² (%)	43.3	41.5	23.6	34.5	59.4	58.2	36.4	43.6	32.7	44.5	36.7	37.9
F (%)	6.64	6.24	3.27	4.88	15.47	14.75	6.66	8.64	5.807	8.92	6.72	7.04
Prob. (%)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Table 5. Regression analysis of performance variables

	Australia		Malaysia		Pakistan	
	ROA	ROE	ROA	ROE	ROA	ROE
AC Chair Meeting	0.79	0.10	-1.63	0.37	-0.32	-0.26
AC Member	-0.95	0.04	0.43	1.13	0.54	-1.24
AC Ownership	0.12	1.01	-0.63	-0.49	1.39	0.96
AC Chair	0.48	0.29	0.23	0.76	1.74	1.08
IND AC	0.11	0.29	-0.08	-1.31	0.89	-0.43
NED AC	0.85	-0.22	0.24	0.14	1.07	2.30
Firm Age	2.49**	3.01**	1.79	0.36	-0.60	-0.53
Board Size	2.29	1.25	0.01	-0.86	-0.66	0.54
Firm Size	5.45**	2.46**	6.60**	2.69**	2.10**	-0.49
R ² (%)	46.7	24.1	50.6	21.0	19.3	12.2
Adj. R ² (%)	38.4	12.2	45.0	12.1	10.2	2.3
F	5.592	2.025	9.102	2.361	2.121	1.24
Prob.	0.000	0.030	0.000	0.005	0.003	0.008

Firm size is significantly and positively associated with firm performance in line with Doyle, Ge, and McVay [2006] who finds that smaller and less profitable firms are more likely to have internal control problems than larger or more profitable ones. Our sample firms contain top firms in Australia, Malaysia and Pakistan with reference to profitability and market capitalization.

Conclusions

In this paper we examine the effects of audit committee structure on earnings management in Australia, Malaysia and Pakistan. These effects generally appear to be related to the controlling power of owners and/or management who attempt to pursue their own self-interest over shareholders. The study is motivated by the gap in existing literature and the limited evidence concerning developing countries, specifically in the Asia Pacific region.

Prior researchers have documented several factors that might cause the ineffectiveness of non-executive directors, such as having limited time, limited access to company information, lack of power and lack of independence. If audit committees are to have a positive impact in terms of enhancing the integrity of companies' financial reporting processes, they will need to retain their independence from the executive board and management. At the same time, the executive and management will need to understand and respect the audit committee's independence and functions.

Generally the findings are not in line with the agency theory that the board of directors and audit committee might mitigate agency problems leading to reduced agency cost by aligning the interests of controlling owners with those of the company. These findings can be interpreted in relation to the institutional theory that views these mechanisms as practices or regulations resulting from coercion by legislators who impose certain practices in order to improve organizational effectiveness, or as a result of imitation. In other words, the findings may be referred to this theory which suggests that companies might adopt practices or regulations as a result of coercion from a legislator who imposes some practices in order to improve organizational effectiveness. However, there is no prediction that the adoption of these regulations will improve organizational effectiveness.

An implication for further research in Asia Pacific economies relates to several areas of "boundary conditions" of the agency, stewardship and organizational theories in corporate governance. Multidisciplinary studies of this nature may contribute to a better understanding of what drives the effectiveness of audit committees. For example, future work can investigate the specific situations and circumstances in which audit committee structure may be beneficial for publicly listed companies. Investigating the factors of board effectiveness

with a multiple theoretical approach may help develop more effective models of corporate governance.

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