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Audit Committee Characteristics on Family Firms Performance in Indonesia

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Abstract

This study addresses the relationship between audit committee characteristics and family firm's performance in Indonesia. The samples use 122 family-controlled companies which are listed in Indonesia Stock Exchange from 2010 to 2014. The findings reveal that audit committee size has a positive relationship with firm performance. The larger audit committee can help companies to monitor and ensure the transparency of financial report. Hence, the investors will feel safe when they invest their fund in the company. However, the audit committee independent has a negative relationship with firm performance. While, debt helps to overcome the financial problems when shareholders need to expand their business.

Keywords: Audit committee characteristics, family firms, firm performance, Indonesia

1. INTRODUCTION

The majority of companies in East Asia countries especially Indonesia is well-known for family businesses. Family firms play an important role and contribute to Indonesia economy through its' Gross Domestic Product (Singapurwoko, 2013). The family firm is identified as the company which passing through the transition from one generation to next generation. Therefore, the dynamic of transition in family firm play an important role to guarantee the sustainability of the company (Singapurwoko, 2013). The sustainability means not only the existence of company, but also as a firm performance. Several studies on the family company have found a significant role in the family company in enhancing economic growth of a country (Singapurwoko, 2013; Itan, 2015; Robin & Amran, 2016). Therefore, those family firms need to implement good corporate governance to reduce the fraud and earning management in a company.

Corporate governance is a set of guidelines which is a company controlled, including the objectives, strategy, and planning structure of companies with a view to achieving the interest of stakeholders and enhancing the firm performance (Steiner & Steiner, 2006). Implementation of good corporate governance is a form of accountability for owners because it shows the transparency of the company that carried out by revealing financial statements which are a communication between the agent and principal (Hai & Lien, 2012). One of the element of corporate governance which can minimise the fraud and control the financial report is the audit committee.

The Indonesia Stock Exchange and the Capital Market Supervisory Agency (Bapepam-LK, 2014) through Kep-339/BEJ/07-2001 are required that public listed companies in Indonesia must have an audit committee, within the framework of the implementation of good corporate governance (GCG). The function of an audit committee is to provide an independent and professional opinion to the board of commissioners regarding issues and

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problems and how to overcome them in order to achieve a high firm performance.

The occurrence of the financial crisis in 1997 has to make Indonesian entities to be more careful in doing business, and the great lesson was learned from Enron case, whereby it involved a manipulation of their financial statements. Hence, the Indonesian government has created a regulation for those public listed companies should have an audit committee to ensure the financial reports on these companies are transparency and accountability. That is why this study is going to focus on audit committee characteristics with firm performance.

This paper examines whether governance is enhancing audit committee characteristics impact on family firm performance in Indonesia. The Code of Corporate Governance in Indonesia requires that public listed companies in Indonesia must have an audit committee, comprising one independent commissioner and two members from outside. The company should establish an audit committee no later than six months after listing on the IDX. Any listed company that has not appointed an audit committee must declare it in a written statement.

2. LITERATURE REVIEWS AND HYPOTHESES DEVELOPMENT

2.1 Importance of Audit Committee

The function of the audit committee is to provide an independent opinion based on the members' professional judgement and report to the board of commissioner on relevant matters such as to identify and solve problems for company to achieve high performance (Al-Matari, Al-Swidi & Fadzil, 2014). Further, the audit committee looks into directors' remuneration, selection, removal, scope of work and independence, in addition to resolving internal conflicts. Audit committees also review and agree upon the chosen accounting policies, including the adoption of the right standards and practices for financial reporting and disclosure of audit and financial reports. Besides monitoring the company's accounting processes, the audit committee ensures the company adheres to the relevant legislation and ethics, control, maintain and prevent the occurrence of fraud (Hamid, Othman & Rahim, 2014).

The stewardship theory claims that a high number of audit committee members can lead to better firm performance. An audit committee with few members could mean lack of diversity of skills and knowledge which can be ineffective (Owen-Jackson, Robinson & Shelton, 2009). Raghunandan and Rama (2007); Sharma, Naiker and Lee (2009); Rainsbury, Bradbury, and Cahan (2009) stated that the quality of the audit committee affects the quality of corporate financial reporting. In addition, the internal control system is critical to ensure the integrity of the company. The main activities of directors are monitoring and being responsible for the internal control of the company, but these tasks have been delegated to an audit committee. Therefore, the task of the audit committee is to provide accurate and quality financial statements with full disclosure to the shareholders (Sharma et al., 2009).

2.2 Audit Committee Characteristics and Firm Performance

The corporate governance regulators have ensured the accuracy financial statement for responsible towards to board of commissioners. Hence, it is important to note that audit committee size and audit committee meeting could serve as critical of corporate governance mechanisms. Financial statements are often used as the basis for assessing the firm's performance. The financial statements are useful to help investors, creditors, potential investors and other users in order to make investment decisions, credit decisions, stock-analysis and determine the prospects of a company in the future. By comparing the data in the income statement (financial ratios) such as return on equity (ROE), investors can know the financial condition and performance of the company (Nugrahani & Nugroho, 2010).

2.2.1 Audit Committee Size and Firm Performance

The audit committee is responsible for controlling the financial reports and monitoring the external audit and internal control systems (including internal audit). Alijoyo, Antonious, Bouma, and Sutawinangun (2004) stated that the audit committee has the function of helping commissioners to improve the accuracy of financial reports, creating a climate of discipline, increasing the effectiveness of the internal audit function and external audit. The audit committee also identifies issues that require the attention of the board of commissioners. In this way, the financial statements disclosed by the company may have a higher degree of reliability. Aldamen, Duncan, Kelly, McNamara and Nagel (2012) provided empirical evidence that companies that establish independent audit committee report earnings containing smaller discretionary accruals as compared to companies that do not form an independent audit committee. The discretionary accruals are related to the quality of corporate profits. Based on the discussion above, the following hypothesis is proposed.

H1: There is a positive relationship between audit committee size and family firm performance.

2.2.2 Audit Committee Independent and Firm Performance

The Code Corporate Governance in Indonesia required the company to have at least three audit committee members compromising one audit committee independent and two members from outside. The audit committee independent is measured through the ratio of independent commissioner members on the committee to all member of the audit committee (Kang & Kim, 2011) Hamid, Ahmad and Embong (2014) stated that audit committee independent plays a major role in minimizing financial fraud. They found that lack of audit committee members and high numbers of inside directors can lead to financial fraud. Therefore, an audit committee with a higher number of independent members is viewed more favorably. Based on discussion above, this study predicts that audit committee independent has negative relationship with family firm performance

H2: There is a positive relationship between audit committee independent and family firm performance.

3. DATA AND RESEARCH METHODOLOGY

3.1 Sample

This study utilised 122 public listed family companies in Indonesia Stock Exchange excluding the financial sector because of different regulations. This study used secondary data from financial reports which started from 2010 to 2014. The criteria of family controlled companies must have 20% shareholding or more and owned by family members. This study also used panel data because of the combination of data time series and cross section.

3.2 Model Specification

This paper propose two important characteristics of the audit committee, that are the audit committee size (H_1) and audit committee independent (H_2), for dependent variable is using return on equity (ROE) as a proxy for firm performance, and control variables are the firm size and debt.

The model use of this study as follow:
$ROE_{it} = \alpha_0 + \alpha_1 ASIZE_{it} + \alpha_2 AINDE_{it} + FSIZE + DEBT + \varepsilon_{it}$

Where by:
ROE = return on equity.
ASIZE = audit committee size.
AINDE = audit committee independent.
FSIZE = firm size.
DEBT = debt.
ε_{it} = the disturbance or error term.

4. FINDING AND DISCUSSION

4.1 Descriptive Analysis

Table 1: Max, Min, Mean and Standard Deviation on Family Controlled Companies

Variables	Min	Max	Mean	Std. Dev
ROE	-7.6848	3.8509	0.7109	0.5285
ASIZE	3	7	3.5262	1.3542
AINDE	0.1666	0.8333	0.4942	0.1241
FSIZE	10.047	13.916	12.097	0.7401
DEBT	0.0039	6.4989	0.6220	0.0565

The proxy of firm performance in this study is ROE. From Table 1, the average value for ROE is 0.7109 or 71% for 122 family controlled companies. These results show that family-controlled companies able to contribute a high return for investors and shareholders. Further, the average number of audit committee size is four people. It indicates that majority family-controlled companies have followed the guidelines from the Code which requires a minimum member of the audit committee should be three people.

Table 2: Frequency and Percentage of Audit Committee Independence on Family Controlled Companies

	Less 33%		Above 33%	
Year	**Freq.**	**%**	**Freq.**	**%**
2010	8	6.55	114	93.45
2011	6	4.91	116	95.09
2012	6	4.91	116	95.09
2013	5	4.09	117	96.91
2014	2	1.63	120	98.37

For audit committee independent, from Table 1, the average value of audit committee independent is 50%. Meanwhile, majority family-controlled companies in Indonesia Stock Exchange have followed the regulation to implement good corporate governance. From Table 2, the findings show that Indonesian family-controlled companies have increased regarding following the regulation of Code Corporate Governance from 2010 to 2014. However, there some family-controlled companies in Indonesia Stock Exchange still not comply with the regulation of Code which required minimum audit committee independent in a company should be 33%.

For control variables, the average value for firm size shows 12 billion rupiahs with minimum 10 billion rupiah and maximum 14 billion rupiahs. Meanwhile, those family-controlled companies are big business because it exceeds the requirement of public listed companies with a value of net assets more than 10 billion rupiahs. Next, the average value debt in Indonesian shows 62%. It indicates that majority Indonesian family-controlled companies are funding their capital by debt amounting to 62% of total assets.

4.2 Panel Regression Analysis

Table 3: Chow Test for Panel Data

Effect Test	Prob.	Conclusion
Cross Section F	0.000	Fixed Effect Test

From Table 3, Chow test results show that the value of Prob. Cross Section F (0.00) is less than α (5%), so the regression model which is most appropriate is the fixed effects model. F-test is less than 0.05, meanwhile that audit committee characteristics (audit committee size and audit committee independent) and control variables (debt and firm size) have a significant relationship with firm performance (ROE).

Table 4: Regression Analysis

Variables		**Coefficient**	**t-statistic**	**Prob.**
Constant		1.7502	1.3321	0.0801
ASIZE	H_1	0.3856	1.2140	.0112**
AINDE	H_2	-1.0412	-1.9547	-.4653***
SIZE		0.1289	1.0527	.02472
DEBT		0.7168	4.8542	0.0000
R^2		0.5241		

*significant at 0.1 (2 tailed); **significant at 0.05 (2 tailed); ***significant at 0.01 (2 tailed); ROE = return on equity; ASIZE = audit committee size; AINDE = percentage of audit committee independent divided by total audit committee; FSIZE = natural log of the book of total assets; DEBT = book value of long-term debt divided total assets.

The result of panel regression analysis in Table 4 shows that hypothesis H_2 is not supported. It is predicted that audit committee independent does not contribute to firm performance. The finding is consistent with a previous study (Klein, 2002). For the results of H_1 is supported, meanwhile, audit committee size proven positive effect on the firm's performance as measured by return on equity (ROE). The function of the audit committee can effectively control the management activity and prevent the fraud regarding increasing a firm performance and earning management (Al-Matari et al., 2014).

5. CONCLUSION AND LIMITATIONS

This study evidences that audit committee size has a positive relationship with firm performance. The audit committees are responsible for controlling the financial reports and ensure the accuracy of financial reports before submitting to the board of commissioners and published in Indonesia Stock Exchange. In this way, the financial statements disclosed by the company may have a higher degree of reliability. Further, audit committee can effectively control the management activity and prevent the fraud regarding increasing a firm performance and earning management. However, audit committee independent does not contribute to ROE. In Indonesian companies, the board of commissioner may promote better firm performance and ensure large shareholders return. Similarly, independent commissioners are better monitors of management than inside directors. In like manner, the independent commissioners are seen as acting in the interest of shareholders which influences a significant excess return. This applies in particular when the independent commissioners are a member of the audit committee. This study just focuses on family-controlled companies in Indonesia Stock Exchange. Therefore, future research may consider comparing the family and non-family controlled companies. Future study can also add in new characteristics of audit committee such as audit committee education, audit committee expertise, and audit committee meeting.

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