

# The Impact of Audit Committees Controls Commitment on Strengthening Corporate Governance: Evidence from Jordan

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## Abstract

This study aims to determine the extent to which the Boards of Directors of the industrial Jordanian Companies listed on Amman Stock Exchange (ASE) comply with the controls of composing audit committees, their working mechanisms, and the impact on the corporate governance. To achieve the objectives of this study, (155) questionnaires were developed and distributed to the staff members relevant to the subject matter of the study. Out of distributed questionnaire, (144) responded questionnaires only were collected from respondents. The number of questionnaires analyzed was (135) and a T-test has been used to test the hypotheses. The results of the study showed that there is a statistically significant correlation on the existence of the commitment of the Boards of Directors of the Jordanian Listed Companies to the disciplines of audit committees' formation and their mechanisms of work. The results also demonstrated the existence of impact of this commitment on the governance of these companies. The commitments to these controls and their work mechanisms have been developed to enhance corporate governance in Jordanian companies.

**Keywords:** audit committees, working mechanisms, audit committees' formation, corporate governance, ASE

## 1. Introduction

Many international institutions, such as; Stock Exchanges and professional organizations in many countries set laws, controls, and ethical principles for the financial and non-financial control over the company's management for the purpose of protecting investors and related parties from financial manipulation and administrative corruption, as well as enhancing confidence and credibility in the accounting information provided by the declared financial statements. The financial statements users, in particular the investors involved in the stock market, require this information. This set of controls and principles is called corporate governance.

For the Boards to be able to effectively carry out their supervising and regularity responsibilities, they must have the capacity to exercise independent substantive governing on the company affairs (Makhlouf et al., 2017; Makhlouf et al., 2018). At this point, the structures of the Boards need to be made of executive and non-executive members (Makhlouf et al., 2018). The Audit committee is one of the Board emanating committees and deemed a key pillar of the corporate governance.

The listed companies are required to form audit committees in compliance with the Jordanian corporate governance requirements issued in 2009. The mechanisms of corporate governance in Jordanian public shareholding companies were amended on 22/5/2017 and applied as of first day of January 2018 for the global trends to activate the corporate governance. Therefore, this study was conducted to determine the importance of the Jordanian public shareholding companies' compliance with the controls of composing the audit committees and their work mechanisms in strengthening corporate governance according to the requirements of the Amman Stock Exchange.

The Audit Committee is one of the committees emanating from the Board of Directors. It represents the tool for ascertaining the application of corporate governance rules. Many tasks and duties has been set out for it, so it may have a role in improving internal control systems, supporting the independence of the external auditor and enhancing the credibility of the financial lists (Oroud et al., 2017). To achieve objectivity, efficiency, independence and effectiveness in the functioning of the audit committees, the Boards are required to adhere to a set of controls and standards when they select the committee members.

In view of the identified knowledge gaps in this field of scientific research, the present study was intended to seek and provide answers for the following questions:

- Are the Board of the Jordanian Public Shareholding Companies obliged to the controls of audit committees' formation, in such manner enhancing the corporate governance?
- Is there any working mechanism set by the Boards of Directors of the Jordanian Public Shareholding Companies to enhance corporate governance?
- What is the impact of compliance with the controls of the formation of audit committees and their working mechanisms on the governance of Jordanian public shareholding companies?

## **2. Objectives of This Study**

- To identify the importance of Jordanian public shareholding companies' Boards commitment with the formation of audit committees.
- To identify the importance of work mechanisms of audit committees in the Jordanian public shareholding companies.
- To identify the impact of compliance of the compliance with the controls of audit committees formation and their work mechanisms on the corporate governance of Jordanian public shareholding companies.

## **3. Literature Review**

Researches and studies indicate that the concept of audit committees and the consequent responsibilities that have been developed significantly since its first emergence to cover the shortcomings in auditing (Rehaili, 2008, p. 194). The American Society of Chartered Accountants formed audit committee first in USA, which is one of the first leading countries initiated to form the audit committee, in 1967 (Abdul Majeed & Ghali, 2003). In France, the establishment of these committees began in 1985 by the Exchange Operations Committee after submitting its report No. 17 to the Presidency of the Republic, which proposed the establishment of audit committees. In 1986, after the organization of a forum on audit committees in USA by the Institute of Internal Auditors, with the contribution of Exchange Operations Committee and the National Company of French Accounts Governors, it has been decided to set up a working group to study the possibility of establishing audit committees similar to the American committees in France. In the United Kingdom, the Cadbury Committee of London Stock Exchange in 1992 issued the formation of audit committees in shareholding companies.

In Jordan, like other countries, many concerned authorities were interested in the existence of audit committees in the Jordanian companies. It was initiated in 2/1/1996, when the Central Bank of Jordan compelled the banks under its Notice No. 7020/68 to form audit committees from the members of the Board of Directors. In 2000, the Banks Act No. 28 was issued under which the banks are obliged to form audit committees from non-executive members (Jordan Banking Law of 2000).

It should be noted that one of the most important reasons behind the formation of audit committees is addressing the independence of the auditor. Therefore, among the proposals adopted was to select the audit committee members from the non-executive members of the Board. The number of the audit committee often three to five members. The number may be increased to reach seven members from the non-executive Board of Directors members (Arens, 2002, p. 123). Jordan's securities law has also required all public shareholding companies whose shares are used in the Stock Exchange to appoint an audit committee, which is composed of two to seven members of an external board of directors who have no relation with the executive policies and independent from the management (al-Tamimi, 2006).

The countries around the world seek to form the audit committees. Boards of shareholding companies carry out this task because the Board is responsible to identify the tasks and duties of the audit committees. Therefore, it is required for the audit committees to be independent from the Board, who form the audit committee and select its members alone. Furthermore, it is necessary for the audit committees' members to acquire the skills to carry out their duties to the best (Warther, 1998, p. 55).

Corporate governance has a continuous importance in the Accounting literature. In the last three decades, the accounting studies have been interested in studying the various dimensions of corporate governance (Yan & Steen, 2014) due to its role in improving the economic, investment and financial performance. Therefore, it has become necessary to apply corporate governance and follow-up its systems in most of the departments to ensure the rights of shareholders, investors and community.

As the concept of corporate governance arose after the emergence of Theory of Agency, which includes a conflict of interest between the management of the organization, stakeholders, and shareholder in general,

American Institute of Chartered Accountants (AICPA) established in 1987 a committee to protect the administrative organizations, called the Committee of Sponsoring Organization –COSO), known as Treadway Commission. Treadway Commission issued its report that includes a range of recommendation related to the application of corporate governance rules and associated prevention of fraud and manipulation in the preparing the financial statements by paying attention to the concept of internal audit system and strengthening its function before the Boards of Directors of the companies (Suleiman, 2006).

The concept of governance aims to create the integration between the interrelationships of the related parties. It also identifies the rules and procedures pertinent to decision making in the economic unit, identifies the structure by which the objectives are set, the means of achieving such objectives and means of performance control (Helayl & Karim, 2017).

The Organization for Economic Co-operation and Development (OECD) is one of the first organizations that discussed and addressed corporate governance. OECD issued the principles of governance the organization in 1999, then developed these principles related to corporate governance in 2004. Most of the countries adopted these principles (Yamin & Ramahi, 2016). These principles have been discussed in OECD/G20 corporate governance conference in April 2015. After this conference, OECD adopted these principles on 8<sup>th</sup> July 2015 and then submitted to the leaders of G20 on 15-16 November 2015 in Antalya, where they were endorsed and launched by the OECD/GV20 principles for corporate governance.

These principles aim to assist policymakers in assessing and improving the legal, regulatory and institutional framework for corporate governance, with the aim of supporting economic efficiency, sustained growth and financial stability. This may be achieved primarily through the provision of appropriate incentives to shareholders, members of the Board of Directors, executive directors, as well as financial intermediaries and service providers, within the framework of relevant controls. (Union of Arab Securities Authorities, 2015).

Study of (Arroud, 2018) aimed to serve the scientific research by examining the impact between the characteristics of the Audit Committee (the size of the Committee, its independence, the number of its meetings and the financial expertise of its members) and the financial performance of the industrial companies listed on the Amman Stock Exchange during the period 2012-2016. The researcher adopted Agency Theory and Resource Dependence Theory to explain the variables of the Model. This study used the methodology of cross-sectional time data on (63) industrial companies by watching (255) views. The study also used the size of the company and the financial leverage as control variables in the study model. By analyzing the data using the fixed regression model, the results indicate that the characteristics of the Audit Committee (the size of the Committee, its independence, the number of meetings and the financial experience of its members) has a moral impact on the return on assets (ROA). The model explains 15% that there was an impact of both the independence of the committee and the number of its meetings. On the other hand, the statistical analysis showed a that the characteristics of the Audit Committee (the size of the Commission, its independence, the number of meetings and the financial experience of its members) impact on the return on the rights of owners. The model was interpreted by 16.80% of the study variables. Based on the results and statistical analyses, the study found that relying on the theory of resources dependence had a greater impact than the agency theory on interpreting study variables. Al-Kafawein (2018), the study aimed to know the role of the corporate governance mechanisms represented by (percentage of board members ‘ ownership, board size, independence of board members, number of times of board meeting annually, board of Directors Rewards) in maximizing profitability (rate of return on assets, rate of return equity, net profit margin) in the Jordanian industrial public shareholding companies.

The Study of (Hussein et al., 2016) titled “The role of internal audit in evaluating financial performance at state universities in the Red Sea State”. The study aimed to identify the concept, importance, objectives and role of internal audit, as well as to identify the concept and essentials of financial performance evaluation. It also includes the role of the internal audit and its effectiveness in the evaluation of the financial performance at the state universities at the Red Sea State. The study problem was that there was no sufficient interest in the internal audit at the state universities at the Red Sea State. The study followed the historical approach, the deductive approach and analytical descriptive approach. The data were collected using the questionnaire and analyzed using statistical and mathematical methods. One of the findings of the study was that internal audit encounter many difficulties, such as a shortage of auditors, and the lack of sufficient interest in internal audit by the administrations of the state universities of the Red Sea State.

Furthermore Nuhu, Umaru, and Salisu (2017) and Azzoz and Khamees (2016) aimed to demonstrate the impact of the quality of the internal audit committees (members of the Committee, their independence, financial expertise of members) on the financial performance of companies

## 4. Methodology of This Study

### 4.1 Study Population

The study population consists of the Jordanian shareholding companies listed in Amman Stock Exchange, located in Amman, the capital of Jordan.

A random sample was selected from the study population. The study sample consisted of (15) companies. (150) questionnaires were distributed to the sample study, and (144) questionnaire thereof were collected, and (9) were excluded for incomplete information. (135) questionnaires were analyzed. Table 1 shows the distribution of the sample members of the study according to the study variables.

Table 1. Distribution of study sample according to the variables of the study in ascending order in terms of number and percentages of categories

Study variables	Variable levels	Number	%
Sex	Female	29	21.5
	Male	106	78.5
	Less than 5 years	15	11
Experience	From 11 to 15 years	35	26
	From 4 to 10 years	35	26
	Above 16 years	50	37
Position	Auditor	15	11.1
	Investor	30	22.2
	Financial intermediary	45	33.3
	Others	45	33.3
	Accounting	25	18.5
Education Specialization	Business Administration	40	29.7
	Marketing	50	37
	Others	20	14.8

We note from table (1) above that the members of the study sample according to the study variables were as follows:

- Sex:

The number of female employees was 29, at 21.5%. The number of male employees was 106, at 78.5%. The number of males was three times than female.

- Experience:

The number of employees with less than 5 years of experience is 15, at 11%. They are the lowest category in the study sample for experience, followed by ascending, employees who have from 5-10 years, and 11-15 years. The number of each category was (35) employees at 26%. Followed by employees of (16) years and over, who were 50 employees, at (37%). This category is the highest in the study sample in respect of experience.

- Position:

The number of auditors was (15), at (11.1%). They are the lowest number in the study sample for position, followed by ascending, the investors, who were (30) employees at (22.2%), then financial intermediary employees and others, who were (45) at (33.3%).

- Specialization:

The number of employees whose specialties are other was (20) employees at (14.8%). They are the least category of the study variables in respect of specialty, followed by ascending, the accountants, who were (25) at (18.5%), then business administration who were (40) at (29.7%), then Marketing specialization, who were (50) employees at (37%) and they are the highest number of study sample in respect of specialty.

### 4.2 Study Instrument

The two researchers developed the study questionnaire after having referred to the theoretical literature in connection with the importance of the Jordanian Public shareholding companies' commitment with the formation of audit commissions controls and the mechanisms of their work in promotion of corporate governance and previous studies related. The questionnaire consists of (15) paragraphs. Five-point Likert scale was adopted. One

point was given to the answer (I do not agree strongly) to five points to the answer (strongly agree). The study tool consists of two parts:

Part 1: related to the personal variables of the employee responding to the questionnaire questions, represented in (sex, experience, academic qualification, and specialization).

Part 2: related to the importance of the Jordanian public shareholding companies' commitment with the controls of audit commissions formation and the mechanisms of their work in promotion corporate governance, which are (15) paragraphs.

#### 4.3 Validity of Study Instrument

The validity of study tool has been confirmed by presenting it to three competent arbitrators to express their point of views in the paragraphs of each hypothesis, in terms of the paragraphs relevance to the study hypotheses, clarity, and proper formulation. They were modified according to the recommendations of the arbitrators' notes and proposals.

#### 4.4 Reliability of Study Instrument

The reliability of the tool has been validated, through the internal consistency of the study tool according to the answers of the study sample relying on Cronbach Alpha. The reliability coefficient was 83.2%, which is acceptable for the purposes of the study.

#### 4.5 The Statistical Methods Used

In order to achieve the objectives of the study, the SPSS program has been used to answer the questions of the study and test its hypotheses using of the appropriate statistical methods as follows: T-test for the independent variables.

### 5. Results

This section contains a presentation of the conclusions of the study by answering its questions, and testing its hypotheses as follows:

Hypothesis I:

HO: There is no statistically significant impact at the significance level ( $\alpha \geq 0.05$ ) on the existence of the commitment of the boards of directors of Jordanian public shareholding companies to the controls of audit commissions' formation.

To answer this hypothesis, addressed by the questionnaire paragraphs (1-6), the arithmetic means, standard deviations, ranks and degrees of practice were found as shown in Table 2 herein below:

Table 2. The arithmetic means, standard deviations, degree of practice of the impact of commitment of the Boards of Jordanian Public shareholding companies to the controls of audit commissions formation

Paragraph	Arithmetic mean	Standard deviation	Rank	Degree of practice
1 The Public Shareholding companies comply with the control of audit committees' formation.	3.4	1.1	3	Average
2 The commitment of public shareholding companies to audit committee controls gives more credibility to financial reports.	3.0	1.1	4	Average
3 The commitment of public shareholding companies to audit committee controls helps in the implementation of corporate governance.	4.0	1.2	1.0	High
4 The commitment of public shareholding companies to audit committee controls facilitates the transfer of share ownership between shareholders.	3.9	1.2	2.0	High
5 The commitment of public shareholding companies to audit committee controls preserves shareholders' equity.	3.0	1.1	4.0	Average
Overall average	3.6	1.2	-	High

Table 2 above shows that the members of the study sample consider that there is an impact on the existence of the boards of directors of Jordanian public shareholding companies' commitment to audit committees' formation. The general arithmetic mean of this hypothesis is (3.6), which indicates high practicing. Paragraph No. (3) was ranked first with high degree of practicing. The said paragraph states "The Boards of the Jordanian public

shareholding companies are committed to the controls of formation of audit commission”.

Paragraph (2) was ranked the last with average degree of practice. It states, “The commitment of the public shareholding companies to the controls of audit committee controls gives the financial reports more credibility”. The paragraphs of the hypothesis were grounds for rejecting the null hypothesis and accepting the alternative hypothesis, which states, “There is an impact on the existence of the commitment of the Boards of Jordanian public shareholding companies to the controls of formation of audit committees”.

Table 3. T-test elated to the impact of the existence of the Boards of the Jordanian Public shareholding companies’ commitment to the controls of formation the audit commissions

Hypothesis I	T calculated value	T tabular value	Significance level less than 0.05
H1	11.6	3.96	0.000

Table (3) above shows that the calculated value is (11.6), which is greater than the tabular value (3.96), with significance level (0.000), which is less than (0.05). This indicates that there is a statistically significant impact at significance level ( $\alpha \geq 0.05$ ) on the commitment of Boards of Jordanian Public shareholding companies to the controls of the Jordanian audit commissions’ formation.

### *Hypothesis II*

HO: There is no statistically significant effect at the level ( $\alpha \leq 0.05$ ) on the existence of working mechanisms for audit committees to be developed by the boards of directors of Jordanian public shareholding companies.

To answer this hypothesis, which is addressed by the questionnaire paragraphs (6-10). The arithmetic means, standard deviations, ranks and degree of practice were found for the paragraphs of this hypothesis as shown in table 4.

Table 4. The arithmetic means, standard deviations, and degrees of practice for the fact of the impact of the existence of working mechanisms for audit committees developed by the Boards of the Jordanian companies

	Paragraph	Arithmetic mean	Standard deviation	Rank	Degree of practice
6	There are audit committees emanating from the board of directors of the Public Shareholding Companies.	3.4	1.1	3	Average
7	The company provides a variety of services through the work of audit committees.	3.0	1.3	4	Average
8	Working methods of audit committees help in facilitating the company’s working procedures.	4.0	1.2	1.0	High
9	Commitment to the working mechanisms of audit committees helps the company to achieve the necessary degree of accountability and follow-up.	3.9	1.2	2.0	High
10	Commitment to the working mechanisms of the audit committees helps the company to detect distractions.	3.4	1.1	3.0	Average
	Overall average	3.8	1.2	-	High

Table 4 above shows that the members of the study sample consider that there is an impact of existence of working mechanisms of the audit committees developed by the Boards of the Jordanian public shareholding companies, the study sample. The arithmetic mean of this hypothesis is (3.8) with high practice degree. Paragraph (8) was ranked first with high practice degree. It states, “Working methods of audit committees help in facilitating the company’s working procedures”. Paragraph (7) was ranked the last, with average practice degree, which states “the company provides a variety of services through the work of audit committees”. The paragraphs of the hypothesis were the ground of rejecting the null hypothesis and accepting the alternative hypothesis, which stipulates, “There is an impact to the existence of the working mechanisms of audit committees developed by the Boards of the Jordanian Public shareholding companies”.

Table 5. T-test related to the impact of the existence of working mechanisms of audit commissions developed by the Boards of Jordanian public shareholding companies

Hypothesis I	T calculated value	T tabular value	Significance level less than 0.05
H1	11.7	3.96	0.000

Table 5 above shows that the calculated value is (11.7), which is greater than the tabular value (3.96), with significance level (0.000), which is less than (0.05), i.e. there is a statistically significant impact on the existence of working mechanisms of audit commissions developed by the Boards of Jordanian public shareholding companies.

### **Hypothesis II**

H<sub>0</sub>: There is no impact of statistical significance at ( $\alpha \geq 0.05$ ) for the audit committees (controls of formation and working methods) on the governance of Jordanian public shareholding companies.

In order to answer on this hypothesis, addressed by the paragraphs (11-15) of the questionnaire, the arithmetic means, standard deviations, ranks and practice degree were found for the paragraphs of this hypothesis as shown in Table 6 herein below:

Table 6. The arithmetic means, standards deviations and practice degree of the impact of audit committees (controls of formation and working methods) on the governance of Jordanian companies

	Paragraph	Arithmetic mean	Standard deviation	Rank	Degree of practice
11	The working mechanisms of audit committees help to implement corporate governance.	3.4	1.1	3	Average
12	The work of audit commissions is considered a control link between the beneficiaries of the financial reports and the company.	3.3	1.1	4	Average
13	All the Company's departments are subject to audit committees.	4.0	1.2	1.0	High
14	The working mechanisms of the Audit Committees work to achieve equality among all shareholders	3.9	1.2	2.0	High
15	The working mechanisms of the Audit Committees help on the protection of rights of stakeholders.	3.7	1.2	2.0	High
	Overall average	3.7	1.2	-	High

Table 6 above shows that the members of the study sample consider that there is an impact of the audit committees (controls of formation and working mechanisms) on the governance of Jordanian public shareholding companies, the study sample. The arithmetic mean of this hypothesis is (3.7) with high practice degree. Para (13) was ranked first with high practice degree. It stipulates, "All the company's departments are subject to the work of audit committees". Paragraph (12) was ranked last, with average practice degree. It stipulates, "The work of audit commissions is considered a control link between the beneficiaries of the financial reports and the company". The paragraphs of the hypothesis were the ground for rejecting the null hypothesis and accepting the alternative hypothesis, which states, "There is an impact for the audit Committees (controls of formation and working methods) on the governance of Jordanian public shareholding companies".

Table 7. T-test related to the impact of audit commissions (controls of formation and working methods) on the governance of Jordanian public shareholding companies

Hypothesis I	T calculated value	T tabular value	Significance level less than 0.05
H1	12.6	3.96	0.000

We note from Table 7 above that the (t) calculated value (12.6) is greater than (t) tabulated value (3.96) with significance level (0.000), which less than (0.05); i.e. there is an impact of statistical significance for the audit committee (controls of formation and working mechanisms) on the governance of Jordanian public shareholding companies.

## **6. Conclusions and Recommendations**

Through the field study, this study concluded the following results:

- 1) There is a statistically significant correlation at the significance level ( $\alpha \leq 0.05$ ) on the existence of a commitment of the boards of directors of Jordanian public shareholding companies to the controls of formation of Jordanian audit committees.
- 2) There is a statistically significant correlation at the significance level ( $\alpha \leq 0.05$ ) on the existence of working

mechanisms of audit committees developed by the boards of directors of Jordanian public shareholding companies.

3) There is a statistically significant correlation at the significance level ( $\alpha \leq 0.05$ ) for the audit committees (their composition and working mechanisms) on the governance of Jordanian public shareholding companies.

The study recommends the followings:

- 1) The need to oblige the boards of directors of Jordanian public shareholding companies to the commit to the controls of formation the Jordanian audit committees.
- 2) The need to have working mechanisms for audit committees to be developed by the boards of directors in Jordanian public shareholding companies.
- 3) The need to enable audit committees, through its controls of formation and working methods, to be able to govern Jordanian public shareholding companies.

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