FACTORS INFLUENCING AUDIT COMMITTEE MEETING FREQUENCY IN INDONESIA LISTED FIRMS

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ABSTRACT

This study aims to examine factors influencing the frequency of audit committee meetings. Frequency of meetings reflects the activities of the audit committee which are often used as a measure of its effectiveness. This study uses ownership concentration, insider ownership, board size, and the proportion of independent commissioners as variables expected to affect the frequency of audit committee meetings. This study is based on research by Greco (2011) with some modifications to accomodate Indonesian context. Population of this study is non–financial companies listed in Indonesia Stock Exchange (IDX) 2013. Sampling technique used is random sampling. A total sample of 85 companies is used for analysis. Data are analyzed using multiple regression analysis. The results of this study indicate that insider ownership has a negative effect on audit committee meeting frequency whereas proportion of independent commissioner has a positive effect on audit committee meeting frequency. However, this study does not find negative effects of the ownership concentration and board size on the frequency of audit committee meetings. Findings support the view that large insider shareholder has substitute effect for monitoring activity by audit committee. Moreover stronger representation of independent commissioner is an effective governance mechanism in a setting featured by large controlling shareholders by its significant role influencing audit committee activities.

KEYWORDS: *frequency of audit committee meetings, ownership concentration, insider ownership, board size, independent commissioners*

1. INTRODUCTION

Nowadays the existence of audit committees has been an important part of Good Corporate Governance (GCG). In many countries, the existence of the audit committee has been legally obliged by regulation to companies in achieving good corporate governance. Many cases of large companies went bankrupt as a result of ineffective in implementing good corporate governance.

GCG emerged as a standard for the company to protect its shareholders interests. One important component of good corporate governance is the board of directors. In Indonesian context, the role of oversight management conducted by board of commissioners. This structure refers to two boards system that is adhered by Indonesian regulations. In this system, board structure consists of board of directors and board commissioners. Board of commissioners ensures the implementation of corporate strategy and overseeing management in running the company. Board of commissioners establishes committees to assist their tasks. Among of the committee is audit committee overseeing the company. Board of commissioners along with its instrument, the audit committee, has a vital role in overseeing the company operation for the benefit of the investors (Restria & Cahyonowati, 2014).

In realizing the GCG, the government of Indonesia requires companies to have an audit committee. This obligation is stipulated in Rule IX.I.5 of the Capital Market Supervisory Agency and Financial Institution. Moreover, the establishment of audit committee in State-Owned Enterprises (SOEs) is stipulated in the Decree of the Minister of State-Owned Enterprises No. KEP-103/MBU/2002 on the establishment of the Audit Committee on State-Owned enterprises and also regulated in the State-Owned Enterprises Act No. 19/2003.

According to Rule Number: IX.I.5, the audit committee is a committee established by and responsible to the board of commissioners with the role for assisting the duties and functions of the board of commissioners. The audit committee has an important role to supervise and monitor the company's financial reporting process, internal control and external audit.

The effectiveness of audit committee can also improve transparency in the securities market, resulting in better protection of shareholders and increased value of the company (McMullen & Raghunandan, 1996;

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DeZoort *et al.,* 2002). In carrying out its functions, duties, and responsibilities, audit committees can hold meetings periodically as determined by the audit committee itself. Audit committee meeting is a means to discuss significant issues previously discussed with management and to monitor the accuracy of financial reporting (Gantyowati & Nugraheni, 2014). Therefore, the frequency of audit committee meetings can indicate the level of diligence of audit committee members in overseeing the company (Raghunandan & Rama, 2007).

The success of the audit committee in carrying out its duties and responsibilities are influenced by diversity of resources of audit committee members. This diversity can be seen from various aspects such as educational background, competence, experience in business and industry, career and work experience. In addition, the audit committee's performance cannot be separated from the activities conducted by the committee such as the number of meetings held by members of the audit committee in each year as well as the time commitment of the members of the audit committee (Rustiarini, 2012). The number of meetings of the audit committee is often used to assess the effectiveness of the audit committee. Blue Ribbon Committee (1999) recommends a minimum of four meetings a year to the audit committee to be effective. KPMG (1999) proposes meeting frequency between three and four times in one year, while PwC (1993) suggests a minimum of four meetings a year to the audit committee to be effective.

Frequency of meetings is often considered in previous studies as a proxy for the level of monitoring activity (Collier and Gregory, 1999; Vafeas, 1999; Lakshmana, 2008; Sharma *et al.,* 2009). Given that the importance of the effectiveness of the audit committee, there are many studies try to determine the factors affecting it. For instance, Greco (2011) analyzes the determinants of the audit committee meeting frequency in Italian companies. These factors include the concentration of ownership, ownership by a company management (insider ownership), the size of the board of directors, CEO duality, the proportion of independent directors, and the existence of an independent commissioner as chairman. This study finds that the concentration of ownership, insider ownership, CEO duality, the existence of an independent commissioner as chairman do not influence the frequency of meetings of the audit committee. While the proportion of independent commissioners, board size, and the size of the company influence the frequency of meetings of the audit committee.

The ownership structure is regarded as a major determinant of board activity. In a condition described by the concentration of ownership of external parties, controlling shareholders might be looking for ways to maximize their own interests and take over the wealth of other investors (Shleifer & Wolfenzon, 2012; Dyck & Zingales, 2004). In this situation, the agency conflict is presence between majority shareholders and minority shareholders. Previous studies have found that controlling majority ownership has a negative impact on the frequency of meetings of the audit committee (Mendez and Garcia, 2007). However, Greco (2011) does not fnd that the concentration affect the meeting frequency of the audit committee.

Based on agency theory, ownership by management has two sides that influence agency costs (Jensen & Meckling, 1976; Shleifer & Vishny, 1997). First, ownership by insider can align management and shareholder interests. Ownership by the company's internal parties can be interpreted as a shareholder of the management and actively participate in corporate decision. Ownership by insider can replace the other supervisory mechanisms (Leftwich *et al.,* 1981; Fama & Jensen, 1983). This occurs because as insider party, they can provide direct supervision to access corporate information. Prior study found that ownership by insider has a negative impact on the company's internal audit committee meeting frequency (Mendez & Garcia, 2007). Second, ownership by insider can entrench management, therefore it increase agency costs (see Sharma et al, 1999; Fama & Wong ,2002).

Board size is also deemed as an important factor affecting audit committee activity. Larger board size gives access to greater resources and higher managerial talents, so it provides more effective oversight. Adelopo *et al.* (2012) document a positive relationship between the size of the board with the activities of the audit committee.However,ut the Greco (2011) and Yin *et al.* (2012) do not findt relationship between board size and meeting frequency of the audit committee.

Prior studies also suggest that the proportion of independent directors on the board contributes to improve the supervision of the company (Carcello *et al.,* 2002). Vafeas (1999) argues that independent commissioners tend to require a board meeting to improve their ability to oversee management. Independent commissioner may require greater internal control over financial reporting processes in order to protect their reputation. These claims resulted in more frequent audit committee meetings held within the company. Nevertheless, Yin et al. (2012) found that the proportion of independent directors is negatively related to the frequency of audit committee meetings.

Based on the discussion, it can be formulated research problems in the following research questions: (1) Does ownership concentration affect meeting frequency of audit committee? (2)Does insider ownership effect on the frequency of audit committee meetings? (3) Does the board size effect the frequency of audit committee meetings? (4) Does the proportion of independent commissioners affect on the frequency of audit committee meetings? This study is expected to contribute especially for the improvement of good

corporate governance practice in Indonesia and other developing countries that are characterized by large controlling shareholders presence.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

In agency theory perspective, high ownership concentration has incentive and entrenchment effects. The majority shareholders have an incentive to closely monitor the management and ask for effective mechanism in ensuring corporate governance implementation (Leftwich *et al.,* 1981; Shleifer & Vishny, 1997). Shleifer and Vishny (1986) and Mendez and Garcia (2007) argue that relatively concentrated ownership of the majority shareholder has a strong motivation to oversee the company's managers for their claims for greater profit. The agency problem between shareholders and managers will be reduced by the majority shareholder oversight and monitoring of manager behavior (Yin et al., 2012). On the other hand, majority shareholders may also have the motivation to expropriate the interest of minority shareholders. They tend to take advantage of the benefits of private control resulting in the less interest in strengthening monitoring environment (Shleifer & Vishny, 1997; Dyck & Zingales, 2004). Mendez and Garcia (2007) and Yin et al (2012) found that the controlling majority shareholders have a negative correlation with meeting frequency of the audit committee. Hence, we predict a negative influence of ownership concentration on the number of audit committee meetings.

H1: Concentration of ownership negatively affects the frequency of audit committee meetings

Agency theory explains the conflict of interests between management and shareholders as a result of the separation of ownership and management. There are two effects of ownership by company internal party that can align the interests of management and shareholders as well as to reduce agency costs (Greco, 2011). The high degree of alignment of interests between management and the majority shareholders are expected to reduce agency costs (Greco, 2011). Ownership by management reduces agency costs because ownership of shares in the company will motivate management to behave as shareholders. It will decrease the asymmetry of information for managers as shareholders since they directly participate in operational activities and supervision of the company. Insider ownership is found negatively related to the audit committee meeting frequency (Mendez & Garcia, 2007). Hence, the increasing ownership by company officials is predicted to reduce the number of audit committee meeting frequency due to the reduced demand of supervision by the audit committee. It leads to the following hypothesis:

H2: Ownership by insider negatively affects the frequency of audit committee meetings

One important factor that is considered to affect the activity of the board is the board size (Greco, 2011). The large size of the board is a form of inefficient corporate governance because it gives rise to coordination problems and slower decision-making. Therefore it yields more frequent audit committee meetings (Vafeas, 1999). The large number of board members can cause more real diversity of perspectives in the discussion. However, increasing board size can also cause a decrease in the activity of the audit committee (Greco, 2011). The number of commissioners would cause a greater reduction in the number of audit committee meeting frequency (Sharma et al, 2009). Larger size of the board offers the greater resources and managerial talent that important for effective monitoring. It will increase the effectiveness of the monitoring by the board of commissioners. Base on the discussion. board size is predicted to have a negative association with the frequency of audit committee meetings.

H3: The size of the board of commissioners negatively affects the frequency of audit committee meetings

Based on agency theory, independent commissioners can provide effective oversight of management. Vafeas (1999) argues that independent commissioners tend to require more frequent meetings to improve the effectiveness of management oversight. Independent commissioner may insist greater internal control over financial reporting processes in order to protect their reputation. This demand could lead to more frequent of audit committee meetings (Menon & Williams1994; Greco, 2011). Hence, it can be concluded that the greater proportion of independent commissioners on the composition of the board members, the more demand to hold a meeting

H4: The proportion of independent commissioners positively affects the frequency of audit committee meetings.

2. METHODOLOGY

2.1 Population and Sample

The population used in this study is non-financial companies listed on the Indonesian Stock Exchange (BEI) in 2013. Companies were selected as sample if they met the following criteria: (1) The Company's non-financial listed in the Indonesia Stock Exchange (BEI) in 2013; (2) The Company has published annual

reports for the period of 2013; and (3) the Company has complete data as required in this study. Based on these criteria, this study obtained 85 companies as sample. Data were collected from company's annual report that was accessed through the official website of Indonesia Stock Exchange (IDX).

2.2 Research Variables

2.2.1Frequency of Meetings of the Audit Committee

The audit committee may call a meeting on a periodic basis as determined by the audit committee itself. According to Rule No.IX.I.5 of the Capital Market Supervisory Agency and Financial Institution, the audit committee holds regular meetings at least once in three months. In this study, this variable is measured by the number of audit committee meetings

2.2.2 Ownership Concentration

Concentration of ownership occurs if there are one or several investors who control significantly the outstanding shares of a company. Ownership concentration in this study is measured by the largest percentage of shares owned by an investor in the company.

2.2.3Insider Ownership

Insider ownership is ownership by the company management. Measurement of this variable based on the total percentage of ordinary shares owned by members of the board of commissioners and board of directors.

2.2.4 Board of Commissioners Size

One important factor that is considered to affect the activity of the board of commissioners is the board size.Board size enables effective decision making and monitoring. Board size is measured by the number of board of commissioner member company *i* divided by the highest number of board of commissioner member of sample.

2.2.5 Proportion of Independent Commissioner

Independent commissioners on the board contribute in improving the supervision of the companies. This variable is measured by dividing the number of independent commissioners by the total number of commissioners.

2.2.6 Control Variables

To control other factors affecting audit meeting frequency, this study also includes several control variables. Those are firm size, leverage, firm age, and profitability.

2.3 Analysis Method

The main analysis method used to test the hypotheses is multiple regression analysis. Regression equation for this study is as follows:

$$ACMEET_i = \alpha + \beta_1 COWN_i + \beta_2 INOWN_i + \beta_3 BCSIZE_i + \beta_4 IND_i + \beta_5 SIZE_i + \beta_6 LEV_i + \beta_7 AGE_i + \beta_8 ROA_i + \varepsilon_i \quad (1)$$

Where:

ACMEET	:	frequency of audit committee meetings company *i* in 2013 divided by the highest frequency of audit meetings of sample
α	:	Constant
$\beta_1 - \beta_8$		Coefficients
I	:	company i
COWN	:	concentration of ownership, the percentage of ordinary share owned by the largest shareholder
INOWN	:	Insider ownership, the percentage of ordinary shares owned by commissioners and directors
BCSIZE	:	board size, calculated from the number of board of commissioner member company *i* divided by the highest number of board of commissioner member of

		sample
IND	:	Independence board, proportion of independent commissioners on the total number of commissioners
SIZE	:	the size of the company, measured by the natural logarithm of total asset
LEV	:	leverage, measured by total debt by total assets in 2013
AGE	:	age of the company, the number of years of listing
ROA	:	prior period performance, measured by the net income per total assets in 2012
ε	:	Error term

3. RESULTS

3.1 Descriptive Statistics

The descriptive statistics of research data is presented in Table 1:

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. deviation
ACMEET	85	. 046	1.000	. 146	. 119
COWN	85	. 102	. 972	. 488	. 207
INOWN	85	.000	. 667	. 040	. 087
BCSIZE	85	. 182	1.000	. 395	. 168
IND	85	. 250	. 800	. 380	. 081
SIZE	85	24.701	31.989	28.464	1.734
LEV	85	. 037	. 935	. 466	. 202
AGE	85	. 031	1.000	. 467	. 265
ROA	85	. 000	. 404	. 070	. 064
Valid N (listwise)	85				

Table1shows the minimum value of audit committee meetings (ACMEET) ACMEET is 0.046 or 2 times and maximum value ACMEET is 1 or 44 times. The average number of audit committee meeting frequency is 0.146 with standard deviation of 0.119. As for concentration of ownership (COWN), it has the smallest value of 10.20% and the greatest value of 97.20%. The average value of concentration of ownership is 48.80%. Those figures indicate that on average, Indonesian company has a relative large individual shareholder.

Insider ownership (INOWN) has the smallest value of 0.00% and the largest value of 66.70%. The average value of insider ownership is 4.00%. Table 1 also documents the minimum value of the number of commissioners (BCSIZE) is 0.182 or two members and a maximum value is 1.000 or 8 members. Board size has an average value of 0.395 or 3 members.

The proportion of independent directors (IND) shows the ratio of existence of independent commissioners. The smallest proportion of independent commissioners is 0.250 and a maximum value of 0.800. The proportion of independent commissioner has an average value of 0.380 with standard deviation of 0.081.

Control variables in this study consist of the size of the company (SIZE), *leverage* (LEV), firm age (AGE), and the company's performance in the previous period (ROA). As presented in Table 1, the average value of the size of the company is 28.464 and the standard deviation of the size is 1.734. Leverage has the smallest value of 0.037 and the greatest value of 0.935. Moreover, company age (AGE) has the minimum value of 0.031 or 1 year and the maximum value is 1 or 32 years with the average value of the company age at 0.467 or 15 years. The company's performance in the previous period (ROA) has the average value of 0.070.

3.2 Hypothesis Testing and Discussion

Regression analysis is used to examine the effect of concentration of ownership, insider ownership, board size, and the proportion of independent commissioner on the audit committee meeting frequency. Data have satisfied regression assumptions of normality, non multicollinearity and homoscedastic. Table 2 presents summary of the regression results.

Table 2: Regression Results

	Coefficients	t	Sig
(Constant)	-5.999	-1.485	.142
COWN	.245	1.891	.062 *
INOWN	-1.393	-2.044	.044 **
BCSIZE	-.073	-.416	.679
IND	.591	1.855	.068 *
SIZE	1.424	1.198	.235
LEV	.155	.511	.611
AGE	.023	.368	.714
ROA	-2.006	-2.028	.046 **
F	2.098		.046 **
Adjusted R square	.095		

Note: dependent variable ACMEET; *, ** significant at the 0.10 and 0.05 levels

3.2.1 The Effect of Ownership Concentration on the Audit Committee Meeting Frequency

Table 2 shows that the concentration of ownership variables regression coefficient is 0.245 and significant at the level of 0.062. Since the coefficient is positive, it indicates that finding is not in the expected direction. Thus, the first hypothesis stating ownership concentration negatively affects the frequency of audit committee meeting is rejected. A positive coefficient can be interpreted that the higher concentration of ownership will increase the frequency of audit committee meeting. This result also does not support the research conducted by Greco (2011) that finds a negative association between ownership concentration and audit committee meeting frequency. Result in line with a view that the agency problem between shareholders and managers will be reduced by the majority shareholder oversight and monitoring of the behavior of the manager (Yin *et al.*, 2012; Shleifer & Vishny,1986; Mendez & Garcia 2007) resulting a positive relationship between ownership concentration and audit committee activity (Yin *et al.* 2012).The results of this study are consistent with research by Raghunandan and Rama (2007) which finds that the concentration of ownership has a positive influence on the frequency of audit committee meetings.

3.2.2 The Effect of Insider Ownership on the Audit Committee Meeting Frequency

As presented in Table 2, the regression coefficient of insider ownership is -1.393 and significant at the level of 0.044. Findings indicate the higher the ownership by insiders, the lower audit committee meeting frequency. Thus the second hypothesis which states that insider ownership negatively affects audit committee meeting frequency is accepted. These results are consistent with research conducted Greco (2011).

Agency theory explains the conflict of interest between management and shareholders as a result of the separation of ownership and company management. Ownership by management reduces agency costs because ownership of shares in the company will motivate management to behave like shareholders. The increasing ownership by company management will reduce the number of audit committee meeting frequency due to the reduced demand of supervision conducted by the audit committee (Greco, 2011). This is because management as shareholders directly involve in operational activities and supervision of the company.

3.2.3 The Effect of Size of Board of Commissioners on the Audit Committee Meeting Frequency

As shown in Table 2, the regression coefficients of board size indicates a value of -0.073 and with a significance level of 0.679. Since the significant level is above 0.05 the third hypothesis which states that the board size negatively affects the frequency of audit committee meeting is rejected. These results, however, are consistent with research conducted by Greco (2011) that did not find a negative influence of the board size on the frequency of meetings of the audit committee.

This finding suggests that monitoring carried out by the board of commissioners is only a formality to fulfill formal regulation of good corporate governance. This result is consistent with research Yin *et al* (2012) and Adelopo *et al* (2012).

3.2.4 The Effect of Proportion of Independent Commissioner on the Audit Committee Meeting Frequency

Table 2 reports that the regression coefficient of board size has a value of 0.591 with a significance level of 0.068. The positive coefficient indicates that proportion of independent commissioners has a positive

relationship with the frequency of meetings of the audit committee as predicted. Thus, the fourth hypothesis which states that the proportion of independent commissioners positively affects the frequency of audit committee meetings is accepted at marginally significant level of 0.1. Results are also consistent with study conducted by Greco (2011).

Based on agency theory, independent commissioners provide effective oversight of management. This is because the independent directors have no business relationship and family with the controlling shareholders and the company. The absence of these relationships makes the commissioners to be more objective and able to supervise them better. Independent commissioners may demand more internal controls to improve protection of shareholder interests. As a result, the audit committee will hold audit committee meetings more frequent to ensure the effectiveness of their roles. Therefore, a growing number of independent commissioners in the board, the more frequent meetings held by the audit committee. On the contrary, research conducted by Yin *et al* (2012) found that independent commissioners negatively affect the frequency of audit committee meetings.

3.2.5 Control Variables

As presented in Table 2 among four control variables, the only profitability (ROA) has a significant influence on audit committee meeting frequency. Firm size does not significantly affect the frequency of audit committee meetings with a positive sign. This suggests that both large companies and small companies do not influence the frequency of audit committee meetings. Result is not in line with Yin *et al* (2012) and Greco (2011) that states that complexity in large cause more problems related to financial reporting. Consequently, it need more intensive monitoring activity by audit committee.

Moreover, result shows that leverage has no significant effect on the frequency of audit committee meetings and has a positive beta coefficient positive. Companies with high debt levels are expected to incur higher monitoring costs (Jensen & Meckling, 1976) that can be reflected in audit committee activity. However, result cannot support such a view. This is consistent with the results of research conducted by Greco (2011).

Firm age that is measured by the number of years since the company listed in the Indonesia Stock Exchange (IDX) also does not has influence on the frequency of audit committee meetings. This suggests there is no significant different regarding audit committee activity between new company and old company. As for company's performance in the previous period that is proxied by *Return on Assets* (ROA), this study finds that corporate performance in the previous period negatively affects the frequency of meetings of the audit committee. This indicates that the company's poor performance in the previous period will increase the frequency of meetings of the audit committee. Companies that suffered losses have impact on the reputation of the audit committee. Therefore, the audit committee will hold meetings more frequently in order to cope with the problem (Vafeas, 1999).

4. CONCLUSIONS AND FUTURE RESEARCH

In realizing the good corporate governance (GCG) in Indonesia, the government has required companies to establish audit committee. In Indonesia, audit committee is a committee established by and responsible to the board of commissioner in order to assist the duties and functions of the board of commissioners. The effectiveness of the audit committee can be seen from the activities of the audit committee. The activity of audit committees can be seen from the frequency of meetings. The number of meetings of the audit committee was used in prior studies to assess the effectiveness of the audit committee.

The result of this study shows that the concentration of ownership has a positive influence on the frequency of audit committee meetings. These findings do not support the first hypothesis (H1) since the direction of coefficient is not as predicted. This suggests that majority shareholders have an incentive to closely monitor the management since they have claims for greater company profit resulting in the more frequent audit committee meetings. As for insider ownership, it has a negative effect on the frequency of meetings of the audit committee. Therefore, these findings support the second hypothesis (H2). The more shares owned by management, it will decrease the need for supervision by the audit committee. Findings support the view that large insider shareholder has substitute effect for monitoring activity by audit committee.

Other findings are board commissioner size does not affect the audit committee frequency. This finding does not support the third hypothesis (H3), whereas the proportion of independent commissioners positively affects the frequency of audit committee meetings. Hence, fourth hypothesis (H4) is accepted. Independent commissioner may demand more board meeting to enhance their ability to monitor management. This has an impact on the audit committee which requires audit committee to hold meetings more frequently. Overall this study offers insight regarding the important role of insider ownership and independent commissioners in implementing good corporate governance in developing country.

This study has some limitations. This study only analyzes non-financial companies listed in IDX and covers one period. In addition, the model still has low adjusted R square and marginal significant coefficient for influence of independent commissioner on audit committee meeting frequency. Based on those limitations, there are suggestions for further research: including all sectors of industries as sample, extending period of sample, and considering developing variable that can represent audit committee effectiveness. There are still needs for further investigation regarding the impact of concentration ownership and board size on audit committee activity, specifically in developing economy and large controlling shareholder setting of environment.

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