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AUDIT COMMITTEE AND FINANCIALLY DISTRESSED FIRMS IN MALAYSIA

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Abstract: *The purpose of this study is to investigate the influence of audit committee characteristics on the performance of financially distressed firms (PN17) prior to their suspension by the Bursa Malaysia. Financial distress within large firms is a sign of weak corporate governance practices, of which the audit committee is one of the key elements. Thus, five determinants of audit committee characteristics have been identified which are expertise, size, independence, diligence and multiple directorships. The sample comprises 14 firms which were suspended by the Bursa Malaysia under PN17 in December 2017. A total of 126 published annual reports were collected starting from the financial year end 2009 until 2017. Data was collected from the firms' annual reports and DataStream. Most prior research has identified audit committee expertise as one of the factors which influence the financial performance of firms. Most of those studies were conducted based on comparisons of audit committee characteristics between financially distressed firms and successful firms. Therefore, this study is vital as it provides additional knowledge to identify the audit committee characteristics that influence financially distressed firms. Five hypotheses have been tested based on audit committee characteristics. Four out of five of these hypotheses are supported, namely audit committee expertise, audit committee independence, audit committee diligence and audit committee multiple directorships. This shows that the audit committee is one of the key players in the corporate governance mosaic, which has an influence on financially distressed firms.*

Keywords: *Audit committee, corporate governance, financially distressed, firm performance*

Introduction

Malaysian government has focused on the development of audit committee for listed firms since 1990, with their formation becoming voluntary among firms listed under the Bursa Malaysia in 1994. It was later strengthened when all listed firms were required to form an audit committee under the Bursa Malaysia Listing Requirements (BMLR). In order to ensure that all the listed firms adopt good governance practises, the Securities Commission (SC) began to regulate the market in 1993. In order to strengthen the function of the audit committee, the Finance

Committee on Corporate Governance was established in 2000 and headed by the Secretary-General of the Malaysian Ministry of Finance. The committee issued guidelines on the formation of audit committees relating to their literacy, size, independence, diligence and frequency of meetings to ensure that good corporate governance was practised. All listed firms are required to abide by these guidelines and in the event of non-compliance, justifications must be properly disclosed in the firm's annual report (Ainuddin, 2001). BMLR also requires all listed firms to form an audit committee with at least three directors, where the majority comprises of independent non-executive directors, where the chairman is an independent director and no alternate director is appointed as a member. Unfortunately, the existence of an audit committee does not automatically guarantee the absence of corporate scandals or failures, as certain weaknesses may arise. The roles and responsibilities of the committee may at times be wrongly identified or justified, and committee members may have inadequate time to perform their duties effectively. Besides that, lack of independence and authority may sometimes result in audit committees being unable to challenge decisions made by the management on behalf of the shareholders (Rashidah, 2010).

According to BMLR (2018), financial distress is defined as a situation where a firm has a deficit in shareholders' equity that violates the listing criteria, causing the de-listing of the firm from the stock exchange. Corporate scandals and financial distress among big companies have become major issues, especially after the 1997/1998 economic crisis in South-East Asia, leaving a negative effect on shareholders and resulting in deficit in shareholders' equity (Ainuddin, 2001). In 2005, PN17 was enforced in order to provide a "freezing" period to prevent firms in financial distress from being immediately de-listed, with all listing activities suspended. This provision is an opportunity for the firms involved to restructure their financial activities and overcome their problems. Audit committee plays an important role in the corporate governance structure (Rahmat and Takiah, 2004). It monitors all of the firm's activities as well as the latter's internal control system in order to protect the interest of the shareholders. To ensure that the corporate strategy planned by the firms is in the best interests of shareholders with regards to financial or operation matters, the audit committee is expected to provide its feedback to the best of its members' knowledge. Hence, it is recognised that an effective audit committee would focus on improving the firm's performance and competitiveness, particularly in a changing business environment which is beyond the control of the firm (Sharan, 1998). Specifically, an effective audit committee is expected to focus on the optimisation of shareholders' wealth and preventing the maximisation of personal interests by the top management (Akeel and Heide, 2000).

On the other hand, lack of competency among audit committee members contributes to the firm's financial distress (Sharon, 2009). Where else, competent audit committee has the capacity to reduce financial distress (Menon, 1999). They work to enhance the firm's performance and reduce the probability of financial distress. In addition, audit committee independence has been negatively associated with the going concern of financially distressed firms (Carcello and Neal, 2000). The greater the percentage of affiliated directors in the audit committee, the lower the probability that financially distressed firms will receive a going concern opinion from the external auditors. Hence, enhanced audit committee characteristics are associated with a positive firm's financial performance and are negatively associated with financial distress. However, research on the effectiveness of the audit committee in relation to financial distress is lacking. The effectiveness of audit committee is usually examined in terms of its quality of reporting (Abbott and Parker, 2000; Kalbers and Fogarty, 1993; Rahmat and Takiah, 2004), fraudulent reporting (Menon and Williams, 1994), quality of auditing (Ali,

1990) and the selection of external auditors (Kuniake, 1981; Einchenseher and Shields, 1985; Cottell and Rankin, 1988; Takiah and Wan-Zanani, 2004). Based on the discussion above, it is clear that financial distress and the performance of a company are influenced by audit committee characteristics. Therefore, it is important to investigate the influence of audit committee characteristics on the performance of firms facing financial distress.

The remainder of this paper is organized as follows. The next section describes the literature review and hypotheses development section. The third section explains the research methodology while the results and discussion are presented in the fourth section. The final section summarizes the conclusion of this study.

Literature Review and Hypotheses Development

Financially competent audit committee has the superior ability to monitor the integrity of a firm's external financial statements. Peecher (2002) states that audit committee who fail to understand the industry's practices experience shortcomings in performing duties related to finance or accounting. DeZoort (2002) found that members who have financial and industry knowledge are more likely to support external auditors in handling management conflicts. Moreover, Abbott (2004) noted that firms with audit committees that have financial and industry expertise are able to produce higher quality annual financial statements. Besides that, DeZoort (2002) stated that audit committee expertise is measured by its members' qualifications, knowledge, independence and authority to protect stakeholder interests by ensuring reliable financial reporting, internal accounting controls and risk management. The audit committee should have the ability to apply such principles with regards to accounting for estimates, accruals and reserves; have experience preparing, auditing, analysing or evaluating financial statements and have an understanding of audit committee functions. Vera-Munoz (2005) identified financial experts within audit committees as those with the ability to read and understand basic financial statements. For instance, DeZoort (2002) found that audit committee members who have auditing knowledge are more willing to support external auditors during auditor-management disputes over accounting policies compared to independent audit committees and senior members of management. Farber (2004) discovered that firms that commit frauds have a significantly smaller number of financially literate audit committee members (i.e. defined in the study as those who have expertise in accounting or related financial management areas; a person who is or has been a senior corporate officer with financial oversight responsibilities) compared to non-fraud firms. Furthermore, Abbott (2000) asserts that firms with financial experts in their audit committee are less likely to experience financial report restatements or fraud.

The probability of financial distress in a firm can be reduced by having in place an audit committee with high financial literacy (Kalbers, 1992). Yulu and Ma (2016) found that the quality of the audit has a negative relationship with financial distress firms and has close linkage with financial condition. Abdul Hamid (1999) argued that internal auditors and external auditors believe that audit committee members need to have financial expertise to ensure that they can carry their duties effectively. Besides that, Shamsul and Abdul Latif (1997) agree that an audit committee performs more effectively when its members are financially literate. These findings provide empirical evidence to support the Bursa Malaysia Listing Requirements (BMLR, 2008) and the Malaysian Code of Corporate Governance (MCCG, 2007), which requires the appointment of at least one member with financial literacy in an audit committee.

Having a financial expert on the board helps when reviewing internal audit proposals (Read and Raghunandan, 2001) and investigating accounting irregularities. Moreover, past experience in accounting and auditing enhances the accuracy of the investigation and the quality of financial reporting. A knowledgeable audit committee makes professional interpretations and judgements of accounting policies compared to those lacking an accounting and auditing background (DeZoort and Salterio, 2001). As such, Sharma, Naiker and Lee, (2009) noted that an independent audit committee with expertise in finance and accounting will usually call for frequent meetings in order to monitor the operations of the firm in question. To that end, the committee should have at least one member who is part of the Malaysian Institute of Accountants (MIA) or has at least three years of experience and has passed the professional examination (BMLR, 2008). Based on the above discussion, the following hypothesis is developed:

H1: There is a significant negative relationship between audit committee expertise and the performance of financially distressed firms.

With regards to Para 15.10 of BMLR (2018), a listed issuer must establish no fewer than three members of an audit committee. Audit committees with fewer members are often viewed as being more effective and dynamic. Due to their smaller size, they are expected to benefit from efficient communication and coordination, as well as higher levels of commitment and accountability among individual board members (Ahmed, 2006). However, the drawback of small boards is that the workload of individual members tends to be heavy, which might limit the board's monitoring ability. Smaller boards also draw upon a less diverse range of expertise, which impacts the quality of advice and monitoring (Guest, 2009). A study by Abbott (2004) confirms that firms with less than three audit committee members tend to experience less financial restatements. However, such restatements are often negatively related to the frequency of audit committee meetings.

In order for an audit committee to effectively control and monitor the top management's activities, it must have enough members to carry out the relevant duties. The committee becomes ineffective if it is either too small or too large. An audit committee with a large number of members tends to lose focus and be less participative compared to those of a smaller size. On the other hand, a smaller audit committee may lack the diversity of knowledge and expertise needed to carry out tasks effectively. An audit committee of the right size would allow its members to utilise their capabilities in the best interests of shareholders (Rahmat and Takiah, 2008). According to Belkhir (2009), a large audit committee would not perform well due to lack of communication, ineffective decision-making and high cost. Where else, Abdullah et al., (2016) highlighted that average AC size for the good financial reporting quality companies is significantly higher than the poor companies. In contrast, Jensen (1993) opined that a smaller board can improve the performance of a firm as it is not easily manipulated by the management. Although the results do not provide strong support for the monitoring function of an audit committee, the positive relationship between the size of the audit committee and the financial performance of the firm is supported by the resource dependence theory (Pierce, 1992). Under this theory, the effectiveness of an audit committee increases when the size of the committee increases because it has more resources devoted to addressing issues faced by the firm. Thus, the following hypothesis is developed:

H2: There is a significant negative relationship between audit committee size and the performance of financially distressed firms.

One of the key characteristics of an audit committee's effectiveness is its independence from the firm's management. As reported by the Blue Ribbon Committee (1999), independence is defined as having no relationship to the corporation that may interfere with the exercise of their independence from the management and corporation. Likewise, Goodwin and Yeow (2001) refer to independence as not having a relationship which would interfere with the exercise of independent judgment in carrying out the functions of the committee. An independent audit committee is able to maintain its integrity as members do not have personal interests in the firm and all decisions made by them are in the best interests of shareholders (Bradbury, 1990). Therefore, audit committee with independent directors are regarded as being better equipped to maintain the integrity of a firm's financial statements (Klien, 2002). Moreover, an independent audit committee is more likely to support external auditors over executive management in conflicts, reducing the probability of financial restatements (DeZoort, 2002). According to Abdullah et al., (2016) there is significant difference in AC independence between poor and good quality companies. The Bursa Malaysia Listing Requirements (BMLR) do not specifically define independence but emphasise it in Para 15.10 (b), which requires all audit committee members to be non-executive directors with a majority of them being independent directors, and the chairman must be an independent director. Audit committee with a higher composition of non-executive directors are considered more independent than those with more executive directors. There is evidence that executive directors dominate the decision-making process of the firm's top management, resulting in less objective decisions. Rahmat and Takiah (2008) observed that audit committees with a majority of independent members helps to enhance the reputation of an audit committee as a good monitoring mechanism. Non-executive directors are also seen as more independent in terms of challenging decisions made by the management. This is important to ensure that all decisions made are in the best interests of shareholders. As a result, the non-executive directors would reduce the probability of financial statement manipulation (Mc Mullen, 1996).

The absence of independence within an audit committee brings negative implications to the shareholders, who rely on the committee to protect their investments and interests. Thus, the audit committee needs to ensure that the management does not abuse the power delegated to them; in order to do this, the committee needs to be separate from the management. In this regard, independent non-executive directors are seen as critical players in corporate governance. Based on the above discussion, it is predicted that financially distressed firms have less audit committee independence, which leads to the following hypothesis being developed:

H3: There is a significant negative relationship between audit committee independence and the performance of financially distressed firms.

Past studies and governance best practices have called for audit committee to be diligent in carrying out their duties (Abbot et al., 2004). According to Yatim (2006), frequent meetings can reduce the likelihood of financial reporting problems as they provide a forum for the audit committee and internal auditors to exchange relevant information and allow the committee to notify the auditors of issues that require greater attention (Raghunandan et al., 1998). As discovered by Kalbers and Fogarty (1998) and Goodwin and Kent (2006), audit committee who meet frequently are better informed and more diligent in discharging their responsibilities. As such, it is reasonable to expect that audit committees who meet frequently will demonstrate greater diligence in performing. Past research suggest that audit committee who meet frequently are more effective in overseeing and monitoring financial activities, which include preparation and reporting of the firm's financial information. It is evident that audit committee of firms with financial difficulties do not hold meetings as frequently as those without financial difficulties (Rahmat and Takiah, 2008). Legally, most jurisdictions describe the director as having two duties: the duty of loyalty and the duty of care (Monks, 2004). The duty of care requires that a director exercise due diligence in making judgements and decisions. This refers to the director's willingness to prepare, ask probing questions and discover as much information as possible when dealing with the management, external auditors, internal auditors and other relevant constituents. The director must be able to show that, in reaching a decision, he or she considered all reasonable alternatives (Monks, 2004).

The MCCG (2017) highlights that audit committees should meet at least four times in a year or once on a quarterly basis. Although BMLR 2018 does not specify the minimum number of meetings, Para 15.16 (3)(c) of the new Listing Requirements requires the audit committee to report the number of meetings held during the financial year along with details of the attendance of each committee member. Furthermore, the Blue Ribbon Committee (1999) contends that audit committees need to sacrifice their valuable time in executing their duties in order to be effective. This is consistent with the view of Conger et al., (1998) and Vafeas (1999), who suggested that board effectiveness depends on the number of meetings held annually, as higher frequency of meetings increases board effectiveness (Vafeas, 1999) and signals its diligence (Menon and Williams, 1994). According to Fuad (2017), audit committee competence has significant negative affect with financial distress firms. Salloum et al., (2014) evidence suggests that the meeting frequency of audit committee members is an important factor as it helps the audit committee to hinder the financial distress of the bank. Meeting frequency plays an important role to ensure audit committee effectiveness. From the extant literature review, this study propose that audit committee of financially distressed firms are less diligent in discharging their responsibilities. Consequently, they are unable to identify and rectify financial reporting problems faced by the firm. Based on the discussion above, the following hypothesis is developed:

H4: There is a significant negative relationship between audit committee diligence and the performance of financially distressed firms.

Principle 4 of the Malaysian Code on Corporate Governance (MCCG) 2012 stipulates that the board of directors should devote sufficient time towards carrying out their duties effectively and think carefully before accepting new directorships, which might impinge on the effective discharge of their responsibilities. Multiple directorships are common among listed firms in Malaysia (Haniffa and Cooke, 2002) due to the high number of directorships allowed to directors. Ahn (2010) discovered that directors who hold multiple directorships have time constraints and reduced attention capacities that might affect their ability to provide sound counsel. This might also affect their ability to effectively contribute to discussions relating to major strategic decisions (e.g. merger and acquisition deliberations). Jiraporn (2009) examined whether holding multiple directorships diminishes a director's ability to effectively monitor firm management and documented that directors with multiple directorships tend to serve on fewer board committees, including compensation and audit committee. Prior research has also found that directors who hold multiple directorships display an increased tendency to miss board meetings (Jiraporn, 2009). This indicates the potential to reduced corporate governance effectiveness since research has shown that effective board meetings contribute to a firm's performance (Vafeas, 1999). Similarly, Rohaida (2013) found that directors who serve on multiple boards become so busy that they cannot monitor management adequately, which then leads to high agency costs. Kallamu (2014) discovered that audit committees with multiple directorships have busy schedules which could potentially affect the performance of a firm when an urgent issue is not addressed in time. An audit committee has numerous responsibilities that represent the interests of shareholders and the financial well-being of the organisation. When the committee serves more than one firms, there is the risk of them not performing to the best of their capabilities due to time constraints. Multiple directorships refer to the number of external appointments held by corporate directors (Ferris, 2003). Haniffa and Hudaib (2006) define multiple directorships as directors who sit on more than one board. Directors with multiple directorships tend to have more exposure to certain tasks and procedures that can be implemented in another firm, making the board performance more effective as fewer transaction costs are incurred (Sarkar and Sarkar, 2009). Thus, they are expected to provide effective monitoring. Similarly, directors who have experience in related strategies are expected to be more capable of contributing to the strategic decision process (Carpenter, 2001).

In the United States, it is often considered best practice for a director to hold less than three multiple directorships. Meanwhile in Malaysia, Para 15.06 of the BMLR (2008) states that the director of an applicant or a listed issuer must not hold more than 25 directorships in firms, of which the number of directorships in listed issuers should not be more than 10 and the number of directorships in firms other than listed issuers should not be more than 15. Ferris (2003) noted that serving on multiple boards means that an individual becomes overcommitted and shirks his or her responsibilities as director. For example, overcommitted directors might serve less frequently on important board committees such as audit or compensation committees. If boards play an important role in firm performance, the implication of the busyness hypothesis is that the presence of multiple directors on a firm's board reduces its management abilities and ultimately, the firm's market value. Additionally, reduced monitoring by these busy directors might exacerbate other forms of agency costs such as increased litigation exposure for the firm. Based on the above discussion, the following hypothesis is developed:

H5: There is a significant positive relationship between audit committee multiple directorships and the performance of financially distressed firms.

Research Methodology

Data Collection

Data collection is based on the sample comprises of 14 firms which were suspended by the Bursa Malaysia under PN17. A total of 126 published annual reports were collected and analysed starting from the financial year end 2009 until 2017. The study used secondary data that was collected from the annual reports of the firms available from the Bursa Malaysia website or the firms' websites. In addition to the annual reports, financial information about the firms was also obtained from DataStream.

Financial Distress Model

Prior studies have used different measures of performance such as Return On Equity (ROE), Return on Assets (ROA), efficiency (Kim and Rasiah, 2010), Earning Per Share (EPS), stock price and dividend payable to measure the performance of firms (Ponnu, 2008) with no consensus on the best method of measuring performance (Ntim, 2009). Thus, this study used ROA as the measurement of the firm's performance. ROA is measured as profit before tax at the year-end divided by total assets (Yermack, 1996; Praptiningsih, 2009). Audit committee expertise (EXP) is measured based on the requirement that at least one member of the audit committee must be a member of the Malaysian Institute of Accountants (MIA) or have at least three years' working experience, and must have passed the examinations in local universities or be a member of an association of accountants qualified by MIA (BMLR, 2008). Audit committee size (SIZE) is determined based on the total number of audit committee members on the board. Audit committee independence (IND) is measured based on the ratio of independent non-executives to the total number of audit committee members. This measurement is aligned with the requirement stated in Para 15.10 of BMLR (2008), which states that the majority of the audit committee must be independent directors. Audit committee diligence (DIL) is measured based on the frequency of audit committee meetings held in one financial year. This best practice is supported by a recommendation by the Malaysian Code of Corporate Governance (MCCG, 2001) that audit committees should meet not less than three times a year. Audit committee multiple directorships (MUL) is measured based on the number of positions held by audit committee members in other firms. As for the control variable, firm leverage is measured based on the ratio between total debts over total assets of the firm.

Descriptive Analysis

Table 1 below shows the descriptive statistics for independent and experimental variables. The performance of financially distressed firms is measured using ROA, which shows that the mean value is -0.487. This indicates that for every RM1 of the assets used, the firm experiences a loss of RM0.487. Based on the results, the financially distressed firms are inefficient in utilising their assets to generate income. In addition, the majority of the audit committee members in the financially distressed firms have minimal qualifications and experience in accounting or finance, with the average number of financial experts being less than one (0.254). The statistics indicate that the PN17 firms did not comply with the minimum requirements of BMLR (2018), where at least one member of the audit committee must be a member of the Malaysian Institute of Accountants (MIA) or have at least three years of working experience and has passed the examinations specified in Part I of the First Schedule of the Accountants Act 1967. In terms of audit committee size, Table 1 shows that on average, the PN17 firms had less than three audit committee members. This proves that the firms did not fulfil the requirements under BMLR (2018), where audit committee should comprise of at least three members. Careful examination of the data further reveals that on average, the PN17 firms had less than one committee member who is an independent (non-executive) director. This is obviously less than the requirement outlined by Bursa Malaysia, which states that a majority of the audit committee must be independent.

Table 1: Descriptive Analysis

Variables	Mean	Minimum	Maximum	SD
FDstress	-0.487	-10.396	-0.002	1.363
AC EXP	0.254	0.000	1.000	0.455
AC SIZE	2.866	2.000	3.000	0.391
AC IND	0.264	0.000	1.000	0.442
AC DIL	1.387	0.000	3.000	1.199
AC MUL	4.223	0.000	7.000	2.470
LEV	2.715	1.214	5.926	1.397

Notes: FDstress is financial distress firms; EXP is the number of audit committee with accounting or finance qualification; SIZE is total number of audit committee members.; IND is the proportion of independent non-executive directors to audit committee DIL is the number of meetings;; MUL Total number of audit committee members holding more than one directorship; and LEV is the ratio between total debts over total assets of the firm.

In terms of frequency of audit committee meetings, the results show that on average, the PN17 firms conducted less than two meetings in one financial year. This is against the BMLR's (2018) requirement that audit committees should meet at least three or four times in one financial year. Additionally, Table 1 shows that the majority of the audit committee members in the financially distressed firms are also directors of other firms, with a maximum of seven directorships. Meanwhile, the leverage of the firm recorded a mean value of 2.715% while the highest leverage is 5.926%, meaning that the firms are highly leveraged and in need of cash. Besides that, it shows that these firms are in a situation of financial distress, as supported by a study conducted by Wruck (1990).

Model Specification

A multiple regression was performed between financially distressed (FDstress) as the dependent variable and audit committee IND, DIL, EXP, SIZE and MUL as the experimental variable. Analysis was performed using SPSS REGRESSION for evaluation of assumptions, as shown below:

$$FDstress = \alpha + \beta AC\ IND + \beta AC\ DIL + \beta AC\ EXP + \beta AC\ SIZE + \beta AC\ MUL + \beta\ LEV + \varepsilon$$

Results and Discussion

Correlation is a test between various sets of data to determine how well they are related to each other. Table 2 shows the relationship between the financial performance of financially distressed firms and audit committee EXP, SIZE, IND, DIL and MUL. The results show that audit committee EXP, IND and DIL have a significant negative relationship with the performance of financially distressed firms. However, audit committee SIZE, MUL and LEV show a positive relationship with the performance of financially distressed firms. Audit committee size recorded a positive relationship with the performance of financially distressed firms, indicating that an increase in the number of audit committee members resulted in an increase in financially distressed firms. This finding is similar to that of a study by Dalton (1999), where it was found that audit committees with large number of members focused less on monitoring the firm’s performance. On the other hand, audit committee expertise, independence and diligence yielded a negative relationship with the financially distressed firms. This means that an increase in these three variables will decrease the firms’ performance. As supported by the results of a study by Davidson (2004), financial crises and corporate scandals are mainly attributed to lack of experts within the audit committee. In addition, Akhigbe and Martin (2006) reported that lack of audit committee independence leads to lower quality and fraudulent financial reporting. The negative relationship between audit committee diligence and the performance of financially distressed firms has also been supported in prior studies. For example, McMullen and Raghunandan (1996) found that audit committees that meet frequently are more effective in monitoring financial activities, including the preparation and reporting of the firm’s financial information. This proves that audit committee of firms with financial difficulties do not hold meetings as frequently as those without financial difficulties. Audit committee multiple directorships yielded a positive relationship with the financially distressed firms. This is supported by Ferris (2003), who discovered that audit committee members that held multiple directorships had a higher tendency to be absent from board meetings and had insufficient time to understand the firm’s situation due to over commitment. As a result, they jeopardised the performance of the firm, which in turn led to financial distress.

Table 2: Summary of Correlation Analysis

Variables	FDstress	AC EXP	AC SIZE	AC IND	AC DIL	AC MUL	LEV
FDstress	1						
AC EXP	-0.556	1					
AC SIZE	0.588	-0.987	1				
AC IND	-0.535	0.970	-0.908	1			
AC DIL	-0.417	0.597	-0.580	0.599	1		
AC MUL	0.386	0.694	0.577	0.618	-0.754	1	
LEV	0.282	-0.491	0.398	-0.457	-0.699	-0.698	1

*Correlation is significant at the level of 0.05 (2-tailed)
Notes: FDstress is financial distress firms; EXP is the number of audit committee with accounting or finance qualification; SIZE is total number of audit committee members.; IND is the proportion of independent non-executive directors to audit committee DIL is the number of meetings;; MUL Total number of audit committee members holding more than one directorship; and LEV is the ratio between total debts over total assets of the firm.

Table 3 below illustrates the results of the multiple regression analysis. The results show that the adjusted R squared (R^2) is 0.283 or8.3% with an F value of 6.497. This indicates the variation in the dependent variable that can be explained by the model. Besides that, the p-value of 0.000 indicates that all the variables are significant. In summary, it proves that the evidence used in this study is valid (Conover, 1999).

Hypothesis 1 predicts that there is a significant negative relationship between audit committee expertise and performance of financially distressed firms. Table 3 shows a p-value of 0.000, meaning that audit committee expertise contributes significantly to financially distressed firms. The table also shows that the coefficient value is -0.351, indicating that audit committee expertise has a significant negative relationship with financially distressed firms, thus supporting Hypothesis 1. This is in accordance with a study by Abbott (2004) and Fuad (2017), in which it was concluded that audit committee members need to be financial experts to understand and oversee the financial performance of a firm. In addition, audit committee expertise enhances the quality of the firm's financial reporting (Krishnan and Lee, 2009). As highlighted by Guner (2008), there is a need for financial expertise within audit committees to emphasise financial crises and corporate scandals. Furthermore, the presence of accounting or finance experts helps a firm prevent the incidence of accounting misstatements, reduce any possibility of litigation against the firm and reduce the attention of regulators on the firm. Farber (2004) found that non-fraud firms typically have audit committee members who are knowledgeable in terms of finance and accounting. However, firms facing financial difficulties tend to have significant fewer financial experts.

Moreover, Table 3 shows that there is a significant negative relationship between audit committee independence and financially distressed firms. The p-value of 0.000 and coefficient value of -0.587 signal a strong relationship between audit committee independence and financially distressed firms. This supports Hypothesis 3 in the sense that there is a significant negative relationship between audit committee independence and the performance of financially distressed firms. This finding is also in line with a study by Gilson (1990), which concluded that, a smaller number of independent members in an audit committee benefit the management more. Since the executive directors would dominate the decision-making process, it would result in less objective decisions that do not benefit shareholders and ultimately jeopardise the performance of the firm. As the audit committee is not independent enough, it will cause information asymmetry as the management will do its best to avoid disclosing necessary information to the board and shareholders. This scenario may also lead to financial scandals and other difficulties for the firm (Vinten and Lee, 1993).

Hypothesis 4 predicts that there is a significant negative relationship between audit committee diligence and the performance of financially distressed firms. As shown in Table 3, the p-value of 0.000 and coefficient value of -0.187 indicates that there is indeed a significant negative relationship between audit committee diligence and financially distressed firms. Based on this result, the hypothesis is supported. According to Vinten and Lee (1993), audit committees that lack time to meet can be a major impediment to the board's effectiveness. Besides that, it is impossible for audit committees to fully understand the firm's situation or monitor its performance without having frequency meetings (Carcello, 2002). As highlighted by Salloum (2014), financial distress of banks has a significant negative relation with the meeting frequency of the audit committee. It is evidenced that the meeting frequency of audit committee members is an important factor as it helps to hinder financial distress. In other words, the audit committee with frequent meetings is able to help audit committee members to ensure the integrity of financial reporting, to provide better monitoring and to review effectively the operations. Furthermore, Rohaida (2013) noted that there is a significant negative relationship between audit committee meetings and fraudulent financial reporting.

Hypothesis 5 predicts that there is a significant positive relationship between audit committee multiple directorships and performance of financially distressed firms. Table 3 shows a p-value of 0.001 (p-value <0.05) and coefficient value of 0.054, indicating that there is indeed a positive relationship between audit committee multiple directorships and financially distressed firms. Thus, this finding is supported. Similarly, Rohaida (2013) found that audit committee members who serve on multiple boards are unable to monitor management adequately due to their over commitment, which eventually leads to the firm's financial difficulties and reduced performance. Ahn (2010) revealed that directors who hold multiple directorships have time constraints and reduced attention capacities that might affect their ability to provide sound counsel and effectively contribute to discussions on major strategic decisions. Kallamu (2014) discovered that the busy schedule of such directors could affect a firm's performance if an urgent issue is not addressed in time. Furthermore, Ferris (2003) noted that serving on multiple boards means that an individual is overcommitted and may shirk his or her responsibility as a director; by not giving their full attention to all the boards they serve, the performance of the firms suffers.

However, hypothesis 2 predicts a significant negative relationship between audit committee size and the performance of financially distressed firms is rejected. Table 3 shows the p-value of 0.000, it can be concluded that there is a strong relationship between audit committee size and financially distressed firms. The coefficient value of 1.408 indicates a positive relationship between audit committee size and financially distressed firms. Despite failing to prove a negative relationship between the two variables, a previous study by Dalton (1999) found that audit committees perform less efficiently if they are too large. This is because the committee members will lose focus and be less participative compared to committees of a small size. These findings are also consistent with a study by Raber (2003), which concluded that audit committee size has a positive relationship with financially distressed firms. They found that if the firms had many members in their audit committee, there was less focus on issues related to the firm due to lack of proper segregation of duties. This led to the audit committee being unaware of any financial crisis within the firm.

Table 3: Multiple Regression Results

Variables	coefficient	t-value	Sig.
AC expert	-0.357	-5.790	0.000***
AC size	1.408	6.174	0.000***
AC independence	-0.587	-5.588	0.000***
AC diligence	-0.187	-4.571	0.001***
AC multiple	0.054	2.387	0.028**
Leverage	0.273		
F-statistic	6.497		
p-value	0.000***		
Adjusted R^2	0.283		
R^2	0.299		

*Significant at 10% level (1-tailed test); **Significant at 5% level (1-tailed test); ***Significant at 1% level (1-tailed test)

Notes: FDstress is financial distress firms; EXP is the number of audit committee with accounting or finance qualification; SIZE is total number of audit committee members.; IND is the proportion of independent non-executive directors to audit committee DIL is the number of meetings;; MUL Total number of audit committee members holding more than one directorship; and LEV is the ratio between total debts over total assets of the firm.

In sum, the findings in this study support the agency theory, which suggests that audit committee expertise, independence, diligence and multiple directorships provide effective monitoring of a firm's management, thereby enhancing profitability and reducing the probability of financial difficulties. Besides that, the presence of audit committee characteristics is positively associated with quality financial reporting and lower incidence of fraudulent financial reporting (Akhigbe and Martin, 2006). The effectiveness of audit committees improves the power of the committee itself and reduces agency problems and chances for expropriation by insiders. With the presence of expertise, independence, diligence and multiple directorships, audit committees are more objective in monitoring the transparency of financial reports and unbiased towards executives, which reduces agency problems between executives and other shareholders.

Conclusion

Best practices of audit committee characteristics are an important determinant of good corporate governance. An effective audit committee has a significant bearing on the financial performance and future direction of a firm. Essentially, an audit committee that practises good corporate governance greatly enhances the firm's performance. The focus of this study was to investigate the relationship between the determinants of audit committee characteristics and financially distressed firms prior to their suspension by the Bursa Malaysia. Enhanced audit committee characteristics act as a benchmark against the Bursa Malaysia Listing Requirements (BMLR, 2008) and Malaysian Code of Corporate Governance (MCCG, 2007, 2012 and 2017). The findings of this study indicate that financially distressed firms are significantly associated with audit committee expertise, as the audit committees of the financially distressed firms are not financially literate. Thus, it can be concluded that their lack of expertise renders them unable to properly monitor the firm's operational activities and financial reporting. This study also revealed that audit committee independence has a significant negative relationship with financially distressed firms. Audit committee independence emphasises the monitoring process and control of the firm's activities and performance. In addition, the findings shows that audit committees with fewer independent members are more easily manipulated by the management, thus jeopardising the future of the firm. The study also supports the idea that audit committee diligence affects financial distress in firms. Frequent meetings and discussions between the audit committee and the management helps the audit committee understand the firm better and monitor its performance effectively. Moreover, time is a vital factor in ensuring that audit committees perform their duties efficiently. The results of the study support the idea that there is a significant negative relationship between multiple directorships among audit committee members and financially distressed firms. Since multiple directorships require audit committee members to serve several boards at the same time, it causes them to lose focus and neglect urgent issues that require their time and attention. However, this study rejects the idea that audit committee size has a negative relationship with financial distress.

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