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AUDIT COMMITTEE EFFECTIVENESS AND SUSTAINABILITY DISCLOSURE OF FTSE4GOOD BURSA MALAYSIA INDEXED COMPANIES

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Abstract: *This study examines the relationship between the audit committee's attributes and sustainability disclosure of companies listed in FTSE4Good Bursa Malaysia Index (FTSE4G). The index consists of top 200 Malaysian stocks in the FTSE Bursa Malaysia EMAS Index, screened in accordance with the transparent and defined environmental, social and governance criteria, that designed to identify Malaysian companies with recognised corporate responsibility practices. Using the resource dependency theory, the study provides empirical evidence on the significant contributions of audit committee's 1) independence, 2) gender diversity, and 3) diligence, towards the level of sustainability disclosure in eighteen (18) FTSE4G companies. The results reveal that audit committee's independence and diligence have significant and positive impact on the level of sustainability disclosure, while audit committee's gender diversity, has no impact. Insights gained from the study are useful for industrial practitioners and scholars of related fields.*

Keywords**:** *Auditor Independence; Diligence; Gender; Sustainability Disclosure; Corporate Governance*

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Introduction

Sustainability reporting emerged as a common business practice in the 21st century. Where once sustainability reporting was the status of some green or community- oriented companies, today it is a best practice used by companies around the world. Sustainability reporting can serve as a distinguishing factor in competitive industries and enhance investor confidence, trust and loyalty. Analysts often incorporate sustainability disclosure of a company in their evaluation of management quality and efficiency, and comprehensive reporting can also provide companies with better access to capital.

One of the keys to have quality sustainability disclosure is the role of an audit committee (AC) plays to enhance transparency and thus promotes firm integrity. In assessing the company's performance, AC acts as an integral feature of corporate governance (CG) that is expected to monitor the financial and non-financial information (Ernst & Young, 2014; Institute of Chartered Accountants Australia, 2014). The existence in the market of false informed stakeholders, the short quality and reliability of financial as well as non-financial information are increasingly worrying. ACs are indeed preoccupied with the sustainable reporting and its accuracy and monitor the reporting process (Trotman & Trotman, 2015).

The AC activities may therefore be the best mechanism for minimizing the risks and uncertainties inherent in the modern corporate environment. The position of the AC and their activities within the organization would also attract prospective investors and minimize the corporate risk of a company (Ghabayen, 2012). Moreover, the expectations of the AC are however very high. Madakawi (2012) argues that an effective AC is expected to resolve the agency's conflicts and thus improve the quality of financial reporting.

Some of the largest corporate failures in the United State such as Enron, WorldCom and Onetel in Australia were due to fraud, dishonesty, poor corporate governance, and lack of proper corporate disclosure. This has led to numerous difficulties, including the financial losses as well as job losses. These scandals have resulted in companies closer than ever to the eyes of different stakeholders including shareholders, regulators and media. Indeed, the stakeholders requested for more efficient ACs in organisations.

ACs play an essential responsibility in enhancing the monitoring corporate disclosure activities. According to Akhtaruddin and Haron (2010), AC is considered a mean of monitoring and improving business disclosure processes including voluntary disclosure. Previous research have been carried out to examine a relationship between AC's characteristics and corporate social reporting (CSR). The problem, however, remains that managers of listed companies lack adequate disclosure. Hence, considering findings from previous studies, this study focuses on AC's independence, gender diversity, and diligence on the level of sustainability disclosure in FTSE4G constituents.

In order to measure the quality on sustainability disclosure, Bursa Malaysia has implemented the FTSE4G Bursa Malaysia Index constituents that selected from the top 200 Malaysian stocks in the FTSE Bursa Malaysia EMAS Index, screened in accordance with the transparent and defined ESG criteria. The index has been designed to identify Malaysian companies with recognised corporate responsibility practices, expanding the range of the benchmarks of the FTSE Bursa Malaysia Index Series for the Malaysian Markets.

Accordingly, this study aims to provide insights and to extend the knowledge on the impact AC's attributes on the level of sustainability disclosure in FTSE4G constituents. The knowledge gained from this study will serve as a useful information for other companies to enhance their sustainability reporting.

Literature Review and Hypotheses Development

Independence of Audit Committee Member

Several studies on the impact of AC's independence on the level of sustainability disclosure have been done, despite the results are mixed. A study by Mohammed Buallay and AlDhaen (2018) found that the independency of AC gives a significant and positive impact on sustainability disclosure. The finding is consistent to other studies conducted by Buallay and Al-Ajmi (2019); Cuadrado-Ballesteros, Rodríguez-Ariza and García-Sánchez (2015); and Jizi, Salama, Dixon and Stratling (2014). However, studies by Said, Zainuddin and Haron (2009), and Haniffa and Cooke (2005) found a negative relationship between the independency of AC and CSR disclosures. Since majority of the studies suggests a positive relationship between AC's independence and sustainability disclosure, the following hypothesis is proposed:

H1: There is a positive relationship between audit committee's independence and the level of sustainability disclosure in FTSE4G companies.

Gender Diversity of Audit Committee Member

Gender is usually considered a demographic variable used to explain CSR attitudes. Gender diversity is believed to enhance the socially responsible behavior of companies. According to Ciocirlan and Pettersson (2012), women usually have a higher perception of risks and have been socialized to care for the needs of others, representing these qualities with a closer feeling towards CSR. The study found that companies with more female employment and a stronger European presence tend to show more climate change concerned. The importance of female representation supported by Barako and Brown (2008) who found the number of female representatives in the board of directors has a significant and positive relationship with the CSR report's quality. Numerous studies (such as Zahid et al., 2020; Sheikh Abu Bakar, Mohd Ghazali & Ahmad, 2019; Modiba & Ngwakwe, 2017; Al-Shaer & Zaman, 2016) also found gender diversity to be significant in influencing sustainability disclosure. Thus, the following hypothesis is proposed:

H2: There is a positive relationship between audit committee's gender diversity and the level of sustainability disclosure in FTSE4G companies.

Audit Committee's Diligence

Diligence of the AC was referred to the number of AC meetings which act as an indicator of the AC effectiveness. The presence of an AC, the number of its meetings and the auditor's attendance for such meetings will reduce the audit risks, and that the external auditor believed that the presence of an AC is an important factor in reducing the substantial risks of auditing.

A study by Zabojnikova (2016) has established that the size of the AC, the frequency of its meetings and its financial experience and its financial performance were significantly positive. Meanwhile, Mwangi (2018) has determined that the reduction of audit risks is also affected by

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frequent meetings of the AC and the auditor's attendance at such meetings. Similar findings were found Osarumwense and Aderemi (2016). The AC helps to resolve disputes and conflicts with the administration, which leads to a higher quality of the audit. In addition, the results indicated that in order to enhance the quality of its financial reporting, AC for non-commercial state corporations must have a high level of independence, diversity, financial competence and quality meetings. The results revealed that AC meetings had a statistically significant relationship to financial reporting quality. Given the significance of audit committee's diligence to the corporate performance, the following hypothesis is proposed:

H3: There is a positive relationship between audit committee's diligence and the level of sustainability disclosure in FTSE4G companies.

Data and Methodology

Data

This study uses a panel data comprises of cross-sectional and time series data of 18 companies indexed in FTSE4Good Bursa Malaysia Index. As of 31st December 2018, a total of 56 companies were listed under the index, however, only 18 companies are chosen in this study, based on their annual reports for the year 2014, 2015, 2016 and 2017. The remaining 38 are excluded because of the listing or delisting scenario of these companies between the study periods.

The sustainability information was collected by using content analysis. This process collects specific information from the text and examines it on the basis of specific criteria. The information about AC's attributes that are made up of AC's independence, gender diversity and diligence are collected from directors' reports and the corporate governance section of annual reports, while sustainability disclosure data are collected from the entire annual reports based on the comprehensive checklist adapted from Sobhani, Amran and Zainuddin (2012).

Theoretical Framework

This study adopts resource dependency theory (RDT) to explain the relationships between independent and dependent variables. RDT states that the resources in the company that can be used to create sustainable competitive advantages include human vision and strategy on board (Helfaya & Moussa, 2017; Shaukat et al, 2016).

The board of directors and its committees, according to RDT, can act as an essential resources to create value and bring sustainable benefits by offering expertise and advice, enhancing the legitimacy and image of the company, building links and establishing externals and facilitating access to resources (Ben-Amar, Chang, & Mcilkenny, 2017). The allocation of the company's resources in obtaining external assurance on sustainability reports is more successful in a well-designed AC. AC members can attract human and relational capital by providing independence and financial expertise which can improve a company's sustainability reporting (Helfaya & Moussa, 2017).

Figure 1 below shows the theoretical framework of the study. The dependent variable is the level of sustainability disclosure, while, the independent variables are made up of audit committee's 1) independence, 2) gender diversity, and 3) diligence.

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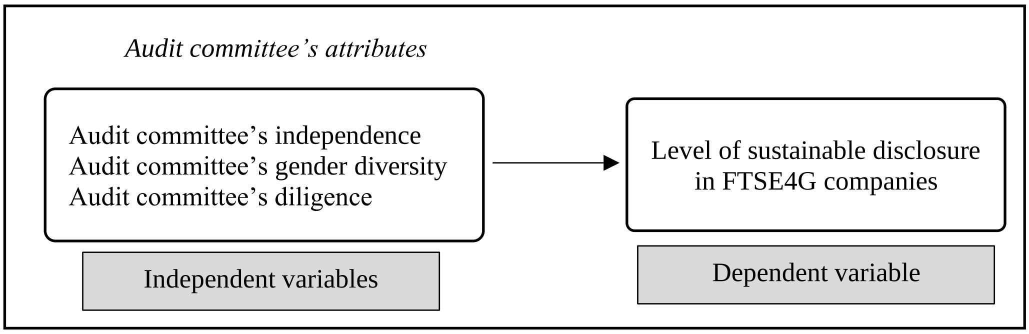

Figure 1: Theoretical Framework

Proposed Model

The present study employs a Panel Estimated Generalized Least Squares (EGLS) regression model to examine the relationship between the audit committee's attributes and the level of sustainability disclosure.

The attributes of audit committee examined in the present study are their independence, gender, and diligence. The dependent variable of the study is the level of sustainability disclosure. Table 1 explains the measurement of the dependent and independent variables. To access the extent of sustainability disclosure in annual reports of the sample companies, a checklist that contains 122 items was adapted from Sobhani et al. (2012).

Table 1: Summary of Proxies and Measurements of All Variables

	Variable	Abbreviation	Measurement
Dependent Variable	Level of sustainability disclosure	SD	Number of items disclosed in the annual report divided by 122 of the checklists
Independent Variables	Audit committee's independence	IND	Proportion of the number of the independent non-executive directors on the AC divided by the total number of AC at the end of the financial year
	Audit committee's gender diversity	FGEN	Proportion of female non-executive directors on the AC
	Audit committee's diligence	DIL	Number of AC meetings
Control variable	Firm size	FSZ	Operating revenue of financial year

The empirical model used in the study is as follows:

$$SD_{i,t} = \beta_0 + \beta_1 FGEN_{i,t} + \beta_2 IND_{i,t} + \beta_3 DIL_{i,t} + \beta_4 FSZ_{i,t} + \varepsilon_{i,t} \quad (1)$$

Panel data analysis with multivariate regression is employed in the study. To examine the relationship between the audit committee's attributes and the level of sustainability disclosure, the Panel Estimated Generalized Least Squares (EGLS) regression model is used to attenuate serial correlation problem in the data.

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Findings and Discussion

Descriptive Statistics

Table 2 presents the results of the descriptive statistics. The mean index (SDI) is 2.2180 ranging from 1.3690 to 2.6964. The results imply that from the year of 2014 until 2017, there is an increase in number the disclosed items. This finding reflects good initiatives made by the FTSE4G companies to be transparent to the wider stakeholders related to their environmental activities.

In relation to AC's attributes, an average of AC's female gender is 87% for four years. That is, 4 out of 18 companies had no female director on the AC for the four years. The remaining had comprised at least one female on their AC and three was the highest. On average, 85.3% of AC members independent. Six out of 18 companies comprised solely of majority independent for four years and the rest consisted of non-independent directors. Lastly, the minimum number of AC meetings conducted was 4 times per year, and the maximum was 21 times per year.

Table 2: Descriptive statistics results

Variables	Mean	Min	Max	SD	N	Skewness	Kurtosis
Dependent variable							
SD	2.2180	1.3690	2.6964	0.26644	72	-0.404	0.776
Independent variables							
IND	0.853	0.6	1.0	0.1350	72	0.524	-0.736
FGEN	0.870	0	3	0.855	72	0.524	-1.657
DIL	7.570	4	21	4.301	72	1.803	2.090
Control variable							
FSZ	3.6719	1.8965	4.6759	0.6212	72	-0.813	0. 564

Normality and Multicollinearity Tests

According to Table 2, the value of skewness and kurtosis for all variables except for the return on asset fell between the threshold points of ±3 (Kline, 2005). This indicates that the distribution of the mean for all variables are normal.

According to Hair, Black, Babin and Anderson (2010), multicollinearity occurred when the Pearson correlation coefficient is 0.90 or above. Thus, based on the Table 3 below, the Pearson correlations reported were within the range from -0.486 to 0.540, which was not exceeding the limit of 0.90 and therefore the multicollinearity assumption was not violated. In addition, another two statistics measures namely tolerance and variance inflation factor (VIF) are applied to determine whether multicollinearity is violated. Tolerance value implies how much variability of specified independent variables was not described. Meanwhile, VIF is inverse of tolerance value. Thus, the tolerance of all variables are all lower than 1.0 and VIF of all variables are less than 10. Hence, there is no multicollinearity issue arose for this set of data.

Table 3: Pearson's Correlation

Variable	SD	FSZ	FGEN	IND	DIL
SD	1				
FSZ	0.482**	1			
FGEN	-0.101	-0.012	1		
IND	0.167	-0.059	.	1	
DIL	0.552**	0.540**	-0.195	0.222	1

*. Correlation is significant at the 0.05 level (2-tailed).
**. Correlation is significant at the 0.01 level (2-tailed).

Regression Results

The results of the model are presented in table 4 and table 5. The results of the econometric analysis suggest that audit committee's independence shows a significant positive relation to the level of sustainability disclosure at 5% significance level, as expected. This result is consistent with the findings of other studies (Mohammed Buallay & AlDhaen, 2018; Buallay & Al-Ajmi, 2019; Cuadrado-Ballesteros, Rodríguez-Ariza & García-Sánchez, 2015; Jizi, Salama, Dixon & Stratling, 2014)

Audit committee's gender diversity has no significant relationship with the level of sustainability disclosure. This result contrasts with the findings of other studies (Zahid et al., 2020; Sheikh Abu Bakar et al., 2019; Modiba & Ngwakwe, 2017; Al-Shaer; Zaman, 2016) that found gender diversity of AC to be significant to the level of sustainability disclosure. The result of this study implies that board gender diversity seemed to have no function or power on determining the extent of sustainability disclosure among companies in FTSE4G. It may indicate that female leaders have limited power to make decisions related to sustainability reporting practices by organisations.

Audit committee's diligence shows a significant positive relation to the level of sustainability disclosure at 1% significance level. This result is supported with studies carried out by Zabojnikova (2016) and Osarumwense and Aderemi (2016) who found the frequency of audit meetings was significantly positive with quality of companies' financial performance. This result attests the notion that ACs that meet regularly improved the transparency and openness of reported earnings and therefore improve earnings quality, as postulated by Bryn, Liu and Tiras (2004). The AC helps to resolve disputes and conflicts with the administration, which leads to a higher quality of the audit.

Table 4: Results (Level of Sustainability Disclosure as Dependent Variable)

Variable	Coefficient	t-statistic	Prob.
C	0.574557	23.95123	0.0000 (*)
IND	0.041799	2.450396	0.0169 (**)
FGEN	0.004352	0.622529	0.5357
DIL	0.007339	6.984970	0.0000 (*)
FSZ	0.017773	3.038779	0.0034 (**)

Notes: R-squared=0.558178, Adjusted R-Squared=0.531801, * significance at 1%, ** significance at 5%.

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Table 5: Aggregate Results of Independent Variables

Variable	Abbreviation	Prob.	Significance	Sign
AC's independence	IND	0.0169 (**)	Significant at 5%	Positive (+)
AC's gender diversity	FGEN	0.5357	Not significant	Positive (+)
AC's diligence	DIL	0.0000 (*)	Significant at 1%	Positive (+)

Based on the results presented in table 4, the variable audit committee's independence has the strongest influence on the level of sustainability disclosure, followed by the variables of firm size and audit committee's diligence.

Conclusion

This study provides an empirical evidence on the impact on multi-dimensional AC's attributes on the level of sustainability disclosure in FTSE4G companies. The study expands the existing literature on corporate governance, sustainability disclosure and resource dependency theory.

This study has made a few contributions from different aspects. First, it adds to the number of existing literature on sustainability reporting that are useful for future studies. Second, it provides information on present practice of sustainability disclosure among FTSE4G companies in Malaysia. Third, the results of this study may give an insight to the policymakers in making future decisions related to corporate governance mechanisms and sustainability disclosure.

This study should be read within its limitations. First, there could be subjectivity in coding the disclosure instrument. However, the use of a detailed and comprehensive CSR checklist of a highly-ranking scientific journal that was cited frequently in other highly-class journals reduced this limitation. Second, the sample of the study is relatively small. Future research are suggested to include more samples to increase their generalisability.

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