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Corporate Governance and Fraudulent Financial Reporting: The Audit Committee Characteristics' Paradigm

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Abstract:

The study interrogated the effect of audit committee characteristics, as a sub-system of the corporate governance framework, on fraudulent financial reporting. This was premised on the need to contribute to the ongoing debate on the influence of CG on the operational efficiency of the firm and assuring the broader perspective of stakeholders' confidence in the capital market paradigm. The study obtained data from the Accounting and Auditing Enforcement Releases (AAERs) issued by the US Security and Exchange Commission (SEC). A matched case-control research design was employed to gather and analyse relevant data using the OLS platform. From the analysis, the study observed that; the audit committee of fraud entities were less likely to have members with financial expertise than their no-fraud counterparts, the audit committee of no-fraud firms meet more frequently than those of the fraud firms, financial statement fraud was less likely to occur as the proportion of independent directors on the audit committee increases, and the size of the audit committee increases the chances of the occurrence of financial statement fraud. The study therefore concludes that a well-constituted audit committee is less likely to lead to financial statement fraud, by implication audit committee characteristics affects the incidence and extent of fraudulent financial reporting. It was therefore recommended that: audit committee membership criteria should include financial expertise as a primary requirement, membership of the audit committee should be dominated by more independent directors, and the size of the audit committee should not be bloated. A minimum of three and maximum of five, but not four or two, to allow for majority opinion in case of variation in judgement.

Keywords: Corporate governance, audit committee characteristics, fraudulent financial reporting, financial expertise.

1. Introduction

Financial statement fraud, regarded as an intentional act resulting in materially misleading financial report, has been adjudged to be one of the factors responsible for the collapse of big multinational corporations including Enron, WorldCom, Mirror Group Newspaper (MGN), as well as Barings Bank (Abdullah et al., 2008). The collapse of these corporate entities raised questions about the credibility of the company's financial reporting process, and it weakened public confidence both in the market and in the Accounting Profession. Also, the occurrence of financial statement fraud creates severe consequences with a devastating ripple effect. The immediate victims of financial statement fraud are the company's shareholders. Others that may be affected include creditors, employees who may lose jobs or pension funds, depositors, underwriters, insurers, auditors, etc. Perpetrators of financial statement fraud may include company's executives, auditors and employees (National Commission on Fraudulent Financial Reporting - NCFRR, 1987). This position was further affirmed by the study sponsored by the Committee of Sponsoring Organisations of the Tread-way Committee (COSO) on fraudulent financial reporting 1998-2007. In 89% of the fraud cases sampled, the chief executive officer and chief financial officer were named as being associated with financial statement fraud, of which 20% were indicted, and 60% of the indicted officers were convicted (Beasley et al., 2010).

Furthermore, a report to the nations on occupational fraud 2014 revealed that senior executives might be responsible for approximately 19% of all fraud. The impact of the loss, organisations suffered from executive fraud is four times that of the management and seven times that committed by employees (The Association of Certified Fraud Examiner's (ACFE), 2014). This suggests a correlation between the authority of the perpetrators of fraud and the financial losses. This statistic gave reasons for concern and raised the need for increased monitoring of the financial reporting process of organisations.

The board of directors and audit committee, in particular, are responsible for overseeing the financial reporting process of public entities. The presence of an audit committee is essential in an organisation. They play a significant role in ensuring that the financial reports of corporations are accurate by providing independent and objective oversight of the financial reporting system (Buchalter & Yokomoto, 2003)

It is their responsibility to ensure the integrity of the company's financial reports. They are expected to set the tone and create an enabling environment that will facilitate the production of credible and reliable financial statements. However, failure of the audit committee to effectively perform its statutory obligation has been adjudged the cause of financial statement fraud (Beasley, 1996; Cohen et al., 2007; Beasley et al., 2009; Asyiquin et al. 2014). Some of the critics pointed to the fact that the executives may select their cronies to function as docile directors who rely on them (executives) for all of their information (Cohen et al., 2007). Thus, it makes the audit committee symbolic and supportive of the executives even when it appears to be independent.

As indicated above, while most of the prior studies on corporate governance mechanisms revealed that the majority of the studies tended to focus on the existence of any significant relationship between various aspects of corporate governance and earnings management or restatement, this study focuses on the relationship between corporate governance mechanisms and the likely occurrence of financial statement fraud. Although, there are studies that have linked corporate governance mechanisms and the incident of fraud as indicated above, only a few have used data from the post-SOX era, when new corporate governance rules have been enacted. Prior studies have included data from AAERs issued by the USA SEC up to the end of June 2006. This affects the acceptability of the findings of prior studies in this contemporary time, as they lacked the ability to show whether the new corporate governance policies being implemented have had any significant effect on the likelihood of financial statement fraud. Thus, this timeframe distinguishes this study from prior ones as it includes data from AAERs up to the end of July 2019. The inclusion of AAERs from 2014 to 2019 makes this study unique from previous studies, and the result from this study may reflect the status of corporate governance in publicly listed companies.

2. Review of the Literature

The presence of an audit committee is essential in an organisation. It plays a significant role in ensuring that the financial reports of corporations are accurate by providing independent and objective oversight of the financial reporting system (Buchalter & Yokomoto, 2003). The audit committee perform three major monitoring functions: monitoring of the company financial report, monitoring of the external auditor independence and oversight of the internal control system (Akeel & Dennis, 2012). Regulatory bodies around the world have recognised the significant role of the audit committee even before the occurrence of the corporate scandal's decades ago. For example, in the 1970s the New York Stock Exchange (NYSE) required the boards of corporations listed on their platform to form an audit committee. They realised that "a strong audit committee could stimulate improvements in financial reporting and control and strengthen the credibility of corporate reports" (Vanasco, 1994:19). In the 1980s, it was recommended for all listed companies on the major American stock exchanges to have an audit committee. As highlighted by Levitt (1998:5) the existence of "qualified, committed, independent and tough-minded audit committees represent the most reliable guardians of the public interest". Thus, it is imperative that the audit committee performs its monitoring function effectively as this will boost investors' confidence in the financial market.

The effectiveness of audit committee to perform satisfactorily its statutory function has attracted lots of interest over the years. Studies have shown (such as Coram et al., 2006) that effective audit committee can actually prevent the incident of financial statement fraud and other fraudulent practises in an organisation. Kaplan et al. (2009) discovered that audit committee of listed firms with efficient and operational working procedures help to reduce the chances of financial statement fraud to a reasonable extent. Law (2011) found that audit committee effectiveness is significantly associated with the absence of financial statement fraud in firms. In addition, the Blue-Ribbon Committee (BRC) report and recommendations on improving the efficiency of corporate audit committees, the SOX Act (2002) and the UK (2010) Corporate Governance Code recommended some essential features that will help the audit committee function effectively in performing its governance responsibilities. These characteristics include independence, financial expertise and size of the audit committee, which are discussed in the section below.

2.1. Audit Committee Presence and Size

The BRC report (1999) and the UK (2010) Corporate Governance Code proposed that audit committees (for large companies FTSE 35) should have a minimum of three independent NEDs and two independent NEDs in the case of smaller companies. The studies conducted by Abbott et al. (2004), Vafeas, (2005), Mohiduddin and Karbhari (2010) and Huang and Thiruvadi (2010) suggested that an audit committee of not more than three members dominated by independent NEDs is a more efficient monitor of management activities. However, empirical studies on the impact of the audit committee presence and size on its effectiveness to monitor the activities of management produced mix results. Vafeas (2005) suggested that insufficient directors on the audit committee might influence its effectiveness. Persons (2009) stated that a large and independent audit committee could prevent the incidents of financial statement fraud. Uzun et al. (2004) found audit committee presence to be connected with a lower likelihood of organisational fraud. Conversely, Beasley (1996), Archambeault (2002) and Beasley et al. (2010) found no significant results between audit committee presence and size, with the occurrence of financial statement fraud.

2.2. Audit Committee Independence

Another characteristic of an effective audit committee as identified in the previous section is the audit committee independence. Section 301 of SOX Act and the listing rule of the NYSE and the NASDAQ mandate companies to have an audit committee comprising solely of independent directors. The aim is to prevent management fraud and improve the credibility of the financial report. However, the SOX Act gave an exception to the independence standard, which can only be granted by the SEC and not the company's board of directors. Section 301 and both the NYSE and NASDAQ listing rules

define an independent audit committee member as one not having any affiliation with the organisation including acceptance of any compensation with exception of what she/he was been paid as directors fees (Persons, 2005).

Prior research highlighted certain characteristics of members of an audit committee as determinants of its effectiveness and showed that corporations where financial statement fraud occurs, are less likely to have an audit committee or have an audit committee that is dominated by directors who are not independent (Lawrence, 2009). Abbott et al. (2000), Uzun et al. (2004) and Persons (2005) have underlined the fact that the autonomy of audit committees from management can positively affect the credibility of the financial reports of corporations. Abbott et al. (2000) suggests that companies with an audit committee that comprise solely of independent NEDs and meets at least twice a year are less likely to be sanctioned. In the same vain, Uzun et al. (2004) found a significant relationship between the proportion of grey directors on the audit committee and the occurrence of fraud.

Furthermore, the study of Persons (2005) revealed that the possible occurrence of financial statement fraud is lower when the audit committee is made up of independent directors and when audit committee members have fewer directorships with other firms. The result was based on a logit regression analysis and a matched sample of 111 fraud firms and 111 no-fraud firms from 1999 to 2003. This result contradicts the findings of Beasley (1996), whose study revealed that the composition of the audit committee does not have a significant effect on the likely occurrence of financial statement fraud. However, the findings of Beasley (1996) are likely affected by the small sample size of 26 fraud and no-fraud corporations used for the analysis. Both studies considered a company or its executive officers that have been a subject of a SEC enforcement action for violation of the SEC antifraud provision (rule 10(b)-5 of the United State of America SEC Act of 1934) to be involved in financial statement fraud. Unlike Beasley who used companies that are publicly reported to have an incident of financial statement fraud during 1980 to 1991 as his sample, Persons' sample companies had a revelation of financial statement fraud between 1999 and 2003, a period where a number of high-profile financial statement fraud occurred and some steps taken to improve corporate governance.

Finally, in a more recent study, Bouke (2006) refined and expanded the independent variables used by Persons (2005) to test different hypotheses. The study used a sample of 76 firms that are subjects of the USA SEC AAERs from 2004 to 2006 along with an industrial, size, stock exchange and time matched sample of 76 no-fraud firms. The results from both the univariate tests and logistic regression analysis found no significant difference in any of the audit committee variables between fraud and no fraud companies. Also, Beasley et al. (2010) found audit committees of both fraud and no-fraud firms to be more independent in the 2001 – 2004 sub-sample than 1991 – 1999 sub-period. The study also found no significant difference between fraud and no-fraud firms in audit committee presence.

2.3. Audit Committee Financial Expertise

Audit committee financial expertise is another important feature of an effective audit committee worth investigating. The SOX Act, the NYSE and NASDAQ listing rules require members of audit committees to possess financial knowledge and at least one should have expertise in accounting. It is believed that audit committee members with knowledge of accounting/finance are more likely to detect financial irregularities (Persons, 2005). Agrawal and Chadha (2005) define financial expertise of a director as someone with a certified public accountant (CPA), chartered financial analyst (CFA), or experienced in financial management. Empirical studies, regulators and corporate governance experts have stressed the importance of financial expertise of audit committee members in fulfilling their primary responsibility of overseeing the financial reporting process and improving the quality of financial reports in organisations.

Archambeault (2002) found the audit committee of fraud firms to be less financial literate compared to their no-fraud counterparts. The result from the logistic regression showed a negative and significant relationship between the proportions of audit committee members with financial expertise and the likelihood of fraud. The study was based on a sample of 138 matched pairs of fraud and no-fraud firms from the U.S. In a survey of 87 U.S. firms identified by the SEC as fraudulently manipulating their financial statements, Farber (2005) found that the board of director of fraud firms have fewer numbers of independent NEDs and members of the audit committee with financial expertise compare to their no-fraud counterparts. In addition, Agrawal and Chadha (2005) found firms whose board of directors or audit committees have an independent director with financial expertise had lower chances of financial restatement. They concluded that independent directors with financial expertise were important as long as oversight of a corporation's accounting reporting process is concerned. Furthermore, Mustafa and Youssef (2010) examined the relationship between the financial expertise of the audit committee and the incidence of misappropriation of assets in U.S. public companies using two types of financial expertise: accounting and non-accounting financial expertise. They classified persons as having financial expertise if the director's biography contained any of the following titles: certified public accountant (CPA), certified management accountant (CMA), chief accounting officer (CAO), principal accounting officer (PAO) or auditor. With a sample of 28 companies that experienced misappropriation of assets from 1987 to 2001, as well as, 28 matched industrial-sized control companies, the authors supported the view that only independent audit committee members with financial expertise can be effective in reducing the occurrence of misappropriation of assets in public enterprises.

Conversely, Persons (2005) obtained an insignificant relationship between audit committee members with financial expertise and the occurrence of corporate fraud. Beasley et al. (2010) found a surprising result. They discovered that fraud firms have more audit committee members with financial expertise than no-fraud companies. Their study found this difference to be statistically significant. Therefore, in view of the submissions of regulatory bodies and governance experts on the qualities of audit committee and its effectiveness to carry out its oversight function and thereby reducing the incidence of financial statement fraud, the following hypothesis is formulated for this study:

- H_1 . A well-constituted audit committee is less likely to lead to financial statement fraud.

3. Materials and Methods

Following prior studies, such as Beasley (1996), Archambeault (2002), Sharma (2004) Uzun et al. (2004), Persons (2005) and Giulia and Andrea (2012), a matched case-control research design was employed to gather and analyse relevant data. In this design, the corporate governance mechanisms of fraud firms (the case) will be compared with those of the no-fraud companies (the control) that are similar in size, industry, stock exchange and time.

3.1. Sample Selection

The sampling frame of fraud companies will comprise only discovered cases of businesses that have fraudulently reported their financial statement and as such, cases of fraud yet to be discovered are not available for discussion in this study. The fraud companies were identified through a review of the Accounting and Auditing Enforcement Releases (AAERs) issued by the Security and Exchange Commission (SEC), since there is no existing list of all companies that have been involved in financial statement fraud. The AAERs contain cases of companies or it's executive that have supposedly violated the USA SEC anti-fraud provision (Rule 10(b)-5 of the SEC Act of 1934).

The collection of original AAREs was the starting point of the data collection process. The AAREs were collected from the SEC website for a period of six years (January 6, 2014 – July 8, 2019). The AAERs were read to identify those that pertain to the violation of the SEC anti-fraud provision (Rule 10(b)-5 of the SEC Act of 1934). As shown in Table 1 below, 576 AAERs were released during the period under review. Only approximately 6% (32) of the AAERs related to the violation of the SEC anti-fraud provision (Rule 10(b)-5 of the SEC Act of 1934) by an officer of the company. Consequently, only 32 AAERs were selected for use in this study. A company will be included in the fraud sample if the fraud period is determinable. In addition, the company's proxy statement or form 10-k must be available as at the time of fraud occurrence, and the company should not be a financial institution. Finally, there should be a no-fraud company that will match the fraud company size, industry, stock exchange and time.

The selection criteria stated above further reduced the number of AAERs from 32 fraud cases to 27 companies. Table 1 below, depicts the outcome of the elimination of 5 cases that did not meet the selection criteria. 2 of the companies related to firms whose proxy statement or form 10-k cannot be found. In one of the cases, no matching pair was found for the fraud company. The remaining 2 cases related to the financial institution experiencing financial statement fraud.

Number of AAERs	Number
AAERs from January 6, 2014, to July 8, 2019 (No. 3094 – 3670)	576
Deduct;	
AAERs not involving financial statement fraud (e.g., multiple AAERs for the same firm or AAERs about administrative proceedings)	544
AAERs relating to firms with no available proxy or financial statement data	2
AAERs relating to firms where the fraud period was not determinable	-
AAERs relating to financial institutions experiencing financial statement fraud	2
AAERs relating to firms where no matching pair could be identified	1
Balance	27

Table 1: Fraud Sample Distribution

3.2. Matching Process

As earlier stated, the criteria for pairing the fraud businesses and their no-fraud counterpart will be the company size, the market where it's stock is traded, its industry it belongs, alongside the availability of the company's proxy statement or form 10-k in the year preceding the time of fraud occurrence. Prior studies have also matched samples base on the four criteria listed above. Studies conducted by Beasley (1996), Sharma (2004), Uzun et al. (2004) and Persons (2005) used the same criteria to identify possible pairs in their case-control studies. Persons (2005) emphasises the significance of the stock market on which the company's stock is traded because each stock exchange have different corporate governance requirements. Consequently, this study paired the samples taking into account of the year of fraud occurrence, the stock exchange where its stock is traded, the primary standard industrial code (SIC) and the size of the company. The size criterion is determined by the total assets of the enterprise.

After matching for the first three criteria, it was difficult to find a no-fraud company with the same plus or minus 30% total asset value in US dollar for all the fraud companies. In line with previous studies, the study accepts the no-fraud company with asset value closest to the fraud company with a maximum limit of 45%. The outcome of the matching process is displayed in table 2.

Panel A					Year of Fraud Occurrence						
2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
3	3	2	2	3	5	4	1	1	2	1	27
11%	11%	7%	7%	11%	19%	15%	4%	4%	7%	4%	100%
Panel B					Stock Exchange						
NYSE		NASDAQ			Over the Counter (OTC)			Total Pairs			
18		26			10			54			
33%		48%			19%			100%			
Panel C					Standard Industry Code (SIC)						
Pairs matched by 1-Digit SIC										2	
Pairs matched by 2-Digit SIC										6	
Pairs matched by 3-Digit SIC										8	
Pairs matched by 4-Digit SIC										11	
Total Pairs										27	
Panel D					Size- Total Assets (million US Dollars)						
	Number	Minimum	Maximum	Mean	Median						
Total companies	54	38	707970	108147.94	30876.50						
No-fraud company	27	38	707970	111973.26	46046.00						
Fraud company	27	55	643118	104322.63	23798.00						
Paired differences	27	17	64853	7650.630	22257						

Table 2: Matching Criteria

3.3. Methods of Data Analysis

Following prior studies, such as Beasley (1996), Archambeault (2002), Sharma (2004) Uzun et al. (2004), Persons (2005) and Giulia and Andrea (2012), this study uses a logit regression model to test the hypothesis. The logit regression model was adopted since the dependent variable (financial statement fraud) is a dichotomous variable. A variable is dichotomous if it consist of only two categories (i.e. fraud and no-fraud) (Field, 2006).

$$fraud = \alpha + \beta_1 pac_i + \beta_2 acsize_i + \beta_3 acind_i + \beta_4 acperin_i + \beta_5 acfe_i + \beta_6 acmeet_i + \beta_7 distress_i + \beta_8 ceoduality_i + \beta_9 total_i + \varepsilon_i$$

Variable Acronym	Measurement
	Company 1 through 54;
ε	The residual term
α	Constant
β	Coefficient
Dependent variable	
Fraud	Dummy variable equals 1 if the company had fraud and 0 otherwise;
Independent variable:	
Audit Committee variables	
Pac	Dummy variable equals 1 if there is audit committee; 0 otherwise;
Acsize	The size of the audit committee defined as the number of members of the committee;
Acind	Number of independent directors in audit committee;
Acperin	The percentage of independent directors in audit committee;
Acfe	Dummy variable equals 1 if a member of audit committee has financial expertise; 0 otherwise;
Acmeet	Number of audit committee meetings in the year prior to fraud;
Control variables	
Distress	Dummy variable equals 1 if company experienced loss 3 years prior to fraud; 0 otherwise;
Ceoduality	Dummy variable equals 1 if the chairman is same as CEO; 0 otherwise; and
Total	Total assets of the firms for the year prior to the fraud year

Table 3: Variable Description

A negative and significant coefficient (β) on the variables depicting the selection of the audit committee would support the postulated prediction concerning H_1

Variables	No. of pairs	Fraud firm	No-fraud firm	Mean difference	p-values
Pac	27	96%	96%	0%	
Acsiz	27	2.96	3.04	-0.08	
Acind	27	2.93	3.04	-0.11	
Acperin	27	95.06%	96.30%	1.24%	
Acf	27	63%	81%	18%	0.066*
Acmeet	27	4.81	5.63	-0.82	0.031**

Table 4: Univariate Test on Audit Committee Effectiveness of Fraud and No-Fraud firms

Data in Table 4 presents a summary of the univariate tests results comparing the mean values of variables that represent the audit committee effectiveness between fraud firms and no-fraud firms. Some differences exist between the audit committee structure of the fraud companies and no-fraud companies and some of these differences were statistically significant.

Surprisingly, the study found no difference in the audit committee presence between fraud and no-fraud companies. This result could be attributable to the implementation of the listing rules of the NYSE and NASDAQ that all listing firms should have an audit committee. The average size of the audit committee and the number of independent NEDs on the audit committee were slightly different for both fraud and no-fraud firms. However, the differences were not statistically significant. Furthermore, on the average, 63% of fraud entities have a member in their audit committee that has accounting or financial expertise, while 81% of no-fraud entities have an audit committee with a member that possesses accounting or financial expertise. The difference was statistically significant ($p < .10$, one-tailed) using both the paired sample t-tests and Wilcoxon signed rank tests. The result suggests that the audit committee of fraud entities were less likely to have members with financial expertise than their no-fraud counterpart. This is consistent with the findings of Archambeault et al. (2002). Finally, the average number of meetings held by the audit committee of fraud firms in the year that precedes the fraud year was 4.81, while the no-fraud firms held on average 5.63 meetings during the year that precedes the year of fraud. The univariate test results found this difference to be statistically significant ($p < .05$, one-tailed). The difference suggests that the audit committee of no-fraud firms meet more frequently than those of the fraud firms. This supports the argument of Abbot et al. (2000) that the audit committee that meet frequently are less likely to be sanctioned.

Independent Variables	Predicted Sign	Estimated Coefficients (β)	Robust Standard Errors	z-statistic	P> z
Audit Committee Effectiveness:					
Acsiz	+/-	13.23139	2.224937	5.95	0.000***
Acind	-	-13.00116	2.4727	-5.26	0.000***
Acperin	-	12.11749	6.917853	1.75	0.080*
Acf	-	-1.494849	.9693373	-1.54	0.123
Acmeet	+/-	.0310664	.0821907	0.38	0.705
Control Variables:					
Distress	None	1.08247	.8547728	1.27	0.205
CEODuality	None	.2238679	.7703508	0.29	0.771
Total assets	None	-1.48e-06	2.65e-06	-0.56	0.575
Wald chi ² (12) =	193.39	prob.>chi ² = 0.000			
Pseudo R ² =	0.1611	*,**,*** Statistically significant at less than the 0.10, 0.05 and 0.01 level, based on two-tailed test			
No. of observation	= 54				

Table 5: Logit Regression Results for 27 Fraud Companies Paired with 27 No-Fraud Companies

Note: Variable Definitions Are Same as Those Displayed In Table 3

3.4. Audit Committee Effectiveness and Financial Statement Fraud

On the audit committee effectiveness, a negative and significant coefficient (β) on the variables depicting the composition of the audit committee would support the hypothesized relationship in H_1 . The result of the number of independent NEDs (acind) on the audit committee was consistent with the research hypothesis (H_1). The study found a negative and robust statistically significant ($p = 0.000$) relationship between the proportion of independent NEDs on the audit committee and the likely occurrence of financial statement fraud. This implied that financial statement fraud was less likely to occur as the proportion of independent directors on the audit committee increases. The finding supports the argument of Abbott et al. (2000), Uzun et al. (2004) and Persons (2005) that the autonomy of audit committees from management can positively affect the credibility of the financial reports of corporations.

Conversely, the logit model produced a significant positive ($p = 0.000$) and robust correlation between audit committee size (acsiz) and the likely occurrence of financial statement fraud at 5% significant level. The result suggests that the size of the audit committee increases the chances of the occurrence of financial statement fraud. This supports the

argument of Andres et al. (2005) and Jensen (1993). They claimed that larger boards are less likely to be efficient and are easily controlled by the CEO.

Finally, the lack of difference in the presence of audit committee observed between fraud and no-fraud companies indicates that it is not the existence of an audit committee that affect the likelihood of fraud but the characteristics of directors that constitute the audit committee.

4. Conclusion, Implications and Recommendations

This study looked at how selected corporate governance mechanisms (such as the composition of the audit committee) affect the occurrence of financial statement fraud in public companies. The aim was to examine the way the effectiveness of audit committee affects the occurrence of financial statement fraud.

On the basis of the hypothesis (H_1) which proposed that a well-constituted audit committee is less likely to lead to financial statement fraud, the study obtained the following result from the univariate tests and the logit regression analysis indicating that:

- The audit committee of fraud entities was less likely to have members with financial expertise than their no-fraud counterpart.
- The audit committee of no-fraud firms meets more frequently than those of the fraud firms.
- Financial statement fraud was less likely to occur as the proportion of independent directors on the audit committee increases.
- The size of the audit committee increases the chances of the occurrence of financial statement fraud.
- On the basis of the findings and conclusion arrived at, it is recommended that:
- Audit committee membership criteria should include financial expertise as a primary requirement,
- Audit committee should meet more frequently to monitor the process leading the production of financial statements rather than adopt a post mortem (after the incidence) approach,
- Membership of the audit committee should be dominated by more independent directors, and
- The size of the audit committee should not be bloated. A minimum of three and maximum of five, but not four or two to allow for majority opinion in case of variation in judgement.

However, there are some limitations to this study which readers should be aware of while interpreting the results. Firstly, the collection of data to populate the fraud and no-fraud sample is a limitation. The study relies on publicly available information to populate the sample. It is only known cases of fraud that are made accessible to the public. Since there are no generally acceptable ways through which financial statement fraud can be measured accurately, then it becomes difficult to confirm whether financial statement fraud had not occurred in other corporations. Therefore, there is a possibility of selecting a firm that have committed financial statement fraud yet to be discovered as a no-fraud entity, which could have biased the findings of this study and thereby limiting the generalisation of the findings to the whole population.

Secondly, the study only investigates the case of a company or its agents intentionally issuing material misstated financial report as Fraud Company. Therefore, other cases of fraud (e.g. misappropriation of assets, employee fraud, bribery and corruption) are outside the scope of this study, thus, limiting the implications of the study. Thirdly, the fraud sample comprises of only companies that have been alleged to report their financial statement fraudulently by the USA SEC. There are limitations when using the AAERs to identify companies that fraudulently report their financial statement. For example, it is only possible to investigate those companies identified by the SEC's AAERs as having reported their financial statement fraudulently since the SEC only pursue cases where the chances of success are high. Thus, making the financial statement fraud identified by the AAERs as not being representative of the population of financial statement fraud occurrence. Finally, the sample size is relatively smaller compared to similar studies on corporate governance and financial statement fraud. The study used 27 publicly listed firms in the U.S. However, this reflects the amount of companies that are alleged to have violated the U.S. SEC anti-fraud provision (section 10(b) rule 10(b)-5).

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