Audit Committee Busyness and The Risk of Financial Distress: Evidence from Indonesia

Melinda Lydia Nelwan, Billy Ivan Tansuria

To Link this Article: http://dx.doi.org/10.6007/IJARBSS/v12-i2/12303  DOI:10.6007/IJARBSS/v12-i2/12303

Received: 15 December 2021, Revised: 17 January 2022, Accepted: 06 February 2022

Published Online: 28 February 2022

In-Text Citation: (Nelwan & Tansuria, 2022)

Copyright: © 2022 The Author(s)
Published by Human Resource Management Academic Research Society (www.hrmars.com)
This article is published under the Creative Commons Attribution (CC BY 4.0) license. Anyone may reproduce, distribute, translate and create derivative works of this article (for both commercial and non-commercial purposes), subject to full attribution to the original publication and authors. The full terms of this license may be seen at: http://creativecommons.org/licenses/by/4.0/legalcode

Vol. 12, No. 2, 2022, Pg. 425 – 437

http://hrmars.com/index.php/pages/detail/IJARBSS  JOURNAL HOMEPAGE

Full Terms & Conditions of access and use can be found at http://hrmars.com/index.php/pages/detail/publication-ethics
Audit Committee Busyness and The Risk of Financial Distress: Evidence from Indonesia

Melinda Lydia Nelwan, Billy Ivan Tansuria
Faculty of Economics and Business, Universitas Klabat (UNKLAB), Airmadidi, North Minahasa – 95371, Indonesia

Abstract
Studies about audit committee ineffectiveness monitoring role and detrimental financial condition are largely focused on its characteristics (i.e., independence, expertise, size, and activity), while the busyness of the audit committee is underexplored. This study extends previous literature on the relationship between the audit committee and financial condition by examining whether the busyness of audit committee members has an impact on the risk of financial distress. It is a panel data study conducted among 119 listed manufacturing companies in Indonesia, for the period of 2012 to 2014. The findings show that the busyness of audit committee financial experts negatively affects the risk of financial distress. Busyness compromises the monitoring role in the financial reporting process, thus increasing the risk of financial distress, which is consistent with the busyness hypothesis. However, the busyness of other audit committee members has a positive impact on the risk of financial distress among safe firms, which is consistent with the reputation hypothesis. Multiple positions enable the accumulation of knowledge, experience, and information that is beneficial for the oversight function. This study contributes to the literature by providing evidence that the busyness of different audit committee members has a different impact on its monitoring role effectiveness.

Keywords: Audit Committee, Busyness, Financial Distress, Financial Expert

Introduction
The global financial crisis from 2008 to 2009 brought a big impact on the economic condition, particularly in Asia. Asian countries (e.g., Japan and Indonesia) faced a more than 30 percent downturn in exports during that time (Heng, 2009). It is supposed that the manufacturing sector is one of the economic sectors that was seriously affected by the global financial crisis compared to other sectors. To some extent, the manufacturing industry is an industry that depends on imports of raw materials. During the crisis, the increase in primary commodity prices which are the raw materials of this sector has led to an increase in production costs. Concurrent with the decrease in exports, the increase in imports might eventually have affected the financial condition of a company, hence increases the risk of financial distress.

Studies regarding the significance of corporate governance on financial distress are substantial. In particular, some studies had shown that corporate governance mechanism can
alleviate the risk of financial distress (e.g., Lee & Yeh, 2004; Wang & Deng, 2006) because effective corporate governance mechanism contributes to better financial performance. In fact, as part of the corporate governance mechanism, an audit committee has become one of the control mechanisms that can ensure the trustworthiness of corporate financial reporting. This is because an audit committee plays a role in overseeing and monitoring the financial reporting process of a company. By ensuring the quality of financial reporting, the audit committee might prevent a decline in corporate financial condition that can cause financial distress. Consequently, it can be argued that the lack of monitoring on the financial reporting process by the audit committee can potentially lead to a detrimental financial condition.

Although previous studies showed that the busyness of audit committee members has an impact on its monitoring role, studies regarding the association of audit committee ineffectiveness monitoring role and detrimental financial condition (i.e., financial distress) are largely focused on its characteristics such as independence, expertise, size, and activity (e.g., Carcello & Neal, 2003; Rahmat, Iskandar, & Salleh, 2009; Salloum, Azzi, & Gebrayel, 2014). On the other hand, other studies found that the busyness of audit committee members has an impact on the quality of financial reporting (e.g., Sharma & Iselin, 2012; Tanyi & Smith, 2015). Tanyi and Smith (2015) particularly found that the busyness of the chairman and financial experts in the audit committee adversely impacts the financial reporting quality.

However, there is little knowledge of whether audit committee members’ busyness can potentially contribute to the risk of financial distress. Therefore, this current study argues that the busyness of audit committee members may compromise the effectiveness of oversight and monitoring role in the corporate financial reporting process. Given that the busyness of audit committee members might cause ineffectiveness, consequently lessening the quality of financial reporting, and given that to some extent the ineffectiveness of the audit committee might be related to the risk of financial distress of a company, this study aims to investigate whether the busyness of audit committee members contributed to the risk of financial distress of a company.

**Literature Review and Hypothesis Development**

**Financial Distress and Corporate Governance**

The financial condition of a company is not only a particular interest in corporate management but for many other parties as well since the going concern of the company might determine the welfare of related stakeholders. Financial distress refers to a declining financial condition, usually occurring before bankruptcy or liquidation (Platt & Platt, 2002). According to Brigham and Daves (2006), there are several types of financial distress. First is the economic failure where revenues are not able to cover expenses, including the cost of capital. Next is the business failure, defined as a business that ceases to operate which results in the loss to creditors. The other type is the technical insolvency, a condition in which the company cannot meet its short-term debts due. This is the first stage of financial distress. Another is insolvency. This happens when the book value of debt is larger than the book value of assets, a condition that precedes liquidation. Last is the legal bankruptcy, which occurs when there is a legal claim filed according to the law on corporate bankruptcy. Considering these stages in financial distress, the sooner the risk of financial distress is made known, the better the chance of the company to address this issue.

Financial distress can be related not only to the economic condition but also to the effectiveness of the corporate governance mechanism in a company. Altman and Hotchkiss (2006) stated that management failure is one factor that can cause financial distress.
Management failure is related to the ineffectiveness of the corporate governance mechanism in a company. Lee and Yeh (2004) found that weak corporate governance increases the probability of a corporation to experience financial distress. On the other hand, Wang and Deng (2006) found that increase in large share ownership, state ownership, and proportion of independent directors could reduce the propensity of financial distress. Those studies provide evidence that corporate governance mechanism contributes to the financial performance of a company.

The effectiveness of corporate governance mechanisms can particularly be determined by the board of directors. There is an argument that busier directors result in a less effective monitoring role, hence lowering financial reporting quality (Tanyi & Smith, 2015). This is based on the busyness hypothesis which asserts that when the workload becomes heavier as demanded by their multiple positions, the directors’ monitoring ability may deteriorate. The study of Liu and Paul (2015) found that director busyness harms firm performance. Their findings are more prevalent towards inside directors, those who not only monitor but are also involved in corporate daily activities. Having busier inside directors are more detrimental in firms that have higher asymmetric information. Despite all these arguments, directors might still have a personal inclination to raise their status, thus seeking multiple positions outside their companies.

The competing argument contends that busier directors are beneficial to enhancing company reputation (Jiraporn et al., 2009). This argument is based on the reputation hypothesis. It is argued that multiple positions might enhance the managerial skills of the directors. This is because they can learn more strategies and management styles applied to other companies. Multiple positions also serve as a signal of managerial quality. Moreover, a good reputation increases the marketability of the directors (Ferris et al., 2003). In turn, reputable directors would attract more demands to join outside boards. Omer et al (2014) studied the relation between director connectedness and firm value. They argued that when directors have more links with the network (i.e., have multiple directorships), they can gain more knowledge and experience and have access to more and better information, thus improving their monitoring role. They particularly found that firms with higher director connectedness resulted in higher firm value. It was found that when directors were more connected with the boards outside of the company, the firm value was even larger compared to those who were more connected inside the company.

Given that board of directors is one mechanism that can closely monitor the overall activities of the firms, the busyness of its members may compromise the effectiveness of its role. Fich and Shivdasani (2006) found evidence that busy boards of large, well-established firms weakened corporate governance due to ineffective monitoring which is detrimental to financial performance. On the other hand, busy directors are associated with more experience and better networking, hence positively contributing to the firm’s value (Field et al., 2013; Omer et al., 2014). However, those studies are largely focused on the board of directors and not on the directors that are members of the audit committee, which allegedly are more closely responsible for overseeing and monitoring the financial reporting process. The audit committee has become one of the control mechanisms that can ensure the trustworthiness of corporate financial reporting. This is because the audit committee plays a role in overseeing and monitoring the financial reporting process in a company. By ensuring the quality of financial reporting, the audit committee might prevent a decrease in corporate financial condition. Therefore, parallel to the argument that busy boards can compromise the
effectiveness of its role, the busyness of audit committee members more likely provides a stronger influence on the risk of financial distress.

**Financial Distress and Audit Committee**

The audit committee has a more direct role in monitoring the financial reporting process of a company. The Indonesia code of good corporate governance states that an audit committee has a role in assisting the board of commissioners in providing thorough supervision over a company, particularly in regards to the accounting policy, internal control, and financial reporting system (National Committee on Governance, 2006). Furthermore, in supervising the financial reporting process, an audit committee has the responsibility to ensure that the financial reports prepared by the management provide a true and faithful representation of the condition of a company.

Several studies have been done to examine the effectiveness of the audit committee monitoring role for the quality of financial reporting. Some of those studies focus more on the impact of audit committee characteristics (i.e., independence, expertise, activity, and size) on financial distress. Rahmat et al. (2009) specifically studied whether audit committee characteristics in financially distressed companies listed on Bursa Malaysia had any difference from those of the non-financially distressed companies. They found that the financial expertise of audit committee members was negatively associated with financial distress. Carcello and Neal (2003), on the other hand, studied whether the choice of disclosure in financially distressed companies had any relation to audit committee independence. It was found that in financially distressed companies, a positive and significant relationship existed between audit committee independence measured by the percentage of affiliated directors and the disclosures of going-concern optimism. Affiliated directors might have a particular interest to maintain corporate reputation. This could result in avoidance in reporting negative information regarding the financial condition of the company. Consequently, they become more optimistic in their opinion on going concern. Additionally, Salloum et al. (2014) studied the effect of audit committee characteristics on financial distress in banks in Lebanon. They found that audit committee meeting frequency was negatively associated with financial distress, thus suggesting the importance of conducting meetings regularly to avoid the risk of financial distress.

Although these studies mentioned have extensively investigated the association between audit committee characteristics and financial distress, there is little knowledge regarding that of the audit committee's busyness. Only a limited number of studies investigated the impact of audit committee busyness on the financial condition of a company, but even those do not explicitly focus on the risk of financial distress. Tanyi and Smith (2015), for example, studied whether audit committee busyness was associated with financial reporting quality. They found that busier audit committee chairman and financial experts resulted in a less effective monitoring role, hence lowering financial reporting quality. However, their study focused more on the possibility of firms engaging in earnings management practices which, they argued, compromised the quality of financial reporting, but not specifically the risk of financial distress. Similarly, Sharma and Iselin (2012) examined the busyness of audit committee members and financial misstatements. They found that there was a positive association between audit committee busyness and financial misstatements and analyzed that audit committee members that held multiple directorships would be too busy to monitor the financial reporting process. Nevertheless, their study only focused on the impact of audit
committee busyness on financial misstatements but not on financial distress which could be the result of long-term financial misstatements.

This study argues that audit committee busyness will compromise the effectiveness of its role in monitoring the financial reporting process. To some extent, this may result in poor financial reporting quality which can increase the risk of firms becoming financially distressed. Therefore, the impact of audit committee busyness on financial distress warrants further investigation. Given the audit committee members might have different roles to influence the financial reporting process, the following are the hypotheses of this study.

H1: The busyness of the audit committee chairman increases the company’s risk of financial distress.

H2: The busyness of audit committee financial experts increases the company’s risk of financial distress.

H3: The busyness of other members of the audit committee increases the company’s risk of financial distress.

The rest of the paper presents the methodology used, including the sample selection and variable measurements. Right after that, it is followed by the results and discussions based on descriptive statistics and multivariate analysis. Finally, the conclusion is presented in the last section, including the limitations, contributions, and direction for future research.

Research Methodology
Sample and Data Selection

The population of this study was the manufacturing companies listed on the Indonesia Stock Exchange from the year 2012 to 2014. The list consisted of 136 companies or 408 firm-year observations. After deducting 55 firm-year with unavailable audit committee data, the sample consisted of 353 firm-year observations. Based on preliminary observation of the data, 13 influential outliers were found. These influential outliers were excluded from the data, resulting in 340 firm-year observations, comprising 117 unique firms. The sample selection can be seen in Table 1.

<table>
<thead>
<tr>
<th>Sample Selection Criteria</th>
<th>Firm-Year Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed manufacturing companies in 2012 – 2014</td>
<td>408</td>
</tr>
<tr>
<td>Less: Unavailable audit committee data</td>
<td>(55)</td>
</tr>
<tr>
<td>Influential outliers</td>
<td>(13)</td>
</tr>
<tr>
<td>Final Sample</td>
<td>340</td>
</tr>
</tbody>
</table>

The data for this study consisted of fundamental financial data and information regarding the number of positions held by the audit committee members. The fundamental financial data were taken from the Indonesian Capital Market Directory (ICMD). The number of positions held by the audit committee members were taken from corporate annual reports and gathered using content analysis method in which the corporate governance disclosure in the annual reports was analyzed to determine the number of positions held by the audit committee chairman, financial experts, and other members.
Financial Distress

Financial distress in this study was measured using Altman Z”-Score, which according to Gunathilaka (2014) yielded higher predictive power than other methods he tested. This formula is more appropriate to be utilized in manufacturing companies. The Altman Z”-Score is shown below:

\[ Z^n = 6.56X_1 + 3.26X_2 + 6.72X_3 + 1.05X_4 \]  

where \( Z^n \) is the overall score, regarded as FINDIST, \( X_1 \) is working capital over total assets, \( X_2 \) is retained earnings over total assets, \( X_3 \) is earnings before interest and taxes over total assets, and \( X_4 \) is book value equity over total liabilities. Companies that scored lower than 1.1 were considered distressed firms. Scores between 1.1 and 2.6 were considered as uncertain, while scores above 2.6 as safe.

Audit Committee Busyness

The busyness of the audit committee was divided into the busyness of the audit committee chair, financial experts, and others. Following Tanyi and Smith (2015): (1) The busyness of the audit committee chair (BUSCHAIR) was measured by the number of other positions held by the chairman inside and outside of the company. (2) The busyness of the audit committee financial experts (BUSFINEX) was measured by the average number of other positions held by the audit committee financial experts inside and outside of the company. (3) The busyness of other audit committee members (BUSOTHER) was measured by the average number of other positions held by the remaining audit committee members inside and outside of the company.

The number of positions was based on positions held by each member, inside or outside of the company. This information was found in corporate annual reports under the profiles of each audit committee member. The average number of positions is calculated by dividing the total number of positions held inside and outside of the company with the number of members. For example, if there are two financial experts in the audit committee of the specific company with a total of 10 positions, the average number is 10 divided by two.

Control Variables

According to Tanyi and Smith (2015), the fundamental characteristics of a company also affect the quality of financial reporting. To some extent, those fundamental characteristics can influence the company’s risk of financial distress. Leverage is one of the company’s fundamental characteristics to measure the usage of debt in its capital structure (Parrino et al., 2012). It refers to the ability of the company to meet its obligation. A highly leveraged company increases the risk of unsuccessfully meeting its obligation, hence facing credit default. The size of a company can also affects financial reporting quality. The bigger the company, the more the resources, the bigger it’s capacity to perform its operational activities. Bigger companies commonly attract more scrutiny from stakeholders, thus having incentive to perform well and having better financial conditions (Rahmat et al., 2009; Salloum et al., 2014).

Corporate financial performance determines its capacity to manage the business, specifically, to measure how efficient the management uses the assets in generating income to the company (Parrino et al., 2012). Companies that can manage their resources well might have better financial performance, hence avoiding the risk of financial distress. Given that those fundamental characteristics may influence the financial condition of a company; these characteristics were included in the analysis to control for firms’ specific information.
measurement of those control variables is as follows: (1) Financial Performance (ROA) is a control variable measured by return on assets which is the ratio of earnings divided by total assets. (2) Leverage (LEV) is a control variable measured by the ratio of total liabilities to total assets. (3) Firm Size (SIZE) is a control variable measured by the natural logarithm of total assets.

**Research Model**
The research model is as follows:

\[
FINDIST_t = \beta_0 + \beta_1 BUSCHAIR_{it} + \beta_2 BUSFINEX_{it} + \beta_3 BUSOTHER_{it} + \beta_4 ROA_{it} + \beta_5 LEV_{it} + \beta_6 SIZE_{it} + \epsilon_{it}
\]

where FINDIST\(_{it}\) is the score obtained from the Altman Z”-Score of company \(i\) at year \(t\), BUSCHAIR\(_{it}\) is the number of positions held by the audit committee chairman of company \(i\) at year \(t\), BUSFINEX\(_{it}\) is the average number of positions held by audit committee financial experts of company \(i\) at year \(t\), BUSOTHER\(_{it}\) is the average number of positions held by other members of the audit committee of company \(i\) at year \(t\), ROA\(_{it}\) is the return on assets, which is the financial performance measured by the ratio of net income to total assets of company \(i\) at year \(t\), LEV\(_{it}\) is leverage, measured by the ratio of total debt to total assets of company \(i\) at year \(t\), SIZE\(_{it}\) is firm size, measured by the natural logarithm of total assets of company \(i\) at year \(t\), and \(\epsilon_{it}\) is the error term.

**Results and Discussion**

**Descriptive Statistics**
The descriptive statistics of the dependent and independent variables are presented in Table 2.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs.</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>FINDIST</td>
<td>340</td>
<td>5.000284</td>
<td>3.543695</td>
<td>-18.3149</td>
<td>12.3248</td>
</tr>
<tr>
<td>BUSCHAIR</td>
<td>340</td>
<td>1.208824</td>
<td>1.959903</td>
<td>0.000</td>
<td>10.000</td>
</tr>
<tr>
<td>BUSFINEX</td>
<td>340</td>
<td>0.942177</td>
<td>1.074948</td>
<td>0.000</td>
<td>5.000</td>
</tr>
<tr>
<td>BUSOTHER</td>
<td>340</td>
<td>0.273559</td>
<td>0.846515</td>
<td>0.000</td>
<td>5.500</td>
</tr>
<tr>
<td>ROA</td>
<td>340</td>
<td>0.057265</td>
<td>0.099908</td>
<td>-0.3459</td>
<td>0.6691</td>
</tr>
<tr>
<td>LEV</td>
<td>340</td>
<td>0.498604</td>
<td>0.27604</td>
<td>0.0372</td>
<td>2.5885</td>
</tr>
</tbody>
</table>

The Z”-Score which proxies for financial distress (FINDIST) had a mean of 5. This means that the average observations were considered as safe firms (Z”-Score > 2.6). In fact, among the 340 observations, only 29 observations (8.5%) were considered distressed (Z”-Score < 1.1). Similarly, 29 observations (8.5%) were considered uncertain (1.1 ≤ Z”-Score < 2.6), and 282 observations (83%) were considered in a safe condition (Z”-Score ≥ 2.6). On average, the chairmen of the audit committees had more than 1 position inside or outside of the company, with a minimum of 0 and a maximum of 10 positions. The average position held by financial experts was around 0.94, with a minimum of 0 and a maximum of 5 average positions. On the other hand, other members of audit committees had an average position of 0.27, with a minimum of 0 and a maximum of 5.5. The profitability as proxied by ROA was approximately 5.7%. The leverage (LEV) was around 50%. This shows that average companies had 50% of
debts compared to total assets. Finally, the SIZE shows that the average observations had 7.5 trillion rupiahs in total assets (log natural of 14).

**Hypothesis Testing**

Because this study is a panel data study, the Hausman test and the Breusch-Pagan Lagrange Multiplier test were performed to find out whether the fixed effects or the random-effects model was more appropriate. It was found that the fixed effects model was preferred; thus, the initial hypothesis testing was conducted using the fixed effects model with robust standard errors. The results of the first hypothesis testing can be seen in Table 3.

<table>
<thead>
<tr>
<th>Variables</th>
<th>Coefficients</th>
<th>P &gt;</th>
<th>t</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>BUSCHAIR</td>
<td>-0.005</td>
<td>0.721</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BUSFINEX</td>
<td>-0.124*</td>
<td>0.016</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BUSOTHER</td>
<td>-0.005</td>
<td>0.906</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROA</td>
<td>8.608***</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEV</td>
<td>-8.602***</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>-0.008</td>
<td>0.964</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>9.035***</td>
<td>0.000</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The results show that the model was significant (p-value = 0.000), and the adjusted R-Square shows that 87.9% of the stage of financial distress could be explained by the independent variables. This means that the busyness of audit committee members had an impact on the stage of financial distress. Indeed, the busyness of the audit committee financial experts was negative and significant (p-value = 0.016). The findings indicate that as the audit committee financial experts become busier, the effectiveness of their monitoring role might be compromised. This causes the Z"-Score to decrease which means that there is a higher risk of becoming financially distressed. This finding supports hypothesis 2. Nevertheless, the significant results did not exist in the busyness of the audit committee chairman and other members; thus, hypotheses 1 and 3 could not be supported. Because the Z"-Score captures the risk of financial distress, the lower Z"-Score indicates a higher risk of the company being in financial distress. This is because companies that were categorized as experiencing uncertain or distressed financial conditions commonly had lower Z"-Scores. Related to this, Dhaliwal, Naiker, and Navissi (2010) had shown that financial expertise in the audit committee improves the quality of financial reporting. Thus, whenever the audit committee financial experts are busier with other responsibilities, the quality of financial reporting might deteriorate, increasing the risk of financial distress. This is consistent with the busyness hypothesis. The negative association between the busyness of audit committee financial experts and the risk of financial distress found in this study supports the findings of Tanyi and Smith (2015) and Rahmat et al. (2009).
Among the control variables, ROA was positive and significant (p-value = 0.000), indicating that as the profitability of the company increased, the Z"-Score also increased. This indicates that the company is in better financial condition. LEV was negative and significant (p-value = 0.000), which means that the higher the company financed its assets with debts, the worse the financial condition of the company might become. However, SIZE was not significant; thus, it did not influence the risk of financial distress.

**Robustness Test**

Based on the Altman Z"-score, the financial condition can be classified into distressed, uncertain, and safe, which can be considered as the stages of financial distress. Accordingly, additional tests were conducted on each stage to refine the robustness of the results. The dependent variables were then divided into three stages of financial conditions consisting of distressed (Z"-Score < 1.1), uncertain (1.1 ≤ Z"-Score < 2.6), and safe (Z"-Score ≥ 2.6). Using the binary variable for each stage of financial condition, the value would be 1 for distressed, uncertain, or safe, and 0 for otherwise. Binomial logistic regression was then used to analyze the data. The results are presented in Table 4.

**Table 4 Audit Committee Busyness and The Stage of Financial Distress**

| Variables | Distressed | | | Uncertain | | | Safe | | |
|-----------|------------|--|---|--|---|--|---|--|---|--|
| BUSCHAIR | 0.232 | 0.378 | -0.099 | 0.517 | -0.004 | 0.982 | | | |
| BUSFINEX | 0.142 | 0.857 | -0.027 | 0.899 | -0.729* | 0.045 | | | |
| BUSOTHER | -0.061 | 0.966 | -0.302 | 0.382 | 2.142* | 0.042 | | | |
| ROA       | -64.309** | 0.008 | -6.765* | 0.042 | 80.494** | 0.003 | | | |
| LEV       | 31.960*** | 0.000 | 1.509 | 0.096 | -38.353* | 0.012 | | | |
| SIZE      | -1.317 | 0.054 | 0.110 | 0.386 | 0.468 | 0.190 | | | |
| Constant  | -8.537 | 0.200 | -4.464* | 0.015 | 20.144 | 0.117 | | | |

Legend: *** p<0.001, ** p<0.01, * p<0.05

As presented in Table 4, distressed observations were like the initial test. Although two of the control variables were significant, there was no indication that the busyness of the audit committee chairman, financial experts, and other members contributed to the distressed condition of the company. Nevertheless, it is shown that ROA was significantly negative, suggesting that as the profitability of the company deteriorates, it is more likely to be in a distressed condition. Similarly, as the company becomes more leveraged, the financial condition will become worse because the LEV was positive and significant. The results are relatively comparable for the uncertain condition.

There are indications that the busyness of audit committee members is more likely to have an influence when the company is in a safer financial condition. In fact, in a safe condition, BUSFINEX was negative and significant (p-value = 0.045). This suggests that when the company is in good financial condition and the financial experts in the audit committee become busier by having several other positions inside or outside of the company, the financial condition may decline. Arguably, financial experts in the audit committee are those who have a better understanding of the financial condition of the company; therefore, whenever they become busier with other duties, their monitoring role on one company might be compromised.
However, the results also show that BUSOTHER was positive and significant (p-value = 0.042), which means that as the busyness of other audit committee members increased, the company was more likely to have a better financial condition. This particular finding is consistent with the reputation hypothesis (Jiraporn et al., 2009). Whenever the other audit committee members have multiple positions, they may accumulate better knowledge and experience which can be beneficial to their monitoring role. Differing with the financial experts in the audit committee, other audit committee members might not have a direct role in ensuring the quality of financial reporting. However, they might provide valuable oversight functions on different aspects. Therefore, the accumulated knowledge, experience, and information would improve the quality of their oversight function and might provide better recommendations to the management.

This finding contributes to the literature. Previous studies have not examined what importance other audit committee members bring to the oversight and monitoring role, and consequently, to the financial condition of a company. This study shows that having more positions, other audit committee members positively contribute to the company’s better financial condition. Among the control variables, ROA was positively and significantly consistent with previous results that the better the financial performance, the higher the Z’-Score. Therefore, the company will be more secure financially. LEV was negative and significant, suggesting that as the company becomes more leveraged, it is more likely that the financial condition will decline (i.e., the Z’-Score becomes lower).

**Conclusion**

This study examined the effect of audit committee member busyness on the stage of the company’s financial distress. Particularly, it investigates whether the busyness of the audit committee chairman, financial experts, and other members contributed to the risk of companies’ financial distress. The initial hypothesis testing results show that only the busyness of the audit committee financial experts affected the condition of financial distress, and the effect was negative. This suggests that as financial experts become busier, the monitoring role is compromised, resulting in a decrease in the financial condition. This result is consistent with the busyness hypothesis.

Since the financial distress measured by the Altman Z’-Score can be classified into three stages (i.e., distressed, uncertain, and safe), the results were more robust when the regressions were performed on each stage. Given that the stage of financial condition was in binary, binomial logistic regression was conducted to test the hypotheses. Among the audit committee members, the chairman was the busiest. However, across the financial condition stages, the busyness of the chairman was not likely to affect the stage of financial condition. Instead, the busyness of audit committee financial experts was found to more likely affect the financial condition of companies that were categorized as safe companies. The results also show that although other members of the audit committee may become busier, their busyness had a positive impact on the company’s financial condition. This is consistent with the reputation hypothesis, which argues that when the members have multiple positions, they will be able to accumulate more knowledge, experience, and information that will be useful in their oversight function.

Overall, the findings indicate that in a better state, the company’s stage of financial condition is more likely to be affected by the effectiveness of the financial experts’ role in the audit committee. As they become busier with other duties, the effectiveness of their role might be compromised, thus weakening their monitoring on the corporate financial reporting
process. This then leads to an increased risk of financial distress. Among the control variables, ROA consistently shows that the company’s financial performance contributes to the stage of financial condition.

One limitation of this study was that the number of positions that determined the busyness of audit committee members was taken from the information provided by the company. This might create bias because it was subject to the company’s discretion whether to provide full disclosure on each of the audit committee members or not. Some companies did not provide clear information about their audit committee members, thus compromising the sample size. Given that the busyness of audit committee members, the financial experts was related to the financial condition of the company, one implication of this study is that regulators must set the standard of information that should be provided by each of the publicly listed company. It was also found that the existence of financial experts in the audit committee was an important mechanism to avoid the adverse financial condition. Therefore, another implication is for the companies to consider appointing less busy financial expert members in the audit committee, or limit the positions held by the financial experts. Likewise, it might be beneficial for the regulators to regulate the number of positions held by the audit committee members to ensure the effectiveness of their monitoring role and for the financial reporting process to not be compromised by their busyness.

For future research, given that most studies have investigated the impact of the audit committee on financial distress, research can also be done to examine whether financial distress, on the contrary, heightens the corporate governance practices among companies. Also, it might be interesting to compare whether the effect of audit committee busyness has a different impact on a different industry. This study contributes to the literature by providing evidence that the busyness of audit committee members contributes to the risk of financial distress.

References


