The Role of the Audit Committee in Corporate Governance and the Influence of the Exchange Rates

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Abstract

The corporate governance as environment/framework in which it evolves the audit function, was analyzed from the conceptual point of view starting from the unanimous definition that was found in the OECD principles and continuing with the corporative governments attributes which define it. The main role of corporate governance is to restore market confidence and in this process plays an important role the audit committee. After determining the role and the importance of the audit committees in the entity framework we had considered necessary to analyze the correlations between the Audit Committee and the influence of the exchange rates. Considering the achievement of the objectives proposed in this research, our research is based on a deductive approach from general aspects to particular aspects that combines quantitative and qualitative studies. Theoretical knowledge is used for a better understanding of a phenomenon and not for making assumptions. Thus, in order to achieve our study, we selected 25 companies listed on Berlin Stock Exchange. Following this study, we concluded that the role of the audit committee is crucial.
Keywords: Audit Committee, Corporate Governance, Exchange Rates

Introduction

In the principle of transparent information to all interested parties, equal importance should be given to both financial and non-financial information. This requirement is highlighted by the study conducted by the consulting firm McKinsey (2001) on the view of institutional investors in emerging countries (Asia, South - East and Latin America) on corporate governance. The study shows that investors paid at least the same importance to non-financial information on corporate governance as to financial information investment decisions (Robu *et al.*, 2004).

At the entity level, an important role in meeting the transparency of the provided information lies trinomial: Internal Audit - Audit Committee - external audit, as shown in studies by (FT DeZoort *et.al.*, 2002; Porter, 2009).

In order to determine its role inside an organization, we try to classify the audit committee function within an entity. The Audit Committee may exercise independent relations with different functions. Compared to the Board, which maintains external relations such as those with shareholders, legislators, lenders and public figures; regularly, the audit committee has no relationship to these categories. But to work in optimal conditions, the

audit committee should link its activity directly with both internal and external functions of the entity. The Audit Committee works closely with both the internal external audit, but also with the entity management, as it can be seen in the figure below.

As can be seen in the figure below there are a number of relations between the audit committee and various functions within the entity. It is also important to maintain the required distance between the external relations of the Board, in order to maintain responsibility of information and disclosure obligations of the audit committee. But we must not neglect the cooperation between management and supervision of the audit committee, as represented in the figure below.

The Audit Committee maintains direct links with internal and external functions of the entity. The tripartite relationship between internal audit - audit committee - external audit can lead to a high degree of transparency and also to fulfill the recommendations of corporate governance codes.
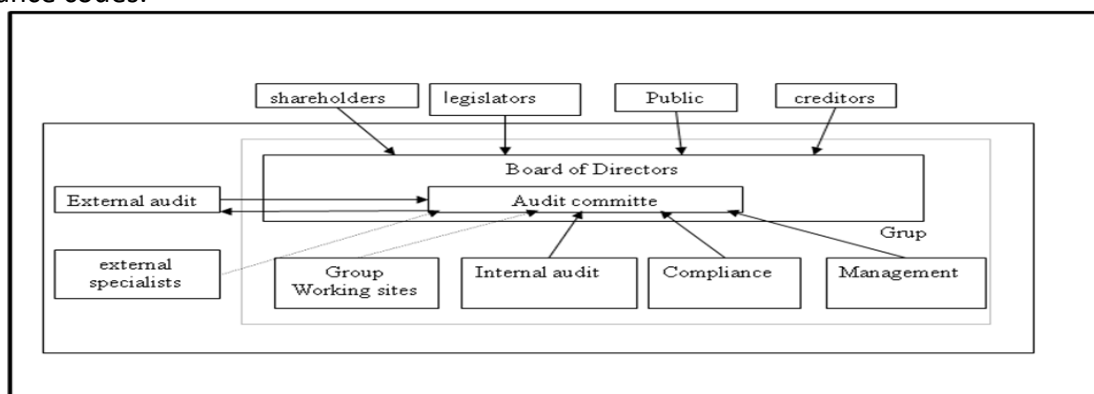
Source: Fulop (2012)

Figure 1. Framing of the audit committee within the entity

In conclusion, the audit committee plays a role in the decision-making process of the entity and comes to the aid of the Board, management, internal audit and external audit function through the independent position is occupies within the entity.

Research Methodology

The methodology involved quantitative research methods with the purpose of classification of information, building statistical models and explaining the results. For the study case we've selected a sample of 25 companies listed on the stock exchange in Berlin and company annual financial reports available on their website. Based on data, we've calculated financial indicators for 2012 for each company, which we then imported into SPSS in order to achieve an empirical analysis of the impact the Audit Committee has on the performance characteristics of the entity.

To achieve that goal we' have chosen a sample of 25 companies listed on the main stock index in Berlin. Thus, we've selected the top 25 in terms of the entity of the market value of the shares. For each entity, we extract information on the audit committee and financial indicators to study a possible correlation between them.

The characteristics of the Audit Committee included in the analysis are:
1. Number of members;
2. Structure of the Audit Committee;
3. Number of meetings;

4. Professional Experience;
5. Independence of Audit Committee;
6. Position of the Audit Committee.

On the basis of these elements, we have formulated six hypotheses:

H1: The number of members of the Audit Committee does not influence the performance of the entity, with the alternative that the members of the Audit Committee do influence the performance of the entity.

H2: The structure of the Audit Committee does not influence the performance of the entity, with the alternative that the structure influences the performance of the entity's audit committee.

H3: The number of meetings does not affect the performance of the entity, with the alternative that the number of meetings influences the performance of the entity.

H4: The professional experience of the members of the Audit Committee does not influence the performance of the entity, with the alternative that the level of experience influences the performance of the entity.

H5: The independence of the Audit Committee does not influence the performance of the entity, with the alternative: audit committee independence affects the entity's performance.

H6: The position of the Audit Committee within the entity does not influence its performance, with the alternative that it does have an influence on the entity's performance

The Study Results

In this section, we analyze the existence of correlations between selected factors and the performance of selected entities in the sample represented by: exchange rates, the market value of the shares (VP), market capitalization (CB), Dividend per share (D/A), dividend yield (Rand_div) and earnings per share (P/A). Because our sample has a relatively small number of elements, we've decided to set a significance threshold of 0.1. The initial form of the model is the following:

VP / CB/ D/A/ Rand_div / P/A= $\alpha 0$ +$\alpha 1$Nr_members+$\alpha 2$Structure+ $\alpha 3$Nr_meetings +$\alpha 4$Prof_ Exp +$\alpha 5$Independence+ $\alpha 6$Position

The first indicator that we have studied is the correlation, through a regression, is the market value of the shares (VP). The Sig of this regression does not exceed the materiality threshold set (0.1), so the model is representative.

Table 1
ANOVA statistical test – dependent variable VP
ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	14493.207	5	2898.641	2.359	.080^b
	Residual	23350.048	19	1228.950		
	Total	37843.255	24			

a. Dependent Variable VP
b. Predictors:(Constant), Independence, Structure, Nr_meetings , Prof_ Exp , Nr_members
Source: Author's projection with SPSS

Table 2

Correlations between variables – dependent variable VP – Berlin Boerse
Correlations

		VP	Nr_members	Structure	Nr_meetings	Prof_Exp	Independence	Position
Pearson Correlation	VP	1.000	-.036	.495	-.295	-.423	-.188	
	Nr_members	-.036	1.000	-.198	.331	.026	-.396	
	Structure	.495	-.198	1.000	-.296	-.193	.028	
	Nr_meetings	-.265	.331	-.296	1.000	.075	-.165	
	Prof_ Exp	-.423	.026	-.193	.075	1.000	.420	
	Independence	-.188	-.396	.028	-.165	.420	1.000	
	Position							1.000
Sig.(1-tailed)	VP		.436	.006	.100	.017	.184	.000
	Nr_members	.436		.172	.053	.451	.025	.000
	Structure	.006	.172		.075	.177	.447	.000
	Nr_meetings	.100	.053	.075		.360	.216	.000
	Prof_ Exp	.017	.451	.177	.360		.020	.000
	Independence	.184	.025	.447	.216	.020		.000
	Position	.000	.000	.000	.000	.000	.000	

Source: Author's projection with SPSS

Regarding the coefficients of the chosen variables, we discover that the Audit Committee is directly proportional to the market value of the share. From the Summary of the model, we find that the variance of the market value of the shares is explained in a proportion of 38.3% by the independent variables, as indicated by the value of R^2.

Table 3
Model Summary – dependent variable VP – Berlin Boerse
Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.619[a]	.383	.221	35.056381	.383	2.359	5	19	.080	.606

a. Predictors: (Constant), Independence, Structure, Nr_meetings , Prof_ Exp , Nr_members
b. Dependent Variable: VP

Source: Author's projection with SPSS

In our case, the most significant factor is related to the Independence variable, the result being the degree of audit committee members' independence largely influences the market value of the shares.

Table 4
Coefficient outline – dependent variable VP – Berlin Boerse
Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	90.0% Confidence Interval of B		Correlations		
	B	Std.Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part
1 (Constant)	78.044	58.337		1.338	.197	-22.828	178.916			
Nr_members	2.941	7.535	.082	.390	.701	-10.089	15.971	-.036	.089	.070
Structure	84.248	40.023	.406	2.105	.049	15.042	153.453	.495	.435	.379
Nr_meetings	-5.487	6.828	-.159	-.804	.432	-17.294	6.320	-.265	-.181	-.145
Prof_ Exp	-21.206	14.312	-.308	-1.482	.155	-45.52	3.541	-.423	-.322	-.267
Independence	-15.432	54.209	-.063	-.285	.779	-109.167	78.303	-.188	-.065	-.051

a. Dependent Variable VP
Source: Author's projection with SPSS

Results regarding the influence of the Audit Committee on CB.

Table 5
ANOVA Statistical Test – dependent variable CB– Berlin Boerse
ANOVAª

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	9.117	5	1.823	1.292	.309ᵇ
	Residual	26.815	19	1.411		
	Total	35.932	24			

a. Dependent Variable CB
b. Predictors:(Constant), Independence, Structure, Nr_meetings , Prof_ Exp , Nr_members
Source: Author's projection with SPSS

Analyzing the Sig (from Table ANOVA) corresponding to the regressions, we notice that it is greater than 0.1, thus the linear relationship between variables is not considered significant. Therefore, the general form of the model is not appropriate and we have to eliminate some variables. By analyzing the Correlations table we eliminate variables whose significance exceeds the permissible Sig: Structure, Nr_meetings, Prof_ Exp and Position.

Table 6
Variable correlations – dependent variable CB– Berlin Boerse
Correlations

		CB	Nr_members	Structure	Nr_meetings	Prof_ Exp	Independence	Position
Pearson Correlation	CB	1.000	.447	-.103	.215	-.075	-.381	
	Nr_members	.447	1.000	-.198	.331	.026	-.396	
	Structure	-.103	-.198	1.000	-.296	-.193	.028	
	Nr_meetings	.215	.331	-.296	1.000	.075	-.165	
	Prof_ Exp	-.075	.026	-.193	.075	1.000	.420	
	Independence	-.381	-.396	.028	-.165	.420	1.000	
	Position							1.000
Sig.(1-tailed)	CB		.012	.313	.151	.361	.030	.000
	Nr_members	.012		.172	.053	.451	.025	.000
	Structure	.313	.172		.075	.177	.447	.000
	Nr_meetings	.151	.053	.075		.360	.216	.000
	Prof_ Exp	.361	.451	.177	.360		.018	.000
	Independence	.030	.025	.447	.216	.020		.000
	Position	.000	.000	.000	.000	.000	.000	

Source: Author's projection with SPSS

By building a new regression with the remaining variables, we obtain the following results:

Table 7
ANOVA Statistical test – dependent variable CB– Berlin Boerse
ANOVA^a

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	8.968	2	4.484	3.658	.042^b
	Residual	26.964	22	1.226		
	Total	35.932	24			

a. Dependent Variable CB
b. Predicators:(Constant), Independence, Nr_members

Source: Author's projection with SPSS

The final regression formula is: CB=α0+α1Nr_members+α5Independence   (1)

The value of F=3.658, tests the global significance of the independent variables. Sig value of the ANOVA model is 0.042, which is less than the chosen significance threshold of 0.1. Therefore the linear relationship between the analysed variables is significant. Following our analysis we can say that we reject the hypothesis H1, H5, and therefore we accept their alternatives, namely that the size of the Audit Committee and the members independence influence the value of market capitalization.

From the Correlations tables, by the examination of the Pearson coefficient, we've noticed that the independence of the members of the Audit Committee is directly correlated with CB, which suggests that an increase in the number of independent members of the Committee will determine an growth in the market capitalization and vice versa. Regarding the relationship between the members of the Audit Committee and capitalization, we conclude that it is an indirect one.

Table 81
Model Summary – dependent variable CB– Berlin Boerse
Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.500[a]	.250	.181	1.107088	.250	3.658	2	22	.042	1.761

a. Predictors: (Constant), Independencea, Nr_members
b. Dependent Variable: CB

Source: Author's projection with SPSS

The variables of this regression explain the variance of market capitalization at rate of 25%, as indicated by the value of R^2. Therefore we consider that between CB and independent variables, there is a low correlation.

Table 9
Coefficients outline – dependent variable CB– Berlin Boerse
Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	90.0% Confidence Interval of B		Correlations		
	B	Std.Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part
1 (Constant)	8.434	1.189		7.094	.000	6.393	10.476			
Independencea	.388	1.222	.351	1.747	.095	.007	.770	.447	.349	.323
	-1.917	1.507	-.242	-1.206	.241	-4.405	.771	-.381	-.249	-.223

a. Dependent Variable CB

Source: Author's projection with SPSS

In our case, the most significant coefficient is found in the Independence variable, the result being that the degree of independence of audit committee members' utmost influences market capitalization.

Another exchange rate for which we analyze the correlations with the Audit Committee is the dividend per share. General regression has the following results:

Table 10

ANOVA statistical test – dependent variable D/A– Berlin Boerse

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	17.501	5	3.500	1.114	.386[b]
	Residual	59.685	19	3.141		
	Total	77.185	24			

a. Dependent Variable D/A

b. Predictors:(Constant), Independence, Structure, Nr_meetings , Prof_ Exp , Nr_members

Source: Author's projection with SPSS

Table 11

Variable correlations – dependent variable D/A– Berlin Boerse

Correlations

		D/A	Nr_members	Structure	Nr_meetings	Prof_ Exp	Independence
Pearson Correlation	D/A	1.000	-.145	.443	-.208	-.045	-.060
	Nr_members	-.145	1.000	-.198	.331	.026	-.396
	Structure	.443	-.198	1.000	-.296	-.193	.028
	Nr_meetings	-.208	.331	-.296	1.000	.075	-.165
	Prof_ Exp	-.045	.026	-.193	.075	1.000	.420
	Independence	-.060	-.396	.028	-.165	.420	1.000
Sig.(1-tailed)	D/A		.244	.013	.160	.415	.388
	Nr_members	.244		.172	.053	.451	.025
	Structure	.013	.172		.075	.177	.447
	Nr_meetings	.160	.053	.075		.360	.216
	Prof_ Exp	.415	.451	.177	.360		.018
	Independence	.388	.025	.447	.216	.020	

Source: Author's projection with SPSS

Sig's value exceeds the chosen threshold of significance; therefore the model is not adequate. Thus, we eliminate variables that do not comply with this criterion, and we will only study the correlation between the structure of the Audit Committee and dividends per share.

Table 12
ANOVA statistical test – dependent variable D/A– Berlin Boerse
ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	15.145	1	15.145	5.615	.027[b]
	Residual	62.040	23	2.697		
	Total	77.185	24			

a.   Dependent Variable D/A
b.   Predicators:(Constant), Structure
Source: Author's projection with SPSS

Sig's value in the ANOVA model is 0.027, which is less than the chosen significance threshold of 0.1. Therefore the linear relationship between the variables analyzed is significant. Following our analysis, we can say that we reject the hypothesis H2, and therefore, we accept the alternative, namely that the Audit Committee's structure influences the amount of dividends per share.

From the Table of Correlations by Pearson's coefficient analysis, we noticed that the structure of the Audit Committee is directly correlated to the amount of dividends per share, which suggests that an increase in non-executive members of the Committee will determine a rise in the dividend per share and vice versa.

Table 132
Model Summary – dependent variable D/A– Berlin Boerse
Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.443[a]	.196	.161	1.642378	.196	5.615	1	23	.027	2.053

a.   Predictors: (Constant), Structure
b.   Dependent Variable: D/A
Source: Author's projection with SPSS

The independent variable of the regression, explains variance of dividends per share at the rate of 19.60%, as indicated by the value of R^2. Therefore, we consider that between the dependent variable and the independent variable there is a low correlation.

Table 14

Coefficients outline – dependent variable D/A– Berlin Boerse

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	90.0% Confidence Interval of B		Correlations		
	B	Std.Error	Beta			Lower Bound	Upper Bound	Zero-order	Partial	Part
1 (Constant)	-.490	1.228	.443	-.399	.693	-2.595	1.614	.443	.443	.443
Structure	4.147	1.750		2.370	.027	1.148	7.147			

a. Dependent Variable D/A

Source: Author's projection with SPSS

From the table of Coefficients can conclude that the linear regression is:

D/A= -0,490+4,147*Structure   (2)

Regarding the correlations established between Audit Committee characteristics and dividend yield, and respectively earnings per share, working in SPSS showed that an influence between these variables has not been identified. Accordingly, we accept all the assumptions we have made.

Conclusions

Given the proposed objectives in this research, our scientific approach was based on a deductive approach, from general to particular. Thus, the starting point in our research was the determination of the role of the audit committee within the entity.

After our analysis, we have rejected the hypothesis H1 and H5, therefore accepting their alternatives, namely that the number of members of the Audit Committee and the independence of members influence the value of market capitalization.

We also reject the hypothesis H2, and therefore we accept the alternative, namely that the structure of the Audit Committee influences the amount of dividends per share.

Regarding the correlations established between audit committee characteristics and dividend yield, respectively earnings per share, working in SPSS showed that identifies an influence between these variables has not been identified. Accordingly, we accept all the assumptions we have made.

From the conducted study on audit committees in Germany, we've established that the founding of an audit committee within the entity is a central element of corporate governance. Well organized audit committees lead to more efficient work in the entity.

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