International Journal of Business and Applied Social Science

E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

The Impact of Audit Committee Structure on Capital Structure: A Case of Omani Listed Companies

Afshan Younas
Faculty of Business Studies
Arab Open University
Muscat, Oman
Email: afshan@aou.edu.om
Oman

Aza Azlina Md Kassim
Faculty of Business Management & Professional Studies
Management & Science University Malaysia
Malaysia

ABSTRACT

Financial scandals have diverted the attention of investors, shareholders, lenders, and different stakeholders toward the corporate governance mechanism. Under the corporate governance system, the conflicts between different stakeholders are managed and controlled. Several variables work as proxies of corporate governance systems. The audit committee structure is an important tool to mitigate the adverse effects of agency problems. This study focuses on the impact of audit committee characteristics on the capital structure. The main purpose of this study is to examine the relationship between audit committee effectiveness and the leverage of the firms. Three proxies of audit committee (AC) structure are used such as AC meeting frequency, AC size, and AC independence, whereas leverage ratio is used to reflect capital structure. The study is conducted on the listed companies in the Sultanate of Oman for the period 2016 to 2019. The result of the study shows a significant negative relationship between AC meeting frequency and AC size with leverage. Whereas AC independence does not show any association with leverage in the case of Omani-listed firms. The result confirms the agency theory notion that the corporate governance system is an effective tool to balance the interest of different stakeholders and control the leverage of the firm. This study provides valuable findings to regulatory bodies and decision-makers to keep the balance capital structure through an effective audit committee structure.

Keywords: AC size, AC meeting frequency, AC independence, Leverage

1. Introduction

The financial scandals in 2002 of large organizations like Enron and WorldCom have shaken all the large businesses and emphasized the attention on corporate governance. After such scandals, the need for corporate governance arises to align the interest of different stakeholders as well as to create a monitoring system for the financial situation of the businesses (Ali, 2016). Corporate governance is the system by which companies are controlled and governed (Cadbury Report, 1992).

Corporate governance is an important mechanism to reduce agency costs and conflicts of interest between owners and managers. There are various proxies of corporate governance which are used to run the mechanism. It has been argued that the audit committee is used as an internal instrument to supervise and control the activities of management. The audit committee's endorsements are focused on the control and reporting functions of boards as well as on external auditors. This reflects the purpose of the audit committee, which was to review the corporate governance aspects specifically related to financial reporting and accountability (Cadbury Report, 1992). Thus, the audit committee is assumed as an effective component of corporate governance, which is essentially required in a good corporate governance mechanism (Jensen & Meckling, 1976).

This study will examine the audit committee's influence on leverage. A balanced capital structure is required under a corporate governance system. Capital structure is important for a company as it will affect its financial health of a company (Waworuntu et al., 2014). It is how the company chooses to balance between debt and equity to finance its business activities. There are consequences to choosing more debt or more capital (Heng & Azrbaijani, 2012). With high leverage, the company will be able to have a useful capital structure strategy and increase the value of the firm due to tax benefits (Modigliani & Miller, 1958). On the contrary, there are increasing bankruptcy costs implied in debt as well as higher returns required by shareholders because of higher risk (Mostafa & Shivaraj, 2014).

The principles of corporate governance suggest that the audit committee should work independently and perform their duties with professional care and skepticism. The audit committee monitors mechanisms that improve the quality of information flows between shareholders and managers, which in turn, help minimize agency problems (Obradovich & Gill, 2013). The audit committee has an important implication

International Journal of Business and Applied Social Science

E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

between the board of directors and management of a company, it works as bridges the gap between these two aspects. Therefore, a strong audit committee functioning will focus on and support the company's financing decision, which would reflect the interest of shareholders. There is a lack of research on the relationship between audit committees as internal control systems and capital structure (Mohammed, 2018). In the same way, studies regarding the relationship between agency problems, corporate governance, and capital structure have been conducted in several developed countries but there is a lack of this type of study in emerging economies, especially in Middle East countries. According to OECD reports, the growth and development records in the Middle East and North Africa region are relatively less compared to developed countries of the world. Thus, this research tries to examine the effect of the corporate governance proxy that is audit committee on the capital structure among public listed companies in Oman.

2. Background of the study

2.1 Concept of Audit Committee

The separation of ownership from management highlights the need for a high-quality audit. Subsequently, managers are constrained to act to protect and promote the interests of shareholders, and deviation from this behaviour is the agency problem (Jensen & Meckling, 1976). Board of directors and audit committees is established to monitor management's behaviour and to ensure that managers act in the best interests of the shareholders. This represents the agency theory perspective that audit committees can reduce the conflict of interest between shareholders and managers (Fama & Jensen, 1983). The audit committee works as a committee of the board of directors which assumes some of the board's responsibilities. It is a statutory committee vested with the responsibility of performing oversight functions on the financial reporting process of companies to ensure financial reporting quality (Ormin et al., 2015). Since 1978, the New York Stock Exchange required all listed companies to have an audit committee. Initially, the establishment of the audit committee is just to fulfil the listing requirement of the respective stock exchanges. Later on, the importance of the audit committee has been recognized as providing assurance services to shareholders that management acts in the best interest (Cadbury Report, 1992).

Cadbury's report (1992) emphasized the importance of audit committees as an internal control system. According to Oman Corporate Governance Code (2016), the tenth principles which specified the role of the board of directors in the establishment of committees states that the board of directors shall establish an audit committee and set out its terms of reference detailing the names of its members, its competences and functions, duties and any other provision (CMA, 2016).

2.1.1 Concept of Audit committee size

Audit committee size refers to the total number of members working in a committee. The audit committee is an essential element of corporate governance and is mainly concerned with building and monitoring processes to provide relevant and credible information to corporate stakeholders (Al-matari et al., 2014a). The audit committee is used to supervise the performance of managers and their decision-making process in order to reduce agency conflict as an internal governance mechanism (Fama & Jensen, 1983). It helps to ensure the best leverage ratio as a system of control since a greater number of committee members reflects more monitoring and overseeing individuals (Benjamin & Karrahemi, 2013). According to the Cadbury report that there should be a minimum of three members and these members should be confined to the non-executive's directors of the company (Cadbury Report, 1992). In the same context, the Omani code of corporate governance mandates that the committee should be comprised of at least three members who are all non-executive directors, and the majority of them have to be independent. The committee chairman should also be independent and at least one member is an expert in finance and accounting (CMA,2016). An audit committee with an ideal size enables members to employ experience and expertise to satisfy the interests of shareholders (Pearce & Zahra, 1992).

2.1.2 Concept of Audit committee meeting frequency

Audit committee meeting refers to the frequency of meetings. The audit committee is considered as the monitoring body over management activities. The number of meetings of the audit committee is an effective measurement of the committee's role. It is argued that more meetings conducted each year, bring a better overview of management activities that are associated with better corporate governance. Audit committee meeting frequency denotes the level of activeness and diligence of the audit committee (Waworuntu et al., 2014). Peizhi & Id (2020), studied the relationship between audit committee meetings and leverage. The study assumed the data of 45 listed companies from 2013 to 2017. The result shows a strong negative association between audit committee meetings and leverage.

As stipulated in the Cadbury report (1992) the committee members should meet at least twice a year. As stipulated in the Oman Code of Corporate Governance that meetings of the committee are deemed to have a quorum if the majority of independent directors of its members are present. Audit committee meetings will be considered as a monitoring and controlling mechanism, so as the members meet more frequently will create an environment of trust. Thus, members will be able to plan and control management activities more effectively on behalf of the board (Tarus & Ayabei, 2016)

2.1.3 Concept of Audit Committee Independence

Audit committee independence refers to the percentage of non-executive (independent) directors on the audit committee. The existence of an audit committee will improve the efficiency of corporate governance through board monitoring. The audit committee needs to be independent to serve as an effective monitoring body and improve corporate

International Journal of Business and Applied Social Science
E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

governance practices in the organization (Oroud, 2019). According to Oman Corporate Governance Code (2016), it is required by the CMA to have at least a minimum of three directors, the majority of whom shall be from the board's independent directors. Further, at least one member should have finance and accounting expertise (CMA, 2016). The separation of corporate ownership and control results in agency conflict problems that require the effective functioning of audit committees as a governance mechanism.

An Independent audit committee could enhance the quality and credibility of financial reporting. In addition, the audit committee independence appraises management actions regarding risk assessment. Independent directors do not have any personal or economic interest in the company in their role of supervision and monitoring the company's executive management as professional agents. Thus, independent committee members are regarded as being better prepared for preserving the integrity of external financial statements and financial conditions (Saiful et al., 2018).

2.2 Concept of Capital Structure / Leverage

The capital structure is the combination of debt and equity capital. it is the financial structure of a company in which a firm will decide how the organization finances its investments through a combination of debt and equity. Debt and equity differ in their nature. Debt refers to the amount which is borrowed from banks and is regarded as leverage. Equity refers to the funds of the firm which is held by the owner or shareholders. The capital structure is about setting the optimal mix ratio between debt and equity to maximize the value of the business. To study the relationship between debt and equity, capital structure is based on two theories, which proposes different perspective to achieve a balance between debt and equity capital (Kumar, 2011). However, the capital structure theory can be divided into two main categories, trade-off theory, and pecking-order theory. These theories can reflect different management behaviors regarding financing decisions, specifically about the effect of the board of directors (Alves et al., 2018). The trade-off theory and pecking order theories attempted to define the financing decisions in firms. The trade-off theory is based on assumption that the optimal capital structure can be achieved as a trade-off between the benefit of debt financing and the cost of debt financing. While pecking order theory is based on assumption that the firm prefers internal to external financing and debt to equity (Acaravci, 2015). Moreover, the trade-off theory is a development of the MM theorem proposed by Modigliani and Miller (1958). This theory takes into consideration the effects of taxes and bankruptcy costs (Modigliani & Miller, 1958). The pecking order theory suggests that managers follow a hierarchy to choose sources of finance. The hierarchy gives first preference to internal financing and then shifts to external financing. The pecking order theory is based on the asymmetry of information in the business. It postulates that there is an unequal distribution of information, which means that managers generally have more information about the business performance, opportunities, and risk than outside investors or creditors (Acaravci, 2015).

3. Literature Review and development of Hypothesis

3.1 Audit committee size and Leverage

Audit committee size is an essential determinant of audit committee effectiveness. According to Cadbury's report (1992), the minimum number of members to work on the committee should be three. Previous research has been conducted on board size (Abor & Biekpe, 2006; Bulathsinhalage & Pathirawasam, 2017; El-Habashy, 2018; Elabed & Slim, 2017; Masnoon & Rauf, 2013; Njuguna & Obwogi, 2015), thus, audit committee size was little explored. According to Anderson, Mansi, and Reeb (2004) audit committee is negatively associated with debt leverage, which means the size of AC has a significant effect on firm leverage (Berkman & Zuta, 2017). Wahyuni (2019) investigated the relationship between the audit committee and the cost of debt. The researcher used different proxies of the audit committee which included audit committee size as well. The sample included data from 61 companies from 2016 to 2017. The result showed a significant effect of audit committee size on the cost of debt. The audit committee is used to supervise the performance of managers and their decision-making process to reduce agency conflict as an internal governance mechanism (Fama & Jensen, 1983). It helps to ensure the best leverage ratio as a system of control. Since a greater number of committee members reflects more monitoring and overseeing of other individuals (Benjamin & Karrahemi, 2013).

Obradovich and Gill (2013) studied the impact of audit committee size and financial leverage. A sample of 333 firms listed on the New York Stock Exchange for three years from 2009 to 2011 was selected. Audit committee and financial leverage showed a positive impact on firms' value. According to the Oman Code of Corporate governance, a minimum of three members is required in the audit committee (CMA, 2016). Since Oman is the first country in the MENA (the Middle East & North Africa) region to adopt the corporate governance system but still it is in its foundation stage of implementing corporate governance system. The audit committee relationship has been tested with firm financial performance (Al-matari et al. 2014b) but not with leverage. Thus, in the light of previous research and to fulfill the current gap in research the following hypothesis is proposed:

H1: There is a significant negative relationship between audit committee size and leverage.

3.2 Audit committee meeting frequency and Leverage

Audit committee meeting frequency is an essential element for the effective working of the audit committee, as the members meet and discussed the issues more frequently, then the monitoring system will be stronger. The literature has documented that an effective audit committee can ensure reliable financial reporting, strong internal control, and functional risk management for companies (Feng et al., 2012). Cadbury report (1992) indicated that the members of the audit

International Journal of Business and Applied Social Science

E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

committee should meet at least twice a year to monitor the performance of management, while the Oman Code of Corporate Governance states that meetings of the committee are deemed to have a quorum if the majority of independent directors of its members are present. Waworuntu et al. (2014) investigated the relationship between audit committee meeting frequency and debt leverage. The study was conducted on Indonesian Public listed companies for the period 2007 to 2011. The multiple regression method is used for analysis. The result reveals that there is a significant negative relationship between audit meeting frequency and debt leverage, which indicates the idea that better working of the audit committee will encourage firms to maintain a healthy capital structure. It is argued that the audit committee as a board's committee undertakes some responsibilities of the board. Hence, an effective audit committee reflects an effective board. Since the board is responsible for minimizing the agency conflict and sharing the true picture of a company, thus audit committee has a significant impact on leverage (Ormin et al., 2015). According to the Oman Code of Corporate Governance, the audit committee members are required to meet at least four times annually to work effectively (CMA, 2016). The research on audit committee meeting frequency and leverage is very scanty. Previous research has been conducted to study the relationship between board meeting frequency and leverage, particularly in Oman, but very limited research has been conducted on the relationship between AC meeting frequency and leverage. Therefore, based on the above discussion the following hypothesis is proposed:

H2: There is a significant negative relationship between audit committee meeting frequency and leverage.

3.3 Audit committee independence and Leverage

Cadbury Report (1992) states that the members of AC should consist of non-executive directors and a majority of the non-executives serving on the committee should be independent. Oman Code of Corporate Governance also indicated the same as stipulated in the Cadbury report. Also, it is recommended that the chairperson of the committee must be selected from the independent directors of the committee. The independence of an audit committee can serve as an act to control financial reporting. Therefore, audit committee independence is significantly associated with measures of earnings quality in prior studies (Hamdan et al., 2013).

Saiful et al. (2018) investigated the relationship between the audit committee and its effect on investment decisions. The study observed 200 Malaysian Listed companies for three years' data, that is 2009, 2010, and 2011. This result provides further confirmation of the role of corporate governance in enhancing the investment performance of the company. But the results of the study show an insignificant association between audit committee independence and leverage in the context of the Egyptian market. Hamdan et al. (2013) researched to investigate the relationship between audit committee characteristics on firm performance on listed firms on Amman Stock Exchange. The study sample contained 106 corporations with a total of 212 observations during the 2009-2009 sample years. The results showed that the audit committee has an impact on financial and stock performance.

According to the Oman Code of Corporate Governance, one-third of audit committee members should need to be independent (CMA, 2016). Audit committee independence is one of the most important characteristics of an audit committee, particularly influencing the effectiveness of the committee in controlling financial reporting and leverage decisions. The importance of an audit committee is rooted in regulatory codes requiring an audit committee to be composed of independent directors because the independence of audit committee members increases the effectiveness of the audit committee (Fakhari & Pitenoei, 2017). Thus, it is assumed that the independence of the audit committee boosts AC effectiveness and further it impacts leverage. Therefore, based on the above discussion the following hypothesis is proposed:

H3: There is a significant negative relationship between audit committee independence and leverage.

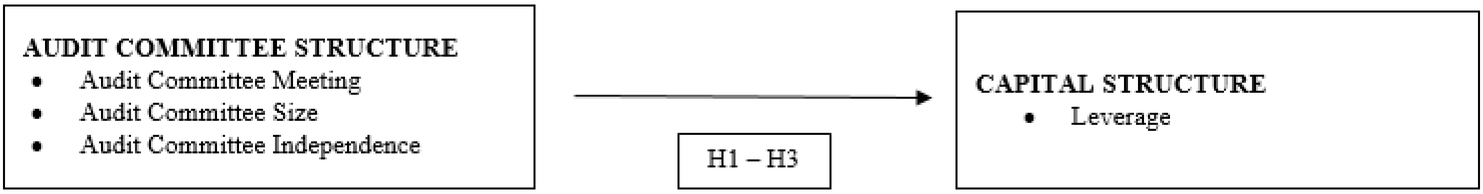

Figure 1. **Research Framework - Relationship between audit committee structure and leverage**

4. Research Methodology

This study seeks to examine the relationship between AC size, AC meeting frequency, and AC independence on firm leverage. This study used secondary data gathered from the annual reports of non-financial listed companies in the Muscat securities market (MSM) from 2016 to 2019. Using secondary data in research work is considered a valuable tool for improving, understanding, and explaining the research problem (Johnston, 2014). Thus, the sample size of the current study is 291 firm-year observations for the periods 2016, 2017, 2018, and 2019. The data includes both numbers of firms and number of years which refer to panel data. The dependent variable is leverage; it is measured as total debt to total assets. Researchers usually suggest a debt ratio to measure the leverage of the business (Al-Shubiri, 2012). The ratio explains as total debts divided by total assets, this ratio indicates the

International Journal of Business and Applied Social Science

E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

level of assets financed by debt. The study assumes three independent variables, which are audit committee size, audit committee meeting frequency, and audit committee independence. Audit committee size refers to the number of members working in a committee. Thus, it is measured as the number of members in AC. Audit committee meeting refers to the frequency of meetings in which audit members meet to discuss the management performance and their activities. So, it is measured as the number of meetings in a year. Audit committee independence refers to the percentage of independent directors working in a committee. This is measured as AC independent members divided by AC total members.

Two control variables are assumed to be constant throughout the analysis. Firm size and firm age are used as control variables, which is also consistent with the study of Al-matari, and Saif (2017) and Buallay et. al. (2017). Firm size refers to the level of a firm's operations. It is calculated as a natural log of the total value of firm assets. Whereas firm age refers to the number of years the business is established (Ahmed & Hamdan, 2015). Thus, firm age is calculated as the number of years since the company was established. The summary of dependent, independent, and control variables is given in table 1.

Table 1: Summary of Variables

Variables	Abbreviation	Description
	Dependent Variable – Leverage	
Leverage	LEV	Total Debt divided Total Assets
	Independent Variable (Corporate Governance)	
AC Size	ACSZE	No. of members working on a committee
AC Meeting	ACMTNG	No. of Meetings frequency
AC Independence	ACINDP	Percentage of Independent members
Control Variable		
Firm Size	FSZE	Natural log of total assets
Firm Age	FAGE	No. of years since the firm established

It is assumed to have a negative relationship between AC size, AC meeting, and AC independence with leverage. To test the hypothesis, the following model is proposed:

$$LEV_{i,t} = \alpha + \beta 5ACSZE_{i,t} + \beta 4ACMTNG_{i,t} + \beta 6ACINDP_{i,t} + Year\ FE + Industry\ FE + Firm\ FE + \varepsilon_{i,t}$$

Here LEV stands for leverage, which is measured as debt to asset ratio.

a constant term
$\beta 1 : \beta 9$ parameters for the independent variables
Subscript *(i)* number of firms
Subscript *(t)* time
ACMTNG audit committee meeting
ACSZE audit committee size
ACINDP audit committee independence
Year FE year fixed effect
Industry FE industry fixed effect
Firm FE firm fixed effect

The current study used STATA 15 for statistical analysis of variables and to check the objectives of the study. STATA is a friendly statistical package that is highly recommended by the researcher for analyzing panel data analysis (Baltagi, 2005). Hausman test was performed to select between regression analysis of fixed effect and regression analysis of random effect. Thus, the value of the Hausman test is less than 0.05, which recommends a fixed-effect model for the current study. In addition, to check the normality of panel data skewness and kurtosis test is used. The value of skewness and kurtosis ranged from -0.5 to 0.5 and from -1 to 1 responsively which indicates that data is normally distributed (Rani Das, 2016). To deal with outliers, the current study winsorizes the total assets. To control the problem of endogeneity, the study used regression analysis with high dimensional fixed effects to control the unobserved or omitted firm characteristics which control the firm, year, and industry (Correia, 2016).

5. Results and Findings

5.1 Descriptive Statistics

Table 2 shows the descriptive statistics employed on the variables used in this study, it indicates the result of mean, median, standard deviation, minimum and maximum values, which are carried through STATA 15. The mean value of leverage is 47.58 which is higher than the mean value of 37.10 percent as reported by Tarus and Ayabei (2016) from Kenya ad also higher than the mean value of 14.00 percent as reported by El-Habashy (2018) from Egypt. Whereas the mean value of AC size is 3.42 ranging from 0 members to 6 members. The average AC size fulfills the minimum requirements as stipulated in the Oman Code of Corporate governance (CMA, 2016). Similarly, the mean value of AC meeting is 4.71 ranging from 0 meetings to 11 meetings in a year, which also satisfy the Oman Code of Corporate Governance requirements

International Journal of Business and Applied Social Science
E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

of holding AC meeting in a year. In addition, the mean value of AC independence is 72.77 percent ranging from 0 percent independence to 100 percent independence, which is under the requirement of the Oman Code of Corporate governance of AC independence should be 33.33 percent. The two control variables firm size and firm age have the mean value of 15.45 and 24.56, respectively.

Table 2: Descriptive Statistical Results

Variables	N	Mean	Median	Std. Dev.	min	Max
LEV	291	47.58	37.63	40.89	0.34	300.07
ACSZE	291	3.42	3.00	0.81	0.00	6.00
ACMTNG	291	4.71	4.00	1.44	0.00	11.00
ACINDP	291	72.77	66.67	27.34	0.00	100.00
FSZE	291	15.45	16.00	2.55	9.00	20.00
FAGE	291	24.56	22.00	10.06	3.00	45.00

(LEV = leverage, ACSZE = Audit committee size, ACMTNG = Audit committee meetings, ACINDP = Audit committee independence, FSZE = Natural Logarithm of firm size, FAGE = Firm age)

5.2 Correlation Analysis

Tables 3 shows the Pearson Correlations. A correlation with a value close to 1 indicated the correlation is strong while a value close to 0 refers to the weaker relationship. Additionally, a negative relationship is indicated by a negative sign as well as a positive association indicated by a positive value.

Table 3: Correlation analysis

Variables	LEV	ACSZE	ACMTNG	ACINDP	FSZE	FAGE
LEV	1.000					
ACSZE	-0.365***	1.000				
ACMTNG	-0.165***	0.308***	1.000			
ACINDP	0.221***	0.265***	0.250***	1.000		
FSZE	0.084	0.087	0.363**	0.107*	1.000	
FAGE	-0.208***	0.136**	0.125**	-0.025	-0.141**	1.000

***:p<0.01;**:p<0.05;*:p<0.10

5.3 Regression Result based on Proposed Model

Table 4 shows the regression results of audit committee variables and leverage. The R2 of the Model is 0.9339 which means that 93.33 percent of the variation in the dependent variable is explained by all the variables in the model. The study tested three hypotheses to examine the relationship between audit committee variables with leverage. The audit committee size shows a significant negative relationship with leverage with a coefficient value of -4.721 and a p-value of 0.037. This result supported hypothesis 1, which predicts that as the AC size increases then it works as a strong monitoring mechanism in the corporate governance system and helps to control the level of leverage. The result of the hypothesis is aligned with the study of Wahyuni (2019), who also found a negative association between AC size and leverage.

Hypothesis 2 assumed a negative association between AC meetings and leverage. In alignment with the expected outcome, the results of hypothesis 2 show a negative relationship with leverage. The coefficient value of the AC meeting is -1.985 with a p-value of 0.059, thus the hypothesis is accepted. These findings are consistent with the study of Peizhi and Id (2020), who found a significant negative relationship between AC meetings and leverage. Hypothesis 3 assumed a negative association between AC independence and leverage. Whereas the coefficient value is 0.041 and the p-value is 0.579. this result is contrary to the proposed hypothesis but since the result is insignificant thus hypothesis 3 is rejected which is consistent with the study of Saiful et al. (2018). The two control variables, which are the firm size and firm age have a positive correlation with leverage, with a coefficient of 5.042 and 2.184, respectively.

Table 4: Audit Committee Variables and Leverage

Hypothesis	Variables	Coefficients	Std. Err.	t-statistics	p-value
H1	ACSZE	-4.721**	2.243	-2.100	0.037
H2	ACMTNG	-1.985*	1.046	-1.900	0.059
H3	ACINDP	0.041	0.074	0.560	0.579
	LN_FSZE	5.042*	2.800	1.800	0.073
	AGE	2.184***	0.734	2.980	0.003
	Firm FE	Yes			
	Year FE	Yes			
	Industry FE	Yes			

R-squared = 0.9339, Adj. R-square = 0.906

International Journal of Business and Applied Social Science
E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

6. Discussion

The study tested three hypotheses to assess the relationship between audit committee variables with leverage. Two hypotheses are accepted, and one hypothesis is rejected in the context of Oman. Hypothesis 1 is supported by the results which reveal that an increase in audit committee members has a significant impact on the level of firm leverage. According to the Oman Code of Corporate Governance (2016), the minimum requirement for an audit committee size is three members as same stipulated in Cadbury Report (1992). Audit committee size is an essential determinant of effective audit committee working. The AC size greatly influences the audit committee, so it is suggested that a large AC size leads to an effective and strong controlling mechanism (Al-matari et al.2014). The results provide good implications for AC size in controlling management activities in the context of Omani firms. This finding is interesting and important for all listed companies to use AC size as a controlling tool of leverage. The result is aligned with the agency theory, which suggests that audit committee size may work to reduce the conflict between the board of directors and management under the corporate governance system (Indrawan et al., 2018).

Hypothesis 2 is also supported by results in the context of Oman, which assumes that AC meeting frequency is negatively associated with leverage. The result of hypothesis 2 confirms that frequent audit committee meetings are an effective tool to control the leverage level of the firm. Since, audit committee members meet more frequently and oversee the management activities through their frequent meetings which provide an opportunity to put control on the leverage of the firm (Waworuntu et al., 2014). The frequent audit committee meetings enable AC members to better control the company and support the implementation of good corporate governance (Fauzan et al., 2019). These results also confirm and support the notion of agency theory which recommends that the audit committee acts as an intermediary to work between the firm's manager and board of directors to control management activities as well as control the leverage (Obradovich & Gill, 2013). This result provides essential insight to all Omani public listed company's stakeholders to control the high level of leverage through frequent AC meetings.

The result of hypothesis 3 is not supported by the data in the context of Oman. An insignificant association between AC independence and leverage shows that AC independence is not the determinant of leverage in the context of Omani-listed companies. According to the Oman Code of Corporate Governance, the required audit committee independence is one-third which is 33.3 percent. Whereas the mean value of AC independence is 72.77 percent which shows that almost all Omani listed companies are rigorously following and implementing the AC independence principle which is stipulated by Code. This result provides good insight to regulators and policymakers regarding the implementation of the AC independence principle.

7. Conclusion

This study attempted to examine the relationship between audit committee characteristics with leverage on Omani public listed companies. There are three hypotheses tested in the current study. Two hypotheses are supported by the results while one hypothesis is not supported in the Context of Omani-listed firms. Audit committee size shows a significant negative association with leverage, similarly, audit committee meetings indicate a significant negative association with leverage. Whereas audit committee independence does not show any significant association with the leverage. Thus, these results confirm the agency theory notion as well as provide fruitful insight to all stakeholders of public listed companies in Oman. Consequently, the audit committee works as a controlling and monitoring mechanism for management activities in the corporate governance system. The study contributes and fills the gap in the literature in the context of Oman and provides an essential understanding of audit committee characteristics to regulators and policymakers.

References

Abor, J., & Biekpe, N. (2006). Does Board Charactertics Affect the Capital Structure Decision of Ghanaian SMEs? *Corporate Ownership and Control*, *4*(1), 113–118.

Acaravci, S. kakilli. (2015). The Determinants of Capital Structure Choice. *International Journal of Economics and Financial Issues*, *5*(1), 158–171. https://doi.org/10.1111/j.1540-6261.1988.tb02585.x

Ahmed, E., & Hamdan, A. (2015). The Impact of Corporate Governance on Firm Performance: Evidence from Bahrain Stock Exchange. *European Journal of Business and Innovation Research*, *3*(5), 25–48. https://doi.org/10.1017/CBO9781107415324.004

Al-matari, E. M., Al-matari, Y. A., & Saif, S. A. (2017). *Ownership Structure, Audit Quality and Firm Performance Moderating and Direct-Effect Models: An Empirical Study*. *13*(1), 28–35. https://doi.org/10.22495/cbv13i1p3

Al-matari, E. M., Al-Swidi, A. K., & Fadzil, F. (2014a). The Effect of the Internal Audit and Firm Performance.pdf. *International Review of Management and Marketing*, *4*(1), 34–41.

E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

Al-matari, E. M., Al-swidi, A. K., & Fadzil, F. H. (2014b). The Effect of Board of Directors Characteristics, Audit Committee Characteristics and Executive Committee Characteristics on Firm Performance in Oman: An Empirical Study The Effect of Board of Directors Characteristics, Audit Committee Characteristics. *Canadian Center of Science and Education*, *10*(11), 149–171. https://doi.org/10.5539/ass.v10n11p149

Al-Shubiri, F. N. (2012). Debt ratio analysis and firm investment: Evidence from Jordan. *International Journal of Economics and Financial Issues*, *2*(1), 21–26.

Ali, M. (2016). Impact of Corporate Governance on Firm' s Financial Performance (A Comparative Study of Developed and Non Developed Markets). *Arabian Journal of Business and Management Review*, *6*(6), 15–30. https://doi.org/10.4172/2223-5833.1000272

Alves, P., Couto, E. B., & Francisco, P. M. (2018). Board of directors' composition and capital structure Research in International Business and Finance Board of directors' composition and capital structure. *Research in International Business and Finance*, *35*(April 2015), 1–32. https://doi.org/10.1016/j.ribaf.2015.03.005

Baltagi, B. (2005). Econometric analysis of panel data. In *Vasa*.

Benjamin, S. J., & Karrahemi, K. E. (2013). A Test of Audit Committee Characteristics and Free Cash Flows. *Corporate Ownership and Control*, *10*(2), 611–626.

Berkman, O., & Zuta, S. D. (2017). The impact of audit committee size and composition on negative events in the life of a company: The case of Israel. *EFM Classification*, 1–24. http://www.efmaefm.org/0EFMAMEETINGS/EFMA ANNUAL MEETINGS/2017-Athens/papers/EFMA2017_0123_fullpaper.pdf

Buallay, A., Hamdan, A., & Zureigat, Q. (2017). Corporate governance and firm performance: evidence from Saudi Arabia. *Australasian Accounting, Business and Finance Journal*, *11*(1), 78–98. https://doi.org/10.14453/aabfj.v11i1.6

Bulathsinhalage, S., & Pathirawasam, C. (2017). The Effect of Corporate Governance on Firms' Capital Structure of Listed Companies in Sri Lanka. *Journal of Competitiveness*, *9*(2), 19–33. https://doi.org/10.7441/joc.2017.02.02

Cadbury Report. (1992). *The Financial Aspects of Corporate Governance*. *27*(3), 68. http://www.icaew.com/~/media/corporate/files/library/subjects/corporate governance/financial aspects of corporate governance.ashx

CMA. (2016). *Oman Code of Corporate Governance*. *July 2015*.

Correia, S. (2016). *Estimating Multi – Way Fixed Effect Models with reghdfe*.

El-Habashy, H. A. (2018). Determinants of Capital Structure within the Context of Corporate Governance in Egypt. *International Journal of Business and Management*, *13*(8), 26. https://doi.org/10.5539/ijbm.v13n8p26

Elabed, I., & Slim, C. (2017). Impact of Firm Specifities and Board Characteristics on Corporate Financial Leverage: Case of Tunisian Listed Firms. *Proceedings of ISER International Conference*, *July*, 1–5.

Fakhari, H., & Pitenoei, Y. rezaei. (2017). The Impact of Audit Committee and Its Characteristics on the Firms' Information Environment. *Iranian Journal of Management Studies*, *10*(3), 577–608. https://doi.org/10.22059/ijms.2017.231317.672627

Fama, E. F., & Jensen, M. C. (1983). Separation of Ownership and Control Separation of Ownership and Control. *Journal of Law and Economics*, *26*(2), 301–325. https://doi.org/10.1086/467037

Fauzan, F., Ayu, D. A., & Nurharjanti, N. N. (2019). The Effect of Audit Committee, Leverage, Return on Assets, Company Size, and Sales Growth on Tax Avoidance. *Riset Akuntansi Dan Keuangan Indonesia*, *4*(3), 171–185. https://doi.org/10.23917/reaksi.v4i3.9338

Feng, Y., Gao, S., Li, W., & Lv, H. (2012). Determinants of audit committee meeting frequency: Evidence from Chinese listed companies. *Managerial Auditing Journal*, *27*(4), 425–444. https://doi.org/10.1108/02686901211218003

Hamdan, A. M., Sarea, A. M., & Reyad, S. M. R. (2013). The impact of audit committee characteristics on firm performance: Evidence from Jordan. *International Management Reciew*, *9*(1), 32–42.

Heng, T. B., & Azrbaijani, S. (2012). Board of Directors and Capital Structure: Evidence from Leading Malaysian Companies. *Asian Social Science*, *8*(3), 123–136. https://doi.org/10.5539/ass.v8n3p123

Indrawan, V., Agoes, S., Pangaribuan, H., & Popoola, O. M. J. (2018). The Impact of Audit Committee, Firm Size, Profitability, and Leverage on Income Smoothing. *Indian-Pacific Journal of Accounting and Finance (IPJAF)*, *2*(1), 61–74.

E-ISSN: 2469-6501
VOL: 8, ISSUE: 7
July/2022
DOI: http://dx.doi.org/10.33642/ijbass.v8n7p1

Jensen, M., & Meckling, W. (1976). Theory of the firm: Managerial behaviour, agency costs and ownership. *Strategic Management Journal*, *21*(4), 1215–1224. http://search.ebscohost.com/login.aspx?direct=true&db=buh&AN=12243301&site=ehost-live

Johnston, M. P. (2014). Secondary Data Analysis: A Method of which the Time Has Come. *Qualitatve and Quantative Methods in Libraryes (QQML)*, *3*, 619–626.

Kumar, R. (2011). Determinants of Firm's Financial Leverage: A Critical Review. *SSRN Electronic Journal*. https://doi.org/10.2139/ssrn.1080883

Masnoon, M., & Rauf, M. (2013). Impact of Corporate Governance on Capital Structure - A study of KSE listed Firms. *Gmjacs*, *3*(1), 94–110.

Modigliani, F., & Miller, M. H. (1958). The Cost of Capital, Corporation Finance and the theory of Investment. *The American Economic Review*, *48*(3), 261–297. https://doi.org/10.1136/bmj.2.3594.952

Mohammed, A. M. (2018). The impact of audit committee characteristics on firm performance: Evidence from Jordan. *Academy of Accounting and Financial Studies Journal*, *22*(5), 1–7.

Mostafa, H., & Shivaraj, B. (2014). A Brief Review of Capital Structure Theories. *Research Journal of Recent Sciences*, *3*(10), 113–118.

Njuguna, C. W., & Obwogi, T. N. (2015). Relationship between board characteristics and capital structure among companies listed in East Africa. *International Journal of Education and Research*, *3*(10), 355–372.

Obradovich, J., & Gill, A. (2013). The Impact of Corporate Governance and Financial Leverage on the Value of American Firms. Paper 25. *Faculty Publications and Presentations*.

Ormin, K., Tuta, M. B. I., & Shadrach, M. (2015). Audit Committee Independence, Meeting Frequency, Attendance and Financial Reporting Quality of Listed Deposit Money Banks in Nigeria. *Research Journal of Finance and Accounting*, *6*(18), 183–190. http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.824.4393&rep=rep1&type=pdf

Oroud, Y. (2019). The Effect of Audit Committee Characteristics on the Profitability: Panel Data Evidence. *International Journal of Economics and Finance*, *11*(4), 104–113. https://doi.org/10.5539/ijef.v11n4p104

Pearce, J. A., & Zahra, S. A. (1992). Board composition from a strategic contingency perspective. *Journal of Management Studies*, *29*(4 July), 411–438. https://doi.org/10.1111/j.1467-6486.1992.tb00672.x

Peizhi, W., & Id, M. R. (2020). *Do corporate governance structure and capital structure matter for the performance of the firms? An empirical testing with the contemplation of outliers*. 1–25. https://doi.org/10.1371/journal.pone.0229157

Rani Das, K. (2016). A Brief Review of Tests for Normality. *American Journal of Theoretical and Applied Statistics*. https://doi.org/10.11648/j.ajtas.20160501.12

Saiful, A., Puteh, A., Branch, P., Campus, T., & Nawawi, A. (2018). The Impact of Audit Committee Independence and Auditor Choice on Firms' Investment Level. *Social Sciences and Humanities*, *26*(3), 1433–1454.

Tarus, D., & Ayabei, E. (2016). Board composition and capital structure: evidence from Kenya Management Research Review Article information: *Management Research Review*, *39*(September 2016), 1056–1079. https://doi.org/10.1108/MRR-01-2015-0019

Wahyuni, P. D. (2019). Good Corporate Governance and Firm Size on Cost of Debt: Evidence from Indonesian Listed Companies. *International Journal of Academic Research in Accounting, Finance and Management Sciences*, *9*(2), 257–265. https://doi.org/10.6007/IJARAFMS/v9-i2/6173

Waworuntu, S. R., Anastasia, K., & Feyari, N. (2014). The Effect of Corporate Governance on Capital Structure in Public Listed Companies in Indonesia. *Proceedings Book of ICETSR*, 243–258.