# Impact of Corporate Board and Audit Committee Characteristics on Voluntary Disclosures: A Case Study of Listed Manufacturing Companies in Sri Lanka

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DOI: 10.29322/IJSRP.9.01.2019.p8502
http://dx.doi.org/10.29322/IJSRP.9.01.2019.p8502

**Abstract:** The main purpose of this study is to investigate the impact of corporate board and audit committee characteristics on voluntary disclosures of listed manufacturing companies in Sri Lanka. In order to achieve the objective of the study, data were collected from annual reports of listed manufacturing companies, which were published by Colombo stock exchange in Sri Lanka for the period of 2012 to 2017. Descriptive and inferential statistics were used for this purpose for the study. Based on content analysis of disclosure, the empirical results of multiple regressions revealed that significant positive impact of board size on voluntary disclosures. Further CEO duality has significant negative impact on voluntary disclosures. Conversely board independence and audit committee size do not have any impact on voluntary disclosure of manufacturing companies in Sri Lanka. The outcome of the study offer evidence to policy makers, investors and accounting professionals on corporate reporting processes of listed manufacturing companies in Sri Lanka.

**Keywords:** Audit Committee Size, Board Size, Board Independence, Voluntary Disclosures

## Introduction

In recent years, the corporate governance and published corporate disclosure of companies have increasingly attracted the attention and demand of scholars, regulatory bodies, policy makers and investors around the world (Rouf, 2011;Yuen, Liu, & Zhang, 2009). Corporate disclosure is very much essential for growth and development of a firm in particular equity market as well as for all stakeholders because it provide them necessary information to reduce the uncertainty and help them to make proper economic and financial decisions (Akhtaruddin & Haron, 2010; Alhazaimeh, Palaniappan, & Almsafir, 2014).

Under this corporate disclosure the annual reports are the main avenue to communicate both financial and non-financial information to stakeholders and other interest parties (Barako, 2007;Khan, Chand, & Patel, 2013). Thus the corporate disclosure within the financial report can be categorized in to two ways ; mandatory and voluntary (non- mandatory) disclosure (Alhazaimeh, Palaniappan, & Almsafir, 2014). Mandatory disclosures are the items that companies must disclosures due to the statutes, regulatory and professional pronouncements (Ousama & Fatima, 2010;Kurawa & Kabara., 2014). Mandatory disclosure rules provide equal access to basic information (Ramadhan, 2014), therefore minimum level of information to be disclosed in the annual reports (Ousama & Fatima, 2010). Because of inadequacy of traditional compulsory information has led to demand for voluntary information that supports investors to make sustainable economic and financial decision (Alsaeed, 2006; Jeewantha, Bandara, & Ajward, 2015). Meanwhile voluntary disclosures means making public the information regarding the firm's operation additional to statutory requirement.

ISSN 2250-3153
Voluntary disclosures described as “information primarily outside of the financial statements that are not explicitly required by accounting rules or standards” (Financial Accounting Standard Board, 2001). Basically voluntary disclosures items may be classified in to historical, current and forecasts items, depending on the past, present and predicted on performance (Rouf, 2011). Numerous studies have investigated on the drivers on corporate disclosures and governance on voluntary disclosure in developed countries like Malaysia, China, Bahrain, Hong Kong, France (Akhtaruddin & Haron, 2010; Huafang & Jianguo, 2007; Ramadhan, 2014; Ho & Wong, 2001; Barros, Boubaker, & Hamrouni, 2013). Noticeably some researchers have conducted in emerging countries like Kuwait, Jordan, Bangladesh (Rouf, 2011; Alfraih & Almutawa, 2017; Albitar, 2015).

However there only few researches have conducted in Sri Lanka based on voluntary disclosures. They are regarding drivers to voluntary disclosures (Jeewantha et al., 2015; Abeywardana & Panditharathna, 2016), relationship between corporate governance levels of the board and company’s voluntary disclosures level (De Silva & Sujeewa, 2015). Moreover that there are several studies have conducted on individual voluntary disclosures items like CSR, environmental reporting in Sri Lanka. Considerably no attempt has been made up to now to study the impact of corporate board and audit committee characteristics on voluntary disclosures level of manufacturing firms in Sri Lanka as a single research. Accordingly it is necessary to undertake this matter to boom the search light on this gap.

**Objectives**

The main objective of the study is to investigate the impact of corporate board, audit committee characteristics on corporate voluntary disclosures levels of listed Manufacturing companies. To achieve the main objective, the following specific objectives were taken for the study purpose:

- To identify the relationship between corporate board characteristics and corporate voluntary disclosures levels of listed Manufacturing companies.
- To assess the relationship between audit committee characteristics and corporate voluntary disclosures levels of listed Manufacturing companies.

**Literature review and hypothesis development**

**Board Size**

Cheng, (2008) argued that boards with more than seven or eight members are unlikely to be effective. Larger board size results in less effective coordination, communication and decision making. In addition, the agency problems associated with larger boards are higher than smaller ones. In this regard, Byard, Li, and Weintrop, (2006) found that voluntary disclosures decreases with board size. Thus, the smaller the board is, the higher the disclosures score of corporate information. On the other hand Albitar, (2015) argues that larger board size are more efficient for corporate performance since they have wide range of collective experience and expertise that may assist in market better decision. Paradoxically prior literature in the advance countries, Al-Janadi, et al., (2013), Allegrini and Greco, (2011) found that board size has a significant contribution in providing quality voluntary disclosures. Similarly within developing countries’ empirical corporate governance and accounting literature, board size has been found to have a significant effect on voluntary disclosure ( Barako, Hancock, and Izan, 2006) while, Albitar, (2015) founds board size has a significant positive relationship with the level of voluntary disclosures.

**Board Independence**

ISSN 2250-3153

Previous empirical literature find evidence that independent directors act to alleviate conflicts between controlling shareholders and outside shareholders (Anderson, Mansi, & Reeb, 2004). Previous empirical studies on this issue yield mixed results. Adams and Hossain, (1998), Chen and Jaggi, (2000) and Li, Pike, and Haniffa, (2008) found significant positive association between voluntary disclosures and the proportion of independent non-executive directors on the board. Similarly, Al-Janadi, et al., (2013) examined the impact of corporate governance mechanisms on voluntary disclosures in Saudi Arabia. They found that none-executive directors have a significant contribution in providing quality voluntary disclosures. On the other hand, Haniffa and Cooke, (2002), Eng and Mak, (2003), Gul and Leung, (2004), and Barako, (2007) found a negative relationship. In this case, non-executive directors are also argued to play limited role, as advisors than active decision makers (Ramadhan, 2014). Moreover, Ho and Wong, (2001),Cheng, Courtenay, and Stephen, (2006) and did not find a significant relationship between board independence and voluntary disclosures.

**CEO Duality**

Board independence can be examined by considering role duality, occurring when the same person undertakes both the roles of chief executive officer and chairman (Li et al., 2008).The person who occupies both roles would tend to withhold unfavorable information to outsiders (Ho and Wong, 2001). Hence, separation of both roles should positively influence disclosure quality. Previous studies documented inconclusive results about the relationship between voluntary disclosure when the chief executive officer role. Some studies indicate that voluntary disclosure decreases with CEO duality (Gul and Leung, 2004), but others advocate the absence of a relationship between CEO duality and voluntary disclosure (Ho and Wong, 2001; Haniffa and Cooke, 2002; Barako et al., 2006; Cheng, Courtenay, an Stephen, 2006).

**Audit Committee Size**

Resource dependency theory argues that larger audit committees are willing to devote greater resources and authority to effectively carry out their responsibilities (Allegrini and Greco, 2011). More directors on audit committee are more likely to bring diversity of views, expertise, experiences and skills to ensure effective monitoring (Bedard & Gendron, 2010). Hence, a higher number of audit committee members is likely to help such committee to uncover and resolve potential issues in corporate reporting process (Li et al., 2012). This indicates that, audit committee size is an integral factor for audit committee to adequately oversee corporate disclosure practices (Persons, 2009). Persons (2009) has found empirical evidence that many directors on audit committee appear to enhance the level of voluntary disclosure. In developing country perspective Albitar, (2015) audit committee size have a significant positive relationship with the level of voluntary disclosure.

From the literature review the following hypotheses are developed for the study purpose

**$H_1$: There is a significant impact of corporate board characteristics on voluntary disclosure**

**$H_2$: There is a significant impact of audit committee characteristics on voluntary disclosure**

**$H_3$: There is a relationship between corporate board characteristics on voluntary disclosure**

**$H_4$: There is a relationship between audit committee characteristics on voluntary disclosure**

**Conceptual frame work**

Based on the literatures, the following conceptual frame work is formulated.

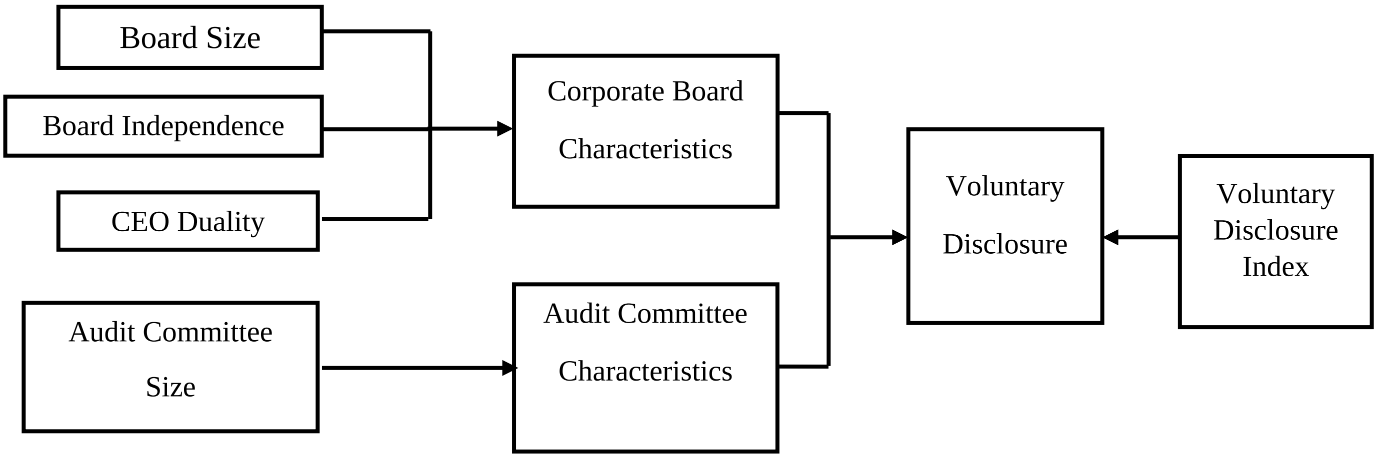


Figure 1 Conceptual Framework

**Methods**

A discussed by mouton (2001) research methodology focuses on the research process a kind of tools and procedures to be used. It describes research design, research approach, sampling procedure, data sources, instrumentation, reliability, validity and mode of analysis.

**Research Design**

This research will be an explanatory studies. The emphasis here is on studying a situation or a problem in order to explain the relationship between variables (i.e., Corporate Board Characteristics, Audit committee Characteristics and Voluntary Disclosures).

**Reliability and validity of the data**

Secondary data for the study were drawn from audit accounts (i.e., income statement and balance sheet) of the concerned companies; therefore, these data may be considered reliable for the purpose of the study. Necessary checking and cross checking were done while scanning information and data from the secondary sources. All these efforts were made in order to generate validity data for the present study. Hence researcher satisfied content validity.

**Mode of Analysis**

The following corporate board and audit committee characteristics and voluntary disclosure index are taken into accounts which are given below.

**Table 1: Calculations of corporate board, audit committee characteristics and voluntary disclosure**

| **Board Characteristics** | |
|---|---|
| Board Size | Number of Directors |

| | |
|---|---|
| Board Independence | Total Number of Independent Directors / Total Number of Directors |
| CEO Duality | Code 1 if CEO also saving as chairman, otherwise 0 |
| **Audit Committee Characteristics** | |
| Audit Committee Size | Number of Members in the Audit Committee |
| **Voluntary Disclosures** | |
| Voluntary Disclosure | VD= Total Score of Individual Company<br>Maximum Possible Score Obtainable<br>Score = 1 if the item is disclosed<br>Score = 0 if the item is not disclosed |

Multiple regression analysis was used to investigate the impact of corporate board and audit committee characteristics on voluntary disclosures which the model used for the study is given below. Voluntary disclosures = f (VD) It is important to note that the voluntary disclosures depend upon board size (BS), board independence (IBD), CEO Duality (CEOD), Audit Committee Size (ACS). The following model is formulated to measure the impact of corporate board and audit committee characteristics on voluntary disclosures is as follows.

$$\mathbf{VDS = \alpha + \beta 1\ INE + \beta 2\ BSIZ + \beta 2\ CEOD + \beta 3\ ACSIZ + \varepsilon}$$

VDS it : voluntary disclosure score for firm i in year t

INE it : independent non-executive directors for firm i in year t

BSIZ it : number of board members for firm i in year t

CEOD it: CEO duality i in year t

ACSIZ it : number of members in audit committee for firm i in year t

$\varepsilon$ : Error

**Findings**

**Correlation**

Table 2 Correlation Matrix

| | **BS** | **IBD** | **CEOD** | **ACS** | **VD** |
|---|---|---|---|---|---|
| **BS** | 1.00 | | | | |
| **IBD** | -.184**<br>(0.029) | 1.000 | | | |
| **CEOD** | -.163<br>(0.053) | -0.204**<br>(0.015) | 1.000 | | |
| **ACS** | 0.364***<br>(0.000) | 0.167***<br>(0.047) | -0.194***<br>(0.021) | 1.000 | |
| **VD** | 0.259***<br>(0.002) | -0.122<br>(0.148) | -0.330***<br>0.000 | -0.032<br>(0.701) | 1.000 |

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

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

(Where BS: board size, IBD: board independence, CEOD: CEO duality, ACS: audit committee size, VD: voluntary disclosures)

Table 2 presents the Pearson Correlation Coefficients of the independent variables (corporate board and audit committee characteristics) as well as the dependent variable (Voluntary disclosures index).

The above table indicates that there is a significant positive relationship between voluntary disclosures index and board size during the study period. The correlation of the board size and voluntary disclosures is 0.259 and p value is 0.002. P value is lower than the 0.01. Further, study revealed that there is significant negative relationship between CEO duality and voluntary disclosures. The correlation of the CEO duality is -0.330 and p value is 0.000 which is less than 0.01. As well, as study illustrates some negative relationships between independent variables, which are not significant. Board independence and audit committee size has insignificant relationship with voluntary disclosures. Because the p value of these two variables are grater that 5% significant level. Then a multiple regression analysis was performed to identify the impact of corporate board and audit committee characteristics on voluntary disclosures as conceptualized in the models. A step wise variable selection was used in the regression analysis and Table 3 provides the summary measure of the models.

**Table 3: Regression Model Summary**

| **Details** | **VD** |
|---|---|
| **BS** | 0.642<br>(0.006) |
| **IBD** | -0.365<br>(0.146) |
| **CEOD** | -24.950<br>0.000 |
| **ACS** | -5.988<br>0.053 |
| **Cons** | 58.382<br>t = 9.16<br>p = 000 |
| **R - squared** | 0.197 |
| **Adj R- squared** | 0.174 |
| **Prob > f** | 0.000 |
| **F Value** | 8.33 |

*Source*; Developed by researcher

According to Table -3 denotes that the impact of corporate board, audit committee characteristics on voluntary disclosures is fully significant because the p value is 0.000. The F value is 8.33 and the R- squared is 19.7% which means that there is a 19.7% impact of corporate board, audit committee characteristics on voluntary disclosures. It represents a lower impact. As well as it is revealed that there are other factors which are 80.3% impact on voluntary disclosures. Further, adjusted R-squared indicate that there is a 17.4% impact of corporate board, audit committee characteristics on voluntary disclosures.

**Hypothesis Testing**

| Serial No | Hypothesis | Tools | Accepted/Rejected |
|---|---|---|---|
| **$H_1$** | There is a significant impact of corporate board characteristics on voluntary disclosures | Regression | Partially Accepted |
| **$H_2$** | There is a significant impact of audit committee characteristics on voluntary disclosures | Regression | Rejected |
| **$H_3$** | There is a significant relationship between corporate board characteristics and voluntary disclosures | Correlation | Partially Accepted |
| **$H_4$** | There is a significant relationship between of audit committee characteristics and voluntary disclosures | Correlation | Rejected |

**Conclusion, Limitations and Future Researches**

Study found that a minimum level impact of corporate board and audit committee characteristics on voluntary disclosure. Considerably the result of the study found a significant positive impact of board size on the voluntary disclosures. The CEO was found to have negative significant influence on the voluntary disclosures in this study. Unfortunately, it was unable to find a significant relationship between board independence and level of disclosures in Sri Lankan listed companies and also it was unable find an impact of board independence on voluntary disclosures. As well as of the study was unable to found a significant impact on audit committee size on voluntary disclosures. Based on the outcome of the study, it is recommended that to introduce a basic format of voluntary disclosures for all manufacturing companies because some of manufacturing companies are referring international voluntary disclosure guide lines (GRI guidelines) for publish their annual report but some are not. Common format will help to encourage the voluntary disclosure level and it will help to attract the investors. Further the results of the board independence contradict with the previous finding (Cheng, Courtenay, & Stephen, 2006;Akhtaruddin & Haron, 2010) which means that the independent directors of the listed manufacturing companies do not have influence on the diclosure level so it better to recommend guidelines regarding the duties of independent directors. Audit committee (AC) is considered as one of the crucial and influential participants of corporate governance as it assists the board of directors in discharging its responsibilities in overseeing corporate management (Bedard and Gendron, 2010) In this respect, it is argued that AC plays a key role in monitoring management disclosure practices' and internal control (Persons, 2009).Hence the result of the study revealed the auditors should pay more attention on the quality of the reporting of the annual reports. This study focused on one avenue of company disclosure, namely corporate annual reports and the extent to which companies voluntarily release information through other means such as the media, represents a limitation of this study. The study used secondary data gathered from listed manufacturing companies in CSE. So this research is covered only one sector only. It is not enough to take decision regarding on one sector. If study can expand to other sectors also, even more accurate conclusion would be given.

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