

# THE IMPACT OF AUDIT COMMITTEE ON THE EFFECTIVENESS OF INTERNAL AUDIT IN LISTED COMPANIES IN MUSCAT SECURITIES MARKET

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## Abstract

This study is conducted to examine the impacts of audit committee (AC) on the internal audit effectiveness (IAE) in companies listed in Muscat Securities Market (MSM). A quantitative approach is employed in this study and a structural equation modelling (SEM) is used to analyze the collected data. Simple random sampling was chosen for the data collection. Survey questionnaires were disseminated to a total of 397 respondents comprising of financial/accounts managers, internal auditors, accountants, and member of audit committee. The results show that AC impacts the IAE, whereby the AC changes the positive connections between the integration ( $\beta = 0.379$ ,  $p < 0.05$ ), relevance ( $\beta = 0.312$ ,  $p < 0.05$ ), flexibility ( $\beta = 0.242$ ,  $p < 0.05$ ), and reliability ( $\beta = 0.213$ ,  $p < 0.05$ ). This indicates that the reliability is the main cause that can influence the IAE. Thus, this study recommends MSM companies to emphasis on increasing the quality and the performance of IAE by improving their AC.

**Keywords:** Audit committee, Internal Audit Effectiveness, Muscat Securities Market.

## I. INTRODUCTION

In recent years, practitioners and scholars emphasized the importance of internal audit (IA) and the functions of internal auditors in the organisation's activities than in the past (Baharuddin et al., 2014; George et al., 2015; Changwony & Rotich, 2015). While this paper was written, concerns like performance assessments and the usefulness of IA have garnered considerable interest (Belay, 2007; Mihret & Yismaw, 2007; Mihret et al., 2010; Abu Azza, 2012; Ramachandran et al., 2012; Endaya & Hanefah, 2013; Wubishet & Dereje,

2014; George et al., 2015). The subject of this research, the internal auditors are obliged to perform autonomously and impartially to improve the strong quality of government services. It is also to establish a good system of internal control, prevent unnecessary misconduct, uphold answerability, enhance transparency, and assure effective corporate governance (Van Peurseem, 2005; Belay, 2007; Coram et al., 2008).

As a result, having a competent unit of internal audit as a component of a modern governance structure in a distinct environment is crucial.

Therefore, the challenges of the internal audit in corporate governance have gained much interest in the past few years for various bases. For instance, an internal audit connects to the management of the internal control-risk to improve the organisation's effectiveness and efficiency by providing critical feedback and suggestions about the performance of an organisation. It also plays a role to minimise the informational asymmetries during judgement, and an essential assurance in the organisations as a procedure to report the financial state of the companies (Mihret & Yismaw, 2007; Cohen & Sayag, 2010; Soh & Bennie, 2011).

Several financial institutions collapsed, and the need for an internal audit that is competent with the presence of AC as the basis of governance for the corporate is necessary (Bedard & Gendron, 2010). In the early 2000s, many of these disasters happened affecting the leading capital market trust to plunge. As a result, attention was placed on the IAE and the function of AC to assist the directors in accomplishing its responsibilities in terms of financial and fiduciary (Puri et al., 2010). AC is responsible for evaluating a firm's financial information and assisting internal audit and financial accountants as a corporate governance instrument. Also, AC is responsible for keeping an eye on the IAE. To carry out these obligations, AC must work with the IAE and accomplish the committee's duties in its capacity. Furthermore, AC and IAE need to be associated to the senior executives to avoid being dominated by different organisational activities (Soh & Bennie, 2011).

According to several extensive archival studies, AC features impact an internal audit (Goodwin, 2003; Cahill, 2006; Mat Zain et al., 2006; Stewart & Kent, 2006; Abbott et al., 2010; Barua et al., 2010; Callahan & Soileau, 2010; Adel & Maissa, 2013). Based on the internal audit budget, the occurrence of AC meetings is determined, which implies that a vigilant AC is more encouraging of the IAE, resulting in more budget for internal audit (Barua et al., 2010).

There has been no evidence of past studies that examined the impact of AC on the IAE in

companies listed in MSM. Thus, this research aims to investigate this matter to discover how consistent the result is with the global ones. This research is organized as follows. The research begins with in-depth reviews of literature related to the AC and IAE. The research continues by presenting the research hypothesis and the connections to the previous studies. The methodology of the research is presented in the third section, and the last section discusses the findings, discussion and conclusion of the research.

## 2. Literature Review

### 2.1 AUDIT COMMITTEE (AC) IN OMAN

The current study emphasizes the most recent audit committee studies, which emphasize the accomplished work in Oman. The reviews of literature mentioned that the significance of audit committees and other control mechanisms in evaluating and monitoring the management, guiding the usage of internal control systems, preparation of financial statements, and other control mechanisms were highlighted (Ammer & Ahmad Zaluki, 2017; Alabdullah, 2018; Alabdullah, 2019; Hamdan, 2020). In Oman, Ahmed et al. (2020) had explored the control mechanisms and firm profitability. They discovered a significant connection between all the mechanisms of CG: ownership, gender, audit committee, the size of the board, and the firm profitability. Another study by Hamdan (2020) looked into audit committee factors, such as in-dependency, audit committee size, audit committee diligence, financial experience, and earnings conservatism. They discovered that ACs are associated with increased independence and financial expertise. In addition, they are associated with earnings conservatism in Gulf Cooperation Council financial institutions (GCC).

Raweh, Kamardin, and Malik (2019) investigated the connection among the features of the AC and audit report latency. They found that the AC size had a favourable correlation with the audit report, and the audit lag can be lessened with the existence of the financial experts in the AC. Meanwhile, Al-Matari, Al-

Dhaafri, and Al- Swidi (2019) investigated the connection among the structure of ownership, government and foreign ownership, and the performance of non-financial companies in Oman. Additionally, they delved into audit quality as a mediator in the association between ownership structure and company performance. This paper shows that audit quality has a moderating impact on the relationship.

## 2.2 Auditing in Oman

Omani legislators implemented a considerable measure to regain the investors' confidence. On November 9, 1998, the Capital Market Authority (CMA) and the Muscat Securities Market (MSM) were recognized as the bodies that control, monitor, and handle securities exchanged in the capital market. CMA announced a few measures aimed to improve the accountability, openness, and disclosure among MSM-listed public joint-stock companies. One of the legislations is the corporate governance code or corporate governance structure, as known in the Middle East (Baydoun et al., 2013). The implementation of the code is still in the early stage. Thus, more improvement is needed in the Omani code (Mohamed et al., 2009). This code comprises the directors, AC, external auditors, internal controls, related party transactions, executive management, and the report of corporate governance. For instance, the non-executive members in the audit committee must at least be three people, with the majority being independent. In addition, all members should be financially knowledgeable, with at least one having financial competence (Capital Market Authority, 2002). The corporate governance code in Oman has been amended several times in 2009 and 2012. The CMA planned to release an updated code by June 2016 with considerable adjustments to the prior provisions. In addition to the Commercial Companies Law, 4/74, and its revisions, and the Accounting and Auditing Profession Law, 77/86, the code has established the standards to maintain this system accomplishing its purpose. For instance, the board of directors and the shareholders should choose publicly traded business auditors on an annual basis and

replaced them after four years with a two-year cooling period.

## 2.3 Hypotheses Development

Based on the expert's opinion, the audit committee was chosen for this study as they stipulated that the audit committee will oversee the internal control that applies to the conditions of the institutions. Consequently, it leads to the improvement of IAE to prevent fraud, theft and tampering with financial reports. The audit committee, in turn, confirms and verifies whether these controls are complete or not. Based on these studies. Even though the audit committee has a wide variety of tasks and obligations, this paper emphasises the audit committee's involvement in strengthening the performance of IAE in companies mentioned on the MSM.

According to Amer et al. (2014), the AC is responsible to oversee the company's financial reporting, financial performance and IAE. The audit committee's foundation is built on two pillars of responsibility: management's obligation to the directors and the transparency of the directors to the stakeholders. The audit committee's position as the company's internal audit effectiveness device is critical for financial reporting accuracy. The audit committee's job is closely related to the board's oversight function since it monitors the firm's external and internal audit processes (Sujatha, 2017). Accordingly, the study recommended an internal control system that prevents access to sensitive data for those authorized to obtain it and install alarms and track movements in places where computers are located.

Four hypotheses were created based on the above discussion.

H1: The audit committee positively moderate the impact of reliability on the IAE in the companies listed in MSM.

H2: The audit committee positively moderate the impact of relevance on the IAE in the companies listed in MSM.

H3: The audit committee positively moderate the impact of integration on the IAE in the companies listed in MSM.

H4: The audit committee positively moderate the impact of flexibility on the IAE in the companies listed in MSM.

### 3. Methodology

In this study, the instrument used for data collection is the questionnaire. The questionnaires were distributed to 167 companies listed in Muscat Securities Market (Financial\Accounts Manager, Accountant, Internal Auditor and Audit Committee member). Before finalizing the questionnaire, pilot analysis and judgement by the experts were done. The questionnaires were sent to the respondents via email using the Google Form link. The distribution of the questionnaires and the compilation of the answers took three months. The basic random sampling method is used in this study, which a total of 468 questionnaires were disseminated, and only 397 responses (96.36%) were accepted after the review process. SPSS and SmartPLS were employed to evaluate the collected data.

### 4. Results and Discussions

#### 4.1 THE PROFILES OF THE RESPONDENTS

Table 1 presents the profiles of the respondents based on age, education level, their role in the organization, and their experience. From the age aspect, the majority of the respondents were aged between 26-30 with 32.23%, followed by respondents aged between 20-25 with 28.21% and 31-35 with 23.43%. Meanwhile, the least number of respondents were aged over 35 with 16.12%. As for the education level, 36.78% of the respondents have a Bachelors Certificate, and 24.43% have a Masters Certificate. Meanwhile, 24.43% were diploma holders, and 14.36% were PhD holders. Only 1% of the respondents hold a professional qualification such as ACCA, CPA, and CIMA. This deduced that the main requirement to work in MSM sectors is to hold a Bachelor's Certificate.

As for the position of the respondents in the organization, majority of the respondents were Accountant with 136 responses (34.26%). However, the least responses were attained from the Audit Committee Member with 77 responses (19.39%). Other responses showed that 98 responses from the Financial / Account Manager (24.69%) and 86 responses from the Internal Auditors (21.66%). This indicates that the Accountants are significant in the MSM sectors supported by other units, such as the Audit and Finance units.

As for the work experience aspect, the majority of the respondents have 1-5 years of work experience with 138 responses (34.76%), while the least responses were from respondents who worked more than 15 years with 66 responses (16.62%). Other responses reveal that 104 responses have 6-10 years of work experience (26.20%), and 89 responses have 11-15 years of work experience (22.42%). These findings provide an overview of the experiences and interests of the respondents gained in the Muscat Securities Market. Moreover, this ratio is acceptable and proves the significance of this study for other companies mentioned in the MSM.

Table 1 *Summary of Frequency Table for Demographic Profile*

Category	Frequency	Percentage (%)
<b>Age</b>		
20-25	112	28.21
26-30	128	32.24
31-35	93	23.43
Over 35	64	16.12
<b>Education Level</b>		
Bachelor Certificate	146	36.78
Diploma degree	93	23.43
Master's Certificate	97	24.43
PHD Certificate	57	14.36
Professional Certificate (ACCA, CPA, CIMA and etc.)	4	1

<b>Current position in the organization</b>		
Accountant	136	34.26
Audit Committee member	77	19.39
Financial / Account manager	98	24.69
Internal auditor	86	21.66
<b>Experience</b>		
1-5 Years	138	34.76
6-10 years	104	26.20
11-15 years	89	22.42
More than 15 years	66	16.62

#### 4.2 Reliability Test of All Constructs

Table 2 *Reliability of Instrument on The Basis of Pilot Test*

Sr.	Dimension	Cronbach's Alpha	No. of items
1	Reliability	0.730	10
2	Relevance	0.823	10
3	Integration	0.761	10
4	Flexibility	0.709	10
5	Internal audit Effectiveness (IAE)	0.740	10
6	Audit Committee (AC)	0.823	10
	Total	0.840	50

To determine the questionnaire's reliability and validity, the questionnaire was checked. Table 2 presents the outcomes from the pilot test to check its consistency. Although there are many thresholds for the Cronbach alpha value set by different scholars, this study has set 0.70 as the threshold for the value of reliability (Hiraoka, 2017).

#### 4.3 Internal Consistency Reliability

Composite Reliability (CR) is used to measure internal consistency (Chin, 1998). CR considers indicators with several loadings, while the internal consistency reliability is underestimate by the Cronbach alpha (CA) and presumed that the pointers are alike (Chin 1998). In this study, CR will be considered. A guideline by Nunally (1978) was used by the researcher, which mentioned that the internal consistency is

satisfactory when the value is  $\geq 0.70$ . If the value is  $< 0.60$ , it indicates that it lacks the reliability of measures. The CR for each item of this study is presented in Table 3, ranges from 0.941 to 0.951 with a value of threshold above 0.70. Therefore, the constructs' internal consistency reliability is valid and reliable.

Table 3 *Results of Final Modified Measurement model*

Model Construct	CR	AVE
Reliability	0.946	0.636
Relevance	0.947	0.645
Integration	0.946	0.640
Flexibility	0.941	0.615
Internal Audit Effectiveness	0.951	0.661
Audit Committee	0.944	0.627

#### 4.4 Fornell and Larcker Criterion

The measurement model undergoes assessment to examine its reliability and validity. Hair et al. (2016) mentioned that the evaluation involves two steps; the validity of convergent and discriminant. The model was estimated to show the empirical measure that shows the connection among the pointers and the constructs. The evaluation of the measurement model comprises the reliability of composite to determine the stability of the internal and the average variance extracted (AVE) to evaluate the validity of the convergent and the discriminant (Hair, 2016). The AVE's square root is tabulated in Table 4. Based on the criteria by Fornell and Larcker, the results confirmed the discriminant validity of the measures.

Table 4 *Discriminant Validity using Fornell and Larcker's criterion*

Variable	AC	F	I	IAE	RV	R
AC	0.881					
F	0.721	0.836				
I	0.818	0.820	0.845			
IAE	0.795	0.781	0.813	0.822		
RV	0.772	0.779	0.835	0.810	0.873	
R	0.758	0.696	0.795	0.729	0.826	0.850

#### 4.5 Model of Goodness of Fit (GOF)

GOF is a global load measure and the AVE's geometric mean, which has an average R2 of the endogenous variable (Hair et al., 2016). GOF is accountable to justify the reliance on the study model at the conceptual and empirical levels. Table 5 exhibits that the value of GOF is higher than 0.36, which is 0.659. The standards of GOF is set to define that the values of the GOF are no fit, small, medium, or large to be accepted globally by the PLS model, as provided by Henseler et al., 2014. The outcome shows that the model of GOF was greater than the adequate validity for the universal PLS model. The overall performance of the model is measured based on the model of the structure (Henseler et al., 2014). The following is the calculation formula of the GOF:

$$\text{Gof} = \sqrt{(\text{AVE} * \text{R}^2)}$$

Table 5 *Goodness of Fit of the Model (GOF)*

	R Square	AVE
Reliability (R)		0.636
Relevance (Rv)		0.645

Table 6 *Path Coefficient Assessment*

Hypothesis	Path coefficient	Std. Error	T- value	P-value	Decision
H1: The role of audit committee moderates the impact of reliability on the IAE of the companies listed in MSM.	0.213	0.073	2.178*	0.049	Fail to reject
H2: The role of audit committee moderates the impact of relevance on the IAE of the companies listed in MSM.	0.312	0.068	3.077**	0.006	Fail to reject
H3: The role of audit committee moderates the impact of integration on the IAE of the companies listed in MSM.	0.379	0.067	3.174**	0.003	Fail to reject
H4: The role of audit committee moderates the impact of flexibility on the IAE of the companies listed in MSM.	0.242	0.061	2.187*	0.04	Fail to reject

Note. T-values > 1.96\* (p < 0.05); T-values > 2.58\*\* (p < 0.01); T-values > 3.29\*\*\* (p < 0.005)

Integration (I)		0.640
Flexibility (F)		0.615
(IAE)	0.682	0.661
AC		0.627
The Average		0.637
GOF	0.659	

#### 4.6 Path Coefficient of Hypothesis Testing

This study evaluates the impacts of the connection between the independent variables, which are flexibility, relevance, integration, and reliability, and the dependent variables of the IAE using AC as the moderator. Four hypotheses were created and tested using the SmartPLS. Table 6 and Figure 1 present the outcomes of the impacts.

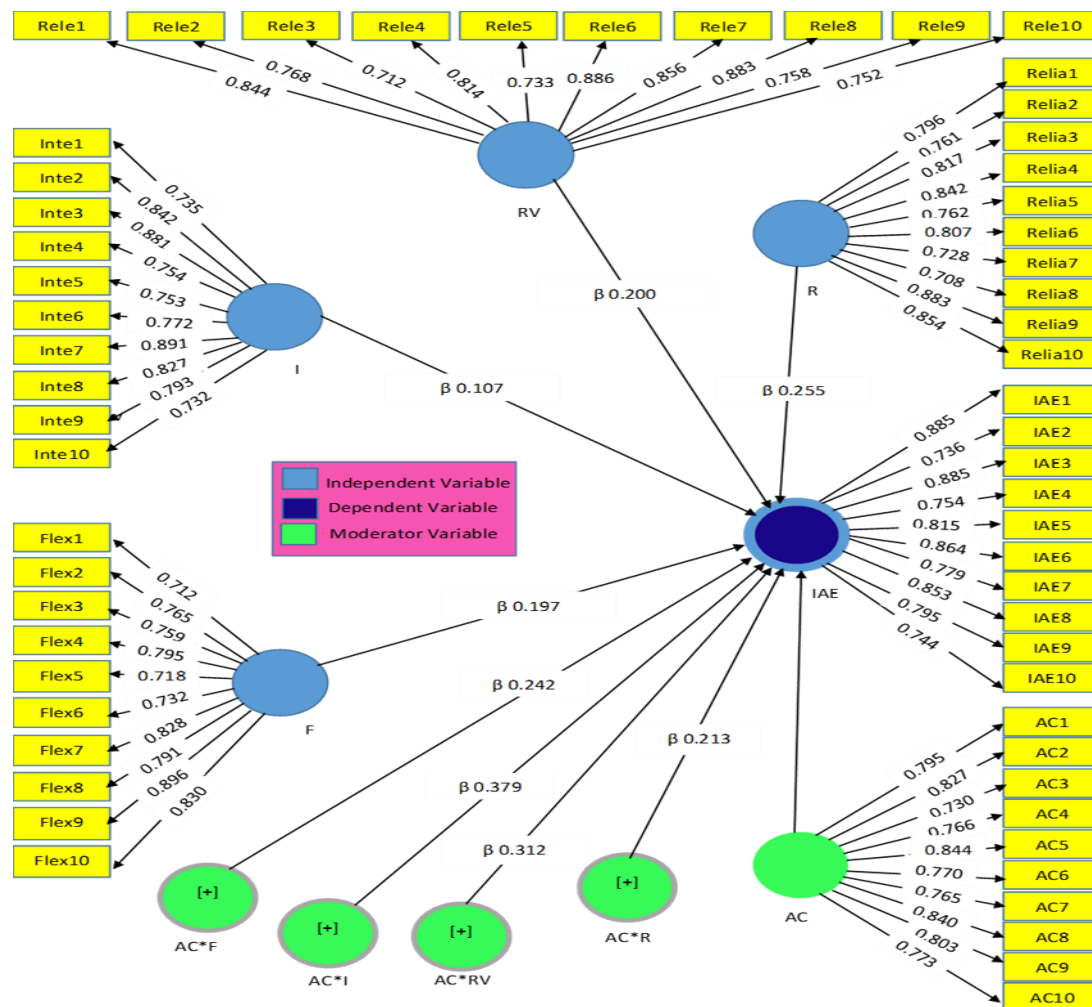


Figure 1: The measurement model of the study

## 5. Conclusion

The impact of AC on the IAE in companies listed in MSM is studied onto 167 companies as the subject of this study. A descriptive study design was applied, and the primary data attained from the questionnaires is used as the source of information. From the questionnaires, the researcher managed to obtain the respondents' profiles, such as the education level and years of working experience, and their interpretations on the IAE in the companies listed in MSM in Oman affected by the AC.

However, the outcomes of the study showed that companies with audit committees have improved the IAE. This has proven that there is a significant correlation between AC and the IAE in the companies listed in the MSM.

This study also encountered several restrictions, such as limitation of place or location as it covers 167 companies listed in MSM. Not only that, this study was done for about a year as it involves the distribution of questionnaires for the collection of data.

The significance of this study benefited the companies in Oman as it represents the management and the founders. It also delivers a greater insight of the possible impact of employing AC to enhance the productivity of the IAE in the companies listed in the MSM.

This study also confirms that the use of structural equation relationships will prevent the companies from errors in the data that can influence the process of making decision. Thus, implementing AC and enhancing the accountants and auditors experience should be done via continuous training.

Overall, this study proposed that the AC should be maintained effectively as a precautionary step for the company's economic growth. A centralized data management should be done to enhance data accuracy and manage the information. Furthermore, the establishment of AC encourages creative and innovative characters among the employees. A department of independent audit with competent and trained staff should be established in an organization to help the implementation of AC.

Finally, a comparison of analysis should be done between the developed countries and developing countries in future studies to attain greater insight into the nature and the level of accounting information systems and their connection to the IAE. Thus, it is crucial to comprehend the quality of AC in other nations too.

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