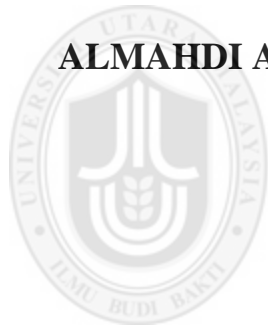


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**AUDIT COMMITTEE CHARACTERISTICS AND INTERNAL
AUDIT BUDGET: MALAYSIAN EVIDENCE**



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Othman Yeop Abdullah Graduate School of Business,
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(International Accounting)

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ABSTRACT

An audit committee is viewed as an essential self-regulatory internal governance instrument that is expected to provide an overseeing role over the entire process of financial reporting. An internal audit is also one of the corporate governance cornerstone that is essential for the effective monitoring of the operating performance of internal control. To ensure its effectiveness, the audit committee monitors the resources available to the internal audit, and internal control functions should be directly reported to the audit committee. This study is set out to explore the effect of audit committee characteristics (i.e independence, expertise, meeting and tenure) on internal audit budget in Malaysia, where governance mechanisms are suboptimal. The study also opens the door to an unanswered question, that is, whether an audit committee index is related to internal audit budget. Data of 96 companies listed on Bursa Malaysia for a three-year period, 2012-2014, was utilized to achieve this end. The regression result shows that there is audit committee meeting and index are significantly and positively associated with internal audit budget. They also indicate that audit committee tenure has a significant and negative impact on internal audit budget. The theoretical, practical, academic and regulatory implications of these findings were discussed in details. On one extreme, the findings of the study supports the recent policy initiatives in relation to audit committee and internal audit. On the other extreme, the result serves as a wake-up call to policy makers in requiring more committed, competent and skilled members on the audit committee.

Keywords: Audit committee characteristics; internal audit budget; Bursa Malaysia

ABSTRAK

Jawatan kuasa audit dilihat sebagai salah satu alat kawal selia sendiri yang digunakan oleh tadbir urus dalaman untuk menyelia keseluruhan proses laporan kewangan. Jawatan kuasa audit dalaman juga merupakan salah satu asas tadbir urus korporat yang sangat penting untuk mengawasi prestasi operasi kawalan dalaman yang lebih cekap. Bagi menjamin kecekapan, jawatan kuasa audit akan menyelia setiap sumber yang disalurkan ke audit dalaman, dan fungsi kawalan dalaman perlu dilaporkan kepada jawatan kuasa audit secara langsung. Kajian ini dilakukan untuk mengkaji kesan daripada ciri-ciri jawatan kuasa audit (contoh: kebebasan, kemahiran, mesyuarat jawatan kuasa dan pemilikan) ke atas bajet audit dalaman di Malaysia, di mana mekanisme pengawasan adalah suboptimal. Kajian ini turut membuka laluan kepada persoalan yang timbul, iaitu sama ada indeks jawatan kuasa audit berkait rapat dengan bajet audit dalaman. Data daripada 96 buah syarikat yang tersenarai di Bursa Malaysia untuk tempoh 3 tahun, 2012-2014, digunakan untuk menjawab persoalan yang timbul. Keputusan analisis regresi menunjukkan bahawa mesyuarat jawatan kuasa audit dalaman dan indeks jawatan kuasa audit adalah signifikan dan berkait secara positif dengan bajet audit dalaman. Analisis regresi turut menunjukkan bahawa pemilikan jawatan kuasa audit adalah signifikan dan mempunyai impak negatif terhadap bajet audit dalaman. Dapatan kajian secara teoritikal, praktikal, akademik dan implikasi peraturan akan dibincangkan secara terperinci. Pada capaian ekstrim, hasil kajian turut menjumpai kajian-kajian yang menyokong inisiatif dasar terkini yang berkaitan dengan jawatan kuasa audit dan audit dalaman. Selain itu, hasil kajian juga dapat dijadikan asas permulaan kepada pembuat dasar untuk mendapatkan individu yang lebih berdedikasi, berdaya saing dan berkemahiran tinggi sebagai ahli jawatan kuasa audit.

Kata kunci: Ciri-ciri jawatan kuasa audit; bajet audit dalaman; Bursa Malaysia

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LIST OF ABBREVIATION

MCCG	Malaysian Code of Corporate Governance
PCAOB	Public Accounting Oversight Board
IIAM	Institute of Internal Auditors Malaysia
BRC	Blue Ribbon Committee
MIA	Malaysian Institute of Accounting
PLCs	Board of Public Listed Companies
AOB	Audit Oversight Board
SEC	Securities and Exchange Commission
IAFNV	Investment in Internal Auditing
AC	Audit Committee
ACC	Audit Committee Characteristics
ACIND	Audit Committee Independence
ACEXP	Audit Committee Expertise
ACMEET	Audit Committee Meeting
ACTEN	Audit Committee Tenure

ACINDEX	Audit Committee Index
ACSIZE	Audit committee size
LEV	Leverage
SIZE	Firm Size
INVEN	Inventory
OCF	Operating cash flow
IAFOS	Internal Auditing Source arrangement
OLS	Ordinary Least Square
CEO	Chief Executive Officer



CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Following recent accounting scandals, deliberate manipulations and fraudulent activities of some corporations such as Enron, Worldcom, and Satyam that lead to accounting failure, internal auditing has increasingly become relevant as an important corporate governance mechanism (Carcello, Hermanson & Raghunandan, 2005; Coram, Ferguson & Moroney, 2008; Sarens & Abdolmohammadi, 2008). In response to these accounting failures, the Congress of the United States passed into law the Sarbanes Oxley Act of 2002 (SOX, 2002). This significantly affected several issues related to corporate governance and corporate financial reporting. Particularly, it pushed for more focus on internal controls and internal auditing. Hence, it is likely that a number of companies have shifted their concentration towards internal auditing during this period. In addition, the Public Accounting Oversight Board (PCAOB) asserted that an outstanding benefit of its standard on auditing an internal control is encouraging companies to invest in competent and objective internal audit function (PCAOB, 2004). Moreover, statistics show that internal audit budgets and number of internal audit staff grew by over 10 percent between 2001 and 2002 in the US (Carcello et al., 2005).

In a same token, internal auditing has become a very crucial component of global businesses. It is a vital constituent of the risk management, internal control structure of the organization (Anderson, Christ, Johnstone & Rittenberg, 2012). Internal auditing is

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