# IMPACT OF AUDIT COMMITTEE INDEPENDENCE, COMPETENCE AND DILIGENCE ON INVESTMENT DECISION MAKING OF NEPALESE LISTED COMPANIES

BY

**Rakesh Kumar Ray**

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# Recommendation

## Certification

## DECLARATION OF AUTHENTICITY

I, Rakesh Kumar Ray, declare that this GRP is my own original work and that it had fully and specifically acknowledged wherever adapted from other sources. I also understand that if at any time it is shown that I have significantly misinterpreted material presented to SOMTU, any credits awarded to me on the basis of that material may be revoked.

Signature: ______________________________

Name: Rakesh Kumar Ray

Date:

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Rakesh Kumar Ray

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# ABBREVIATIONS

| | |
|---|---|
| AC | :Audit Committee |
| AVE | : Average Variance Extracted |
| BFI | : Bank and Financial Institution |
| BOD | : Board of Directors |
| CEO | : Chief Executive Officer |
| CFO | : Chief Financial Officer |
| COM | : Competence |
| CR | : Composite Reliability |
| DIL | : Diligence |
| GAAP | : Generally Accepted Accounting Principles |
| IDN | : Investment Decision Making |
| IND | : Independence |
| MBA | : Master of Business Administration |
| NEPSE | : Nepalese Stock Exchange |
| NFRS | : Nepalese Financial Reporting System |
| rho_A | : Reliability Indices for each construct |

## EXECUTIVE SUMMARY

This main objective of this study is to examine the impact of the audit committee's (AC) independence, competence and diligence on the company's investment decision-making of Nepalese listed companies. The study attempted to test hypothesis regarding the impact of audit committee independence, competence and diligence on investment decision making. This study has adopted a descriptive method to evaluate the effect of audit committee independence, competence and diligence on investment decision making. The data on audit committee factors have been collected from 70 respondents working as accountant, auditor, Chief Finance Officer or Chief Executive Officer in a listed company of Nepal.

Mixed method has been used for this primary research. The data has been collected through both close-ended and open-ended questionnaire. Out of total population contacted, 70 responses were received on quantitative questionnaire. The same 70 respondents were further contacted for qualitative responses, out of which 31 respondents responded. Purposive sampling technique has been adopted. The questionnaire that has been used in this study is developed by Al-Hadrami, A., Rafiki, A. and Sarea, A. (2020). Some modification has been made in the questionnaire to make it relevant in context of Nepal. One independent variable has been added to the questionnaire, namely Audit Committee Diligence as questionnaire developed by Abbott, L.J., Parker, S., & Peters, G.F. (2004).

The data were not normal so Measurement Model Analysis has been conducted with SMART PLS to analyze the convergent validity and discriminant validity. Correlation and path analysis has been done to measure the significance of audit committee independence, competence and diligence on investment decision making.

The findings suggest that there is a significant impact of audit committee independence on investment decision making. On the other hand, findings suggested that there is no significant impact of audit committee competence and diligence on investment decision making. However, the analysis from central values, correlation coefficients and qualitative analysis suggest that competence and diligence also contribute to better investment decisions.

# CHAPTER I

# INTRODUCTION

## 1.1 Background

The audit committee is regarded as the most important board subcommittee due to its specific role of protecting the interests of shareholders in relation to financial oversight and control (Mallin, 2007). The primary role of the AC is to oversee the firm's financial reporting process, the review of financial reports, internal accounting controls, the audit process and, more recently, its risk management practices (Klein, 2002)

The main source of financial information that investors rely on to make their investment decision is the investee companies' annual report. The information provided must be credible and reliable to assist investors and other users to make the right decisions. Therefore, the interest in corporate governance begins to grow rapidly all over the world.

The audit committee is viewed as a monitoring mechanism that can help alleviate agency problems by reducing information asymmetry between insiders (managers) and outsiders board members (Klein, 1998; Chen et al., 2008; Sarens et al., 2009), since its key functions are to review financial information and control management's conduct of affairs (Fama & Jensen, 1983). A growing body of literature suggests that audit committee is as a delegate body of the board of directors charged with safeguarding and advancing the interests of shareholders (Bedard et al., 2004; Klein, 2002). The board usually delegates responsibility for the oversight of financial reporting to the audit committee to enhance the breadth of relevance and reliability of the annual report. Therefore, the audit committee has been considered as a very important monitoring mechanism of corporate governance for oversight of the company's financial reporting process (Joshi & Wakil, 2004).

Sabia and Goodfellow (2005) posited that audit committee must include the right people to be effective through two main features which are independence and competence. Although the studies on a relationship between the audit committee features or effectiveness and investment decision-making are rarely conducted, Cohen et al. (2014, 2016) revealed the relationship between audit committee effectiveness and financial reporting quality, internal control quality and external audit quality. An experimental study by Cohen et al. (2016) on 342 reasonably informed investors (MBA students) found that the existence of social and professional ties between the audit committee, the CEO and industry expertise affects respondents' assessment of audit committee independence, competence, effectiveness and the investors' judgment. Additionally, they found that the most effective audit committee and an aspect that is more favorable for investment decision is the one that includes financial experts, regardless of audit committee ties with the CEO.

An effective corporate governance mechanism would improve the quality of supervising the management actions and activities (Dechow et al., 2010). One important composition of corporate governance is an audit committee. This committee is formed from firms' boards of directors (BoD) to oversee the activities of the company's management and ensure the compliance with the firms' regulation in general and the financial guidelines in particular. In the United States, the accounting scandals occurred in the last decade such as the Enron scandal that had increased the urge for more robust regulations to protect users of the financial information. The initial step to improve this protection was provided by the Blue-Ribbon Committee (BRC) report issued in1999. This report offered several recommendations mainly to improve firms' audit committees' (AC) effectiveness and to strengthen their independence. Later in 2002, Sarbanes–Oxley Act modified a range of ACs' requirements and added more responsibility to this committee. These requirements call for more independent and competent audit committee. With that, audit committee members should not have any relationship with the management and should include nonexecutive and nonrelated members. The existence of this important feature will ultimately result in a better financial reporting control and monitoring (Koh et al., 2007). Moreover, the audit committee's competence improves the company's ability to prevent and detect any fraudulent activities and strengthen its internal control (Zhang et al., 2007; Hoitash et al., 2009). Bedard et al., (2014) found that the most important characteristics of audit committee which have a positive relationship with audit committee's effectiveness are audit committee's independence and competence.

The independence of an audit committee is crucial to the auditors' work as they would receive the support from the audit committee for any disputes with the management, rather than merely being under the management control (Cohen et al., 2014), which might affect the investor's decision. Moreover, it has been assumed that the higher the audit committee's level of competence, the more qualitative the financial reporting provided (Cohen et al., 2014) that might have a positive impact on the investors' decisions.

Diligence is considered a process factor which is required for effective audit committee operations (DeZoort et al., 2002; Kalbers and Fogarty, 1993). The literature identifies board meeting frequency as an indirect signal for board diligence (Menon and Williams, 1994; Abbott et al., 2004; Conger et al., 1998; Carcello et al., 2002; Farber, 2005). Conger et al. (1998) suggest that an increase in board meetings may improve the effectiveness of the board. Abbott et al. (2004) and DeZoort et al. (2002) suggest that committee size may also proxy for audit committee diligence.

This study provides an investigation of the influence of the audit committee's independence, competence and diligence on the investment decision in one of the growing market, Nepal. Therefore, it is expected that this study will fill the gap of the literature regarding the impact of audit committee independence, competence and diligence on investment decisions in a developing country.

### 1.2 Statement of Problem

BRC (1999) report stated that the main aim of the audit committee is to increase the investors' trust in the financial reporting by way of providing quality reports. Therefore, the audit committee must be effective in practicing its duties. Bedard et al., (2014) had reviewed the previous studies that investigated the impact of more than one characteristic on the effectiveness of audit committee namely existence of audit committee, audit committee independence, audit committee competencies, audit committee size and number of meetings conducted. The majority of the studies found a positive association between audit committee effectiveness and the presence of audit committee, audit committee independence and audit committee competencies. However, only few studies found a positive relationship between audit committee effectiveness and audit committee size and the number of meetings conducted which measures audit committee diligence.

Al-Hadrami, Rafiki, and Sarea, (2020) in their study found that audit independence and audit competence have a positive and significant influence on investment decision-making. Bhattrai (2017) in his study found that board size negatively impacts financial performance of commercial banks in Nepal whereas audit committee size and portion of independent directors positively impact the financial performance of commercial banks in Nepal but the author has cited inclusion of only commercial banks in his study. This study aims to confirm the findings of the study in terms of impact of audit committee independence and competence on investment decision making, but in all the types of institutions listed in

Nepal Stock Exchange using both quantitative and qualitative analysis. Further, this study aims to add audit committee diligence as an independent construct to investigate its impact on investment decision making. Criteria for effective investment decision and items for audit committee characteristics are based on past studies.

The study intends to address following research issues:

- What are the practices of audit committee's independence, competence, diligence and investment decision in the context of Nepal?
- Is there an impact of the audit committee's independence, competence and diligence on the company's investment decision-making of Nepalese listed companies?

## 1.3 Research Objectives

This main objective of this is to examine the impact of the audit committee's independence, competence and diligence on the company's investment decision-making of Nepalese listed companies. Following are the specific objectives of the study:

- To examine the practices of audit committee's independence, competence, diligence and investment decision.
- To analyze the impact of the audit committee's independence, competence and diligence on the company's investment decision-making of Nepalese listed companies.

## 1.4 Research Hypothesis

A number of studies found a significant, positive relationship between audit quality and the independence of audit committee (DeZoort & Salterio, 2001; Yang and Krishnan, 2005; Lin et al., 2006). Krishnan (2005) investigated the relationship between audit committee independence and internal control problems where the results showed a significant relationship of both variables, indicating that the existence of more independent directors in the audit committee decreases the internal control problems.

Accordingly, it has been argued that the engagement of the audit committee in active investigation and questioning during meetings would rely more on the independence of the audit committee. In other words, if audit committee members are not independent, this would increase the influence of the management on the quality of financial reporting (Cohen et al., 2016). Therefore, investors may not trust the financial information provided by a company with biased audit committee. Therefore, it is expected that an independent audit committee will positively affect the investor's decision. This expectation leads to the following hypothesis:

**H1: Audit committee independence positively effects companies' investment decision.**

With regard to the quality of internal control, Krishnan (2005) found a positive relationship between the number of audit committee members possessing financial experience and the quality of internal control. Likewise, Krishnan and Visvanathan (2007) found an inverse relationship between the financial experience of audit committee members and fraudulent practices in the firms investigated. Meanwhile, Abbott et al. (2002) did not find any significant relationship between audit committee competence (having financial expertise) and financial report misstatements.

Similarly, Yang and Krishnan (2005) and Lin et al. (2006) found no significant relationship between audit committee competence and the quality of financial reporting.

Accordingly, most of the previous studies made an assertion on the positive relationship between the competence of audit committee (financial and industry expertise) and the quality of financial reporting, that will be valued by investors (Cohen et al., 2016). Investors will assess the financial reporting produced as being more reliable if they believe in the competence of the

audit committee; hence it will affect their investment positively. This expectation led to the following hypothesis:

**H2: Audit committee competence positively effects companies' investment decision.**

Prior studies have established that audit committee diligence (with audit committee meeting frequency and size as proxies) is a significant factor in the context of audit committee effectiveness. Abbott and Parker's (2000) findings suggest that audit committees that meet at least twice a year are more likely to select an industry specialist as an external auditor. Industry specialists are considered to provide a greater quality audit service; such services are considered to enhance the integrity of the external financial statements. Abbott et al. (2003a) find that audit committee that meet at least four times a year have a lower non-audit fee. Abbott et al. (2003b) and Carcello et al. (2002) find that audit committees that meet at least four times a year have higher audit fees, these fees represent the quality of the audit. Abbott et al. (2004) find that audit committees composed of less than three members are more likely to experience a financial restatement; however, they find that meeting frequency is negatively related to the probability of financial restatements.

**H3: Audit committee diligence positively effects companies' investment decision.**

### 1.5 Scope and Relevance

Sabia and Goodfellow (2005) posited that audit committee must include the right people to be effective through two main features which are independence and competence. Although the studies on a relationship between the audit committee features or effectiveness and investment decision-making are rarely conducted, Cohen et al. (2014, 2016) revealed the relationship between audit committee effectiveness and financial reporting quality, internal control quality and external audit quality. An experimental study by Cohen et al. (2016) on 342 reasonably informed investors found that the existence of social and professional ties between the audit committee, the CEO and industry expertise affects respondents' assessment of audit committee independence, competence, effectiveness and the investors' judgment. Additionally, they found that the most effective audit committee and an aspect that is more favorable for investment decision is the one that includes financial experts, regardless of audit committee ties with the CEO. This study provides a unique investigation of the influence of the audit committee's independence, competence, and diligence on investment decision in one of the growing markets. No previous study has been conducted in Nepal. Therefore, it is expected that this study will fill the gap of the literature regarding the impact of audit committee independence, competence and diligence on investment decisions in a developing country.

### 1.6 Limitations

The following are the limitations of this study:

- This study uses three independent variables audit committee independence, competence and diligence to measure impact on investment decision making. Other independent variables could be added to this study.
- Since this study measures investment decision of investors, there's always a room for biased response. So, other studies may use more objective measures of the study variables.
- Online methods have been used to collect data and therefore the accountability may be low.

- Data from larger number of samples could have been used to make the findings of the study more generalizable.

### 1.7 Organization of the Study

This study is organized in five chapter. The organization of the study can be presented as:

- The first chapter includes the background of the study, statement of the problem, study objective, study hypothesis, rational of the study and the limitation of the study along with the organization structure of the study.
- The second chapter contains review of various literature regarding audit committee independence, competence, diligence and investment decision making. This chapter further explains the theoretical framework for the study.
- The third chapter covers the study design, population and sample of the study, nature and source of data and data instrumentation used in data analysis.
- The fourth chapter includes the analysis of the data and the presentation of the results.
- Lastly, the fifth chapter covers discussions, conclusions and implications of the study.

# CHAPTER II

# RELATED LITERATURE AND THEORITICAL FRAMEWORK

This chapter includes review of literature on the impact of audit committee independence, competence and diligence on investment decision. It includes the review of previous studies and theories related to audit committee and its characteristics. It also includes theoretical framework that relates to the study.

## 2.1 Audit Committee

The audit committee is viewed as a monitoring mechanism that can help alleviate agency problems by reducing information asymmetry between insiders (managers) and outsiders board members (Klein, 1998; Chen et al., 2008; Sarens et al., 2009), since its key functions are to review financial information and control management's conduct of affairs (Fama & Jensen, 1983). A growing body of literature suggests that audit committee is as a delegate body of the board of directors charged with safeguarding and advancing the interests of shareholders (Bedard et al., 2004; Klein, 2002). The board usually delegates responsibility for the oversight of financial reporting to the audit committee to enhance the breadth of relevance and reliability of the annual report. Therefore, the audit committee has been considered as a very important monitoring mechanism of corporate governance for oversight of the company's financial reporting process (Joshi & Wakil, 2004).

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## 2.2 Main Theories of Audit Committee

The authors viewed the corporate governance from different perspectives in addition to different theoretical frameworks. The Agency Theory, Stakeholder Theory, Stewardship Theory and Resource Dependence Theory are theories that have been recognized by the researchers in order to get insight and better understanding of Audit Committee issues. Therefore, for the purpose of this study, these theories are used as the theoretical framework in order to provide understanding of audit committee characteristics and firm performance (Nelson & Jamil, 2011).

### 2.2.1 Agency Theory

Agency Theory assumes that the interest of the principal and agent varies and that the principal can control or reduce this by giving incentives to the agent and incurring expenses from activities designed to monitor and limit the self-interest activities of the agent (Jensen & Meckling, 1976; Fama & Jensen, 1983; Hill & Jones, 1992). According to Bonazzi and Islam (2006), the principal will ensure that the agent acts in the interest of the principal by giving him the incentives and by monitoring his activities.

Among the measures established to reduce the self-serving nature of the agent is an independent audit committee. Therefore, in order to reduce information asymmetry, there is the need for governance mechanisms such as board subcommittees composed of directors with the appropriate attributes such as independence, expertise and experience to prevent or reduce the selfish interest of the agent (Wiseman *et al.*, 2012).

### 2.2.2 Stakeholder Theory

One of the criticisms of the Agency Theory includes the view that it provides with a short-term perspective and explanation of the purpose of a firm (Freeman, 1984). An alternative to an Agency Theory is known as a Stakeholder Theory and it is defined by, e.g., Fort and Schipani (2000), as ensuring the conditions of the responsibilities to the various stakeholders to create value and co-ordinate the management levels among various stakeholders including stockholders, employees, customers, creditors, suppliers, competitors, even the whole society. This theory proposes that the essence of corporate governance activities is not only to benefit the shareholders but also the other relevant stakeholders. However, Jensen (2001) has realized that proponents of the Stakeholder Theory have been unable to provide realistic solutions of the numerous conflicting interests of stakeholders that businesses need to protect. He therefore suggested a strand of

Stakeholder Theory which he referred to as the "enlightened Stakeholder Theory". He suggested that a business would not be able to maximize shareholders value if any stakeholder is ignored or mistreated.

Stakeholder Theory is very important in the context of the control mechanisms adopted by the companies, such as audit committees that we examine in our work.

### 2.2.3 Stewardship Theory

Stewardship Theory suggests that managers are concerned about the welfare of the owners and overall performance of the company, this contradicts Agency Theory which believes that agents are self-centered and individualistic (Donaldson & Davis, 1991). The theory suggests that managers will do everything in order to achieve the goals of shareholders (Boyd *et al.,* 2011). Based on assumptions of the Stewardship Theory, Ntim (2009) argued that firm performance will be enhanced if the executives have more powers and are trusted to run the firm. The theory suggests that having majority executive directors on a committee will increase effectiveness and produce superior result than majority independent directors on a committee (Al Mamun *et al.,* 2013). This could be because of the technical knowledge of the executive directors about the company and industry (Ntim, 2009). The Stewardship Theory assumes that the steward is able to unify the different interests of stakeholders and that he willingly acts in a way that will protect the interest and welfare of others (Hernandez, 2012) assuming that the actions of the steward are aimed to protect the long-term welfare of the principal.

Moreover, this theory assumes people are motivated to perform their work by the intrinsic reward they derive from their jobs. Thus, the nature of the reward is different from the Agency Theory where the focus of the reward to managers is extrinsic in nature. In the context of finance firms and based on the assumptions of the Stewardship Theory, inside directors will be able to contribute more in decisions of the board subcommittees due to their technical expertise, experience and knowledge about the company and the finance industry.

### 2.2.4 Resource Dependence Theory

The Resource Dependence Theory studies how the external resources of an organization affect its behavior and thus focuses on interdependence between organizations and their external environment. The theory originated in the 1970s with the publication of *The*

*External Control of Organizations: A Resource Dependence Perspective* by Jeffrey Pfeffer and Gerald R. Salancik. The board members provide resources and board composition relates directly to the ability of the board to bring the resources to the company. According to this theory, the audit committee serves as a source of advice and counsel for the board of directors with the goal to bring valued resources to the firms.

### 2.3 Characteristics of Audit Committees and Previous Studies

The key audit committee attributes according to the existing literatures which will be further examined relate to: (i) Audit Committee Independence, (ii) Audit Committee Competence; and (iii) Audit Committee Diligence.

#### 2.3.1 Audit Committee Independence

Director independence can be considered a precedent concept in the context of good corporate governance. Independent directors are considered to be better equipped to maintain the integrity of the external financial statements as they do not have personal or economic ties with executive management and are regarded as professional referees whose role is to oversee and monitor the company's executive management (Bradbury, 1990). Therefore, audit committees with independent directors can be regarded as better equipped to maintain the integrity of company financial statements (Klien, 2002; Vera-Munoz, 2005).

Deli and Gillan (2000) claimed that an audit committee serves as a reinforcing agent to the independence of internal as well as external auditor, audit committees are expected to be more effective in the oversight of financial reporting when they are independent. Xie et al., (2003) mentioned that the more independent audit committee is argued to provide better governance compared to less independent audit committee. In literature fewer financial misstatements are associated with more independent audit committees (Beasley, 1996; Abbott et al. 2000; Garcia-Meca & Sanchez-Ballesta 2009).

Several research studies have investigated the impact of having an audit committee on financial reporting quality. A common hypothesis is that independent audit committee directors would ensure better financial reporting and the expectation is generally supported by existing empirical evidence (Lin et al. 2006).

Most of the previous studies had focused on investigating the relationship between audit committee independence and its effectiveness. For example, Bedard et al., (2014) carried out a comprehensive review of the literature based on 83 analyses investigating the association between audit committee effectiveness and its independence. It is found that 47 (53%) had a positive relationship between audit committee independence and its effectiveness, while 35 (42%) showed no significant relationship. Similarly, Klein (2002) found that the proportion of independent members (nonexecutive) had a positive significant relationship with audit committee effectiveness. However, some studies did not find any significant relationship between audit committee independence and its effectiveness (Lin et al., 2006; Waweru and Riro, 2013). Other studies investigated the association between audit committee independence and the quality of financial reporting. For instance, Lary and Taylor (2012) conducted a study among Australian-listed companies and revealed a significant relationship between the independence of audit committee and its effectiveness. It indicates that the more independent the audit committee, the less incidence and severity of the financial restatement. Meanwhile in Bahrain, Desoky and Khasharmeh (2016) surveyed the listed companies' financial managers, internal auditors, accountants and other employees, and they found that financial reporting quality is positively associated with the audit committee's independence. The same result was found in Belgium by Valminck and Sarens (2015) who found a significant positive relationship between the financial statements' quality and audit committee independence. Additionally, Bruynseels and Cardinaels (2014) found that the existence of any social or professional association between audit committee members and the management negatively affects the quality of financial reporting.

Bhattrai (2017) suggested that there is positive relationship between independent director and financial performance which is the reason why Nepalese banks have maintained at least one independent director. Al-hadrami, Rafiki & Sarea(2020) also found that there is positive relationship between audit committee independence and investment decision making.

**2.3.2 Audit Committee Competence**

Knowledge in accounting and finance provides a good basis for audit committee members to examine and analyze financial information. The educational background becomes an important characteristic to ensure audit committees perform their roles effectively.

Moreover, audit committees that comprise at least one financial expert have greater interplay with their internal and external auditors (Raghunandan et al. 2001). Many studies argue that audit committees' members' knowledge/expertise or experience is directly associated with effective functioning of audit committees (Bedard et al., 2004; McDaniel et al., 2002; Beasley &Salterio, 2001 and DeZoort&Salterio, 2001).

DeZoort and Salterio (2001) argue that the audit committee's financial expertise increases the likelihood that detected material misstatements will be communicated to the audit committee and corrected in a timely fashion. Abbott et al. (2004) suggested that the financial expertise of the audit committee is related with a higher financial reporting quality. Choi et al., (2004) show that the presence of at least one member with financial expertise sitting on the audit committee is negatively related to the level of earnings management.

The interest in Audit Committee competence started since the BRC report was issued in 1999. The report recommends that audit committee members must own specific personal characteristics. Accordingly, the US Stock Exchange has requested that every audit committee member must possess the required financial knowledge and the audit committee must include at least one financial expert member. Later in 2002, Sarbanes–Oxley mandates the public firms to hire at least one financial expert member in their audit committee or to justify the reason for not following this requirement.

The existence of financial and industry experts in the audit committee is an indication of its effectiveness. This may increase the investors' trust in the financial reporting, which in turn may affect their investment decision positively (Cohen et al., 2016). Bedard et al., (2014) had conducted a review and found that many previous studies indicated a positive relationship between audit committee competence and its effectiveness. Defond et al. (2005) asserted that the market has a positive reaction toward firms that appoint accounting financial experts in their audit committee.

Moreover, other studies focused on the importance of audit committee competence to the quality of the internal audit function (Goodwin, 2003; Raghunandan et al., 2001; Goodwin and Yeo, 2001). A study by Goodwin (2003) in Australia and New Zealand companies revealed that audit committee members with financial literacy (accounting and finance) have an important influence on the relationship between audit committee and the function of internal audit.

DeZoort (1998) suggests that audit committees with members with financial and industry sophistication follow cognitive heuristics similar to the external auditors in decision making, and that industry sophistication positively impacts audit committee oversight judgments. DeZoort and Salterio (2001) find that members who have financial and industry sophistication are more likely to support the external auditor in external auditor-management conflict situations. Coates et al. (2007) finds that more expert audit committees attract superior stock market returns. Carcello et al. (2002) and Abbott et al.'s (2003b) findings suggest that audit committee members with financial and industry expertise are more likely to demand higher quality audits. The quality of audit service provided is deemed to be represented in the audit fee.

The financial competency of audit committee members is analyzed in several prior studies. Abbott et al. (2004), Aier et al. (2005) and Farber (2005) find that companies that experience restatements in their external financial statements, had audit committees with lower financial competency. Carcello and Neal (2003) verify that the financial literacy of an audit committee does indeed proxy for the effective monitoring over maintaining external auditor independence and vetting the integrity of the external annual financial statements. McDaniel et al. (2002) concluded that financial literacy (viewed as second-hand accounting knowledge) is primary in maintaining the integrity of the external financial statements, however financial expertise (viewed as first-hand accounting experience) cannot be justified. Recommendation 4.2 of ASX CGPRs states an "audit committee should include members who are all financially literate [. . .] able to read and understand financial statements" (ASX, 2010b). This recommendation is similar to the governance recommendations of the USA, the UK, and European Union (Collier & Zaman, 2005; Zaman et al., 2011), which highlights the extent to which audit committee governance characteristics are being globalized.

Turning to the concept of industry sophistication of audit committee members, there is little evidence of the effectiveness of this attribute in prior studies. Since industry sophistication is viewed as compensating for financial expertise. Further, evidence suggests that audit committees with financial and industry expertise are more likely to demand higher quality audits (Carcello et al., 2002; Abbott et al., 2003b). Therefore, in the area of financial competency, coupled with industry competency, it is expected that audit committees will be more effective in their monitoring roles.

Al-hadrami, Rafiki & Sarea (2020) also found that there is positive relationship between audit committee competence and investment decision making.

### 2.3.3 Audit Committee Diligence

Diligence is considered a process factor which is required for effective audit committee operations (DeZoort et al., 2002; Kalbers & Fogarty, 1993). Diligence refers to the desire of audit committee members to carry out their monitoring roles and:

[...] includes factors such as the number of board meetings and the behavior of individual [...] [which includes] preparation before meetings, attentiveness and participation [...] [and] post-meeting follow-up [...] [but] the factor that is publicly observable is the number of board meetings (Carcello et al., 2002).

The literature identifies board meeting frequency as an indirect signal for board diligence (Menon and Williams, 1994; Abbott et al., 2004; Conger et al., 1998; Carcello et al., 2002; Farber, 2005). Conger et al. (1998) suggest that an increase in board meetings may improve the effectiveness of the board. Abbott et al. (2004) and DeZoort et al. (2002) suggest that committee size may also proxy for audit committee diligence.

Bhattrai (2017) suggested that there is positive relationship between audit committee size and financial performance of the Nepalese banks. Higher the audit committee size leads to better financial performance of the banks.

## 2.4 Summary of Literature

Majority of the study found the association between Audit Committee Independence, Competence and Diligence with Firm Performance. Al-hadrami, Rafiki & Sarea (2020) found that the audit committee independence and audit committee competence have a positive and significant influence on investment decision-making.

Table 2.1

*Summary of Articles Reviewed*

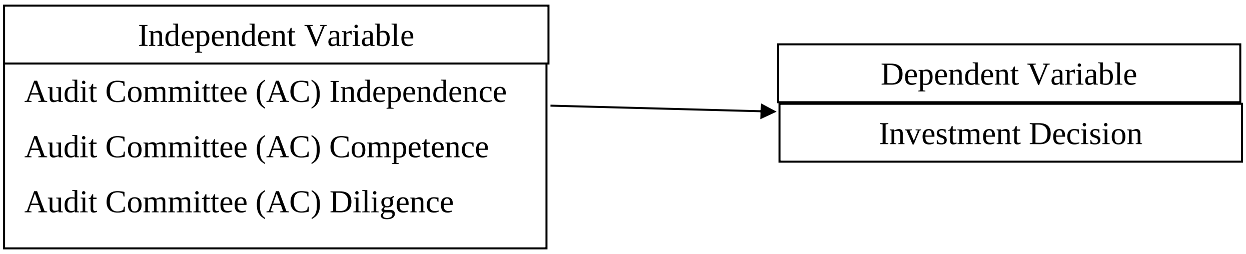
| Authors | Major Findings | Measure/ Variables used |
|---|---|---|
| (Al-hadrami, Rafiki & Sarea, 2020) | It is found that the audit committee independence and audit committee competence have a positive and significant influence on investment decision-making. | Audit Committee Independence, Competence and Investment Decision |
| Bhattrai (2017) | Findings suggest that audit committee size and portion of independent directors are positively correlated with return on equity. | Board size, Audit size, Independence of Directors and Return on Equity |
| (Zábojníková, 2016) | Findings suggest that there is a significant positive relationship between the audit committee size, frequency of its meetings and its financial experience and firm financial performance. On the contrary, the audit committee independence appeared to be negatively correlated with firm performance. | Audit Committee Independence, Size, Meeting Frequency, Financial Performance |
| Dey (2008) | Discovered a positive relationship between audit committee independence and firm performance | Audit Committee Independence, Firm Performance |
| Nuryanah and Islam (2011) | Positive relationship between audit committee independence and firm performance | Audit Committee Independence, Firm Performance |

| | | |
|---|---|---|
| Dar *et al.* (2011) | Discovered a negative relationship between audit committee independence and firm performance | Audit Committee Independence, Firm Performance |
| Hamid and Aziz (2012) | a positive relationship between audit committee expertise and firm performance | Audit Committee Expertise, Firm Performance |
| Abbott, Parker, and Peters, (2004) | The results indicate that there was a positive relationship between audit quality and the percentage of non-executive directors in the audit committee. | Board Size, Audit Committee Independence, Audit Committee Expertise, and Audit Committee Meetings and Audit Quality |
| Cohen, Hoitash, Krishnamoorthy, and Wright, (2014) | Results suggest that industry expertise, when combined with accounting expertise, can improve the effectiveness of the audit committee in monitoring the financial reporting process. | Audit Committee Accounting Expertise, Audit Committee Financial Expertise and Financial Reporting Quality. |

**2.5 Research Gap**

Al-Hadrami, Rafiki, and Sarea, (2020) in their study found that audit independence and audit competence have a positive and significant influence on investment decision-making. Bhattrai (2017) in his study found that board size negatively impacts financial performance of commercial banks in Nepal whereas audit committee size and portion of independent directors positively impact the financial performance of commercial banks in Nepal but the author has cited inclusion of only commercial banks in his study. This study aims to confirm the findings of the study in terms of impact of audit committee independence and competence on investment decision making, but in all the types of institutions listed in Nepal Stock Exchange using both quantitative and qualitative analysis. Further, this study aims to add audit committee diligence as an independent construct to investigate its impact on investment decision making. Criteria for effective investment decision and items for audit committee characteristics are based on past studies.

## 2.6 Theoretical Framework




(Source: Al-hadrami, Rafiki & Sarea, 2020 and Abbott, Parker & Peters, 2004)

*Figure 2.1* Theoretical Framework

## 2.7 Operational Definition of Variables

The variables under study are defined below:

- Audit Committee Independence: Audit committee independence means presence of non-related members in audit committee, existence of non-executive directors, absence of social connection between audit committee and management. Further, it means audit committee of the investee company is financially independent and that it has independent members (Al-hadrami, Rafiki & Sarea, 2020).
- Audit Committee Competence: Audit committee competence entails members with financial literacy, financial expertise, industry expertise and competence to improve the financial reporting quality and build internal control system (Al-hadrami, Rafiki & Sarea, 2020).
- Audit Committee Diligence: Audit committee diligence includes factors such as the number of board meetings and the behavior of individual, preparation before meetings, attentiveness and participation along with the size of audit committee (Abbott, Parker & Peters, 2004).
- Investment Decision Making: Investment decision should be consistent to continue the current investment in the future. It further entails recommendation of current investment to other investors upon being asked for advice (Al-hadrami, Rafiki & Sarea, 2020).

# CHAPTER III

# RESEARCH METHODS

This chapter is mainly concerned with the procedure that have been used to collect data and analyze the data for achieving the objectives of this study. Basically, it deals with the study design, population, sample size consideration, instruments used to collect data, source and methods of data collection and details about data analysis tools and techniques.

## 3.1 Research design

In order to execute the study, mixed method approach has been adopted. The study attempted to test hypothesis regarding the impact of audit committee independence, competence and diligence on investment decision making. This study has adopted a descriptive research designto evaluate the effect of audit committee independence, competence and diligence on investment decision making. The data on audit committee factors have been collected from 70 respondents working as accountant, auditor, Chief Finance Officer or Chief Executive Officer in listed company of Nepal.

## 3.2 Population and Sample

The number of total populations is 197, listed companies on NEPSE as of June 3, 2021. The entire population is the sample of this study. Telephone and face-to-face interview were used as a better feasible option for data collection. Purposive sampling has been used as a sampling method where all the population, listed companies of Nepal, has been included as sample.

## 3.3 Nature and Sources of Data

The study is based on the primary research. Mixed method has been used to examine the impact of audit committee independence, competence and diligence on investment decision making. The data has been collected through both close-ended and open-ended questionnaire. Out of total population contacted, 70 responses were received on quantitative questionnaire. The same 70 respondents were further contacted for qualitative responses, out of which 31 respondents responded. Qualitative responses were transcribed by the researcher during and after the interview.

## 3.4 Instrumentation

The questionnaire that has been used in this study is developed by Al-Hadrami, Rafiki, and Sarea, (2020). Some modification has been made in the questionnaire to make it relevant in context of Nepal. One independent variable has been added to the questionnaire, namely AC Diligence as questionnaire developed by Abbott, Parker, and Peters, (2004). The questionnaire has been divided into three sections. First section of the questionnaire contained demographic factors. And, second part contained sixteen close-ended Likert scale questions related to the independent variables. Third part contained open-ended questions on research domain subject to respondents' perception. All the sixteen questions were given score ranging from 1-5.

## 3.5 Data Analysis Technique

In the process of data analysis, first of all, the normality of the data has been analyzed, that is if the collected data are normal or not by Shapiro-Wilk Test and Histogram. Since, the data were not normal, PLS-SEM was adopted for data analysis. After the test of normality, descriptive analysis has been used to present the data of the respondents of each item and demographic variables.

Secondly, since the data are not normally distributed, Measurement Model Analysis has been conducted with SMART PLS to analyze the convergent validity and discriminant validity. For the convergent validity, Composite Reliability with a minimum threshold of 0.70 and AVE with the minimum threshold of 0.50 have been set (Henseler, et al., 2014). Whereas, in the case of discriminant validity Fornell Larcker criterion has been used where the square root of each construct's AVE must be higher than its correlation with another construct, and each item loads highest on its associated construct. Similarly, Heterotrait-Monotrait Ratio has been used where the value must be less than 0.90. And in the case of Cross-Loading criteria, the value of cross-loading of each construct should be less than 0.7. (Henseler, et al., 2014; Hwang et al, 2010).

Thirdly, Correlation analysis has been used to understand the degree of the relation of audit committee independence, competence and diligence on investment decision making and path analysis has been conducted to test the impact of audit committee independence, competence and diligence on investment decision making.

Lastly, qualitative analysis has been made from the information gathered from interview using thematic approach.

### 3.6 Ethical Considerations

Ethical issues are critical concerns in research. The research study should respect the nonnegotiable value of honesty and fairness. Ethics refers to doing right and avoiding wrong in research. Ethics and norms are maintained while conducting the survey as well as during the writing of the report.

As per the standard set by the university, the rules and regulations have been followed and no unethical activities have been performed throughout the survey as well as report writing. The application of appropriate ethical principles can prevent from the creation of harm. To collect data and selection criteria of research strategies also have some ethical implications. The current study is subject to certain ethical standards and has substantial ethical considerations. Responses were involved with the acceptance of participants. The respondents were completely made aware of the objectives of the research project for academic purposes and only for the purposes of this particular research. They were also reassured that their responses will be treated as confidential. The respondents made assured of their participation in the research is voluntary and are free to withdraw anytime due to any causes. In spite of that, if there was a denial of respondents to participate in the survey due to any reason, it was also respected.

During the conduction of the research, expect from the above participants were not harmed or abused either physically or psychologically. In contrast, the researcher attempted to create and maintain a flexible, comfortable, and cooperative environment. Respondents were given assurance on providing the confidentiality of their data provided to the researcher and were told that no information would be leaked to any third party. They were also assured that the data provided by them will only be used for academic purposes.

# CHAPTER IV

# ANALYSIS AND RESULTS

This chapter deals with presentation and analysis of primary data collected through survey and interview. The measurement model has been tested using Smart PLS and hypotheses that were formulated in the initial phase for this research study were tested and analyzed using Smart PLS 3. Therefore, this chapter aims to fulfill the objectives set at the beginning of the study.

## 4.1 Demographic Profile of Respondents

Table 4.1

*Demographic Profile of Respondents from Quantitative Responses*

| Demographic Variables | | Frequency | Percent |
|---|---|---|---|
| Gender | Male | 62 | 88.6 |
| | Female | 8 | 11.4 |
| Occupation level | Accountant | 26 | 37.1 |
| | Auditor | 26 | 37.1 |
| | CFO | 17 | 24.3 |
| | CEO | 1 | 1.4 |
| Education | Bachelor | 34 | 48.6 |
| | Master | 36 | 51.4 |
| Experience | Less than 10 | 28 | 40.0 |
| | 10 to 15 | 29 | 41.4 |
| | 16 to 20 | 10 | 14.3 |
| | More than 20 | 3 | 4.3 |
| | Total | 70 | 100.0 |

Table 4.1 exhibits the demographic profile of the respondents from quantitative responses who took part in this survey. Respondents have been divided into four main categories. They are Gender, Occupational Level, Education and Experience. Out of 70 respondents, 88.6percent are male and 11.4 percent are female. It can be observed that there are clearly a greater number of male respondents than female respondents.

Similarly, 37.1 percent are accountant, 37.1 percent are auditors, 24.3 percent are CFO and 1.4 percent are CEO. The table makes it clear that there are more respondents who are accountants and auditors.

Similarly, 48.6 percent of respondents have educational qualifications up to Bachelor and51.4 percent have qualifications up to master's degree. This means that majority of the respondents have educational qualification of master's degree.

With regard to experience, 40 percent of the total respondents have an experience of less 10 years, 41.4 percent have experience from 10 to 15 years, 14.3 percent have experience of 16 to 20 years and 4.3 percent have experience of more than 20 years.

Table 4.2

*Demographic Profile of Respondents from Qualitative Responses*

| Demographic Variables | | Frequency | Percent |
|---|---|---|---|
| Gender | Male | 27 | 87.1 |
| | Female | 4 | 12.9 |
| Occupation level | Accountant | 18 | 58.1 |
| | Auditor | 10 | 32.3 |
| | CFO | 3 | 9.6 |
| Education | Bachelor | 18 | 58.1 |
| | Master | 13 | 41.9 |
| Experience | Less than 10 | 16 | 51.6 |
| | 10 to 15 | 12 | 38.7 |
| | 16 to 20 | 3 | 9.7 |
| | Total | 31 | 100.0 |

Table 4.2 exhibits the demographic profile of the respondents from qualitative responses who took part in this survey. Respondents have been divided into four main categories. They are Gender, Occupational Level, Education and Experience. Out of 31 respondents, 87.1 percent are male and 12.9 percent are female. It can be observed that there are clearly a greater number of male respondents than female respondents.

Similarly, 58.1 percent are accountant, 32.3 percent are auditors, and 9.6 percent are CFO. The table makes it clear that there are more respondents who are accountants and auditors.

Similarly, 58.1 percent of respondents have educational qualifications up to Bachelor and 41.9 percent have qualifications up Master's degree. This means that majority of the respondents have educational qualification of bachelor's degree.

With regard to experience, 51.6 percent of the total respondents have an experience of less 10 years, 38.7 percent have experience from 10 to 15 years, and 9.7 percent have experience of 16 to 20 years.

### 4.2 Descriptive Statistics

Table 4.3

*Descriptive Statistics of Audit Committee Independence*

| | | Statistic | Std. Error |
|---|---|---|---|
| Audit Committee Independence | Mean | 4.1286 | .06303 |
| | Median | 4.0714 | |
| | Variance | .278 | |
| | Std. Deviation | .52736 | |
| | Minimum | 2.57 | |
| | Maximum | 5.00 | |
| | Range | 2.43 | |
| | Interquartile Range | .57 | |
| | Skewness | -.308 | .287 |
| | Kurtosis | .181 | .566 |

Table 4.3 exhibits the descriptive statistics of audit committee independence. The mean is 4.1286 which suggests that average respondents agree with the statement that measured audit committee independence whereas the median is 4.0714 with the standard deviation of 0.5274 which means that some of the respondents have slightly disagreed and some have agreed with the statements that measured audit committee independence.

The skewness is -0.308 which means that the data are negatively skewed or skewed left. Similarly, the value of kurtosis is 0.181 which is less than 3 which means that it is platykurtic. This gives the indication that the data set has lighter tails than a normal distribution.

Table 4.4

*Descriptive Statistics of Audit Committee Competence*

| | | Statistic | Std. error |
|---|---|---|---|
| | Mean | 4.3500 | .05898 |
| | Median | 4.5000 | |
| | Variance | .243 | |
| | Std. Deviation | .49344 | |
| | Minimum | 3.00 | |
| Audit Committee Competence | Maximum | 5.00 | |
| | Range | 2.00 | |
| | Interquartile Range | .75 | |
| | Skewness | -.429 | .287 |
| | Kurtosis | -.383 | .566 |

Table 4.4 exhibits the descriptive statistics of audit committee competence. The mean is 4.35 which suggests that average respondents agree with the statement that measured audit committee competence whereas the median is 4.5 with the standard deviation of 0.4934 which means that some of the respondents have slightly disagreed and some have agreed with the statements that measured audit committee competence.

The skewness is -0.429 which means that the data are negatively skewed or skewed left. Similarly, the value of kurtosis is -0.383 which is less than 3 which means that it is platykurtic. This gives the indication that the data set has lighter tails than a normal distribution.

Table 4.5

*Descriptive Statistics of Audit Committee Diligence*

| | | Statistic | Std. error |
|---|---|---|---|
| Audit Committee Diligence | Mean | 4.2857 | .07984 |
| | Median | 4.5000 | |
| | Variance | .446 | |
| | Std. Deviation | .66796 | |
| | Minimum | 2.00 | |
| | Maximum | 5.00 | |
| | Range | 3.00 | |
| | Interquartile Range | 1.00 | |
| | Skewness | -.890 | .287 |
| | Kurtosis | .768 | .566 |

Table 4.5 exhibits the descriptive statistics of audit committee diligence. The mean is 4.2857which suggests that average respondents agree with the statement that measured audit committee diligence whereas the median is 4.5 with the standard deviation of 0.668 which means that some of the respondents have slightly disagreed and some have agreed with the statements that measured audit committee diligence.

The skewness is -0.890 which means that the data are negatively skewed or skewed left. Similarly, the value of kurtosis is 0.768 which is less than 3 which means that it is platykurtic. This gives the indication that the data set has lighter tails than a normal distribution.

Table 4.6

*Descriptive statistics of Investment Decision Making*

| | | Statistic | Std. error |
|---|---|---|---|
| Investment Decision Making | Mean | 4.1762 | .07422 |
| | Median | 4.3333 | |
| | Variance | .386 | |
| | Std. Deviation | .62095 | |
| | Minimum | 3.00 | |
| | Maximum | 5.00 | |

| | | |
|---|---|---|
| Range | 2.00 | |
| Interquartile Range | .75 | |
| Skewness | -.372 | .287 |
| Kurtosis | -.803 | .566 |

Table 4.6 exhibits the descriptive statistics of Investment Decision Making. The mean is 4.1762 which suggests that average respondents agree with the statement that measured investment decision making whereas the median is 4.3333 with the standard deviation of 0.621 which means that some of the respondents have slightly disagreed and some have agreed with the statements that measured investment decision making.

The skewness is -0.372 which means that the data are negatively skewed or skewed left. Similarly, the value of kurtosis is -0.803 which is less than 3 which means that it is platykurtic. This gives the indication that the data set has lighter tails than a normal distribution.

Table 4.7

*Descriptive statistics of Audit Committee Independence's Items*

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| It is important to our investment decision that the Audit Committee of the investee's company has non related members | 70 | 3 | 5 | 4.114 | 0.6265 |
| Our investment decision is affected positively by the existence of non-executive directors in the audit committee of the investee company | 70 | 2 | 5 | 3.871 | 0.8151 |
| Our investment decision is affected positively by the absence of the social connection | 70 | 2 | 5 | 3.771 | 0.7257 |

| | | | | | |
|---|---|---|---|---|---|
| between the audit committee members and the management | | | | | |
| Our investment decision is affected positively by the absence of the professional connection between the audit committee members and the management | 70 | 2 | 5 | 4.157 | 0.7919 |
| It is important to our investment decision that the audit committee of the investee company is financially independent | 70 | 3 | 5 | 4.4 | 0.6895 |
| It is important to our investment decision that audit committee members do not have any financial interest in the investee company | 70 | 2 | 5 | 4.329 | 0.7167 |
| It is important to our investment decision that the audit committee of the investee company includes only independent members | 70 | 2 | 5 | 4.257 | 0.8109 |

Table 4.7 shows that the overall average of the investors' responses regarding the importance of audit committee independence to their investment decision is 4.1286 out of 5. In addition, the average range of responses regarding the seven elements of this variable is between 3.7 and 4.4. The surveyed investors indicated that the most important item of the audit committee independence that affects their investment decision is the financial independence of the audit committee with an average of 4.4 out of 5, followed by the lack of financial interest of audit committee in investee's company and inclusion of independent committee of that the independence of audit committee is viewed as an important factor that affects the investment decision made by investors.

Table 4.8

*Descriptive statistics of Audit Committee Competence's Items*

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| It is important to our investment decision that the audit committee of the investee's company includes members with financial literacy (for example accounting and finance) | 70 | 3 | 5 | 4.4 | 0.6232 |
| It is important to our investment decision that the audit committee of the investee's company includes members with financial expertise | 70 | 3 | 5 | 4.329 | 0.6751 |
| It is important to our investment decision that the audit committee of the investee's company includes industry expertise that improves the quality of the financial reporting | 70 | 3 | 5 | 4.386 | 0.6437 |
| It is important to our investment decision that the audit committee of the investee's company has the required competency to improve the internal control quality | 70 | 3 | 5 | 4.529 | 0.6307 |

Table 4.8 exhibits the overall average of the investors' responses regarding the importance of audit committee competence to their investment's decision is 4.35. In addition, the average range of responses regarding the four elements of this variable is between 4.3 and 4.5. The investors surveyed indicated that the most important item of the audit committee competence that affects their investment decision is competency of investee company audit committee to improve the internal control quality, followed by the financial literacy and industry expertise that improves quality of reporting. This indicates that audit committee competence is viewed as an important factor that affects the investment decisions made by

investors. Audit committee that includes more qualified members is seen by investors as a highly effective committee unlike audit committee with less or no competence.

Table 4.9

*Descriptive statistics of Audit Committee Diligence's Items*

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| It is important that Audit Committee has at least 3 members | 70 | 2 | 5 | 4.208 | 0.734 |
| It is important that Audit Committee conducts meeting at least 4 times a year | 70 | 2 | 5 | 4.371 | 0.765 |

Table 4.9 shows that the overall average of the investors' responses regarding the importance of AC diligence to their investment's decision is 4.3. In addition, the average range of responses regarding the two elements of this variable is between 4.208 and 4.37. The investors survey indicated that both audit committee meeting of at least 4 times in a year with audit committee size consisting at least 3 members are almost equally deemed important.

Table 4.10

*Descriptive statistics of Investment Decision's Items*

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| I shall continue considering the current investment in the next few years | 70 | 3 | 5 | 4.13 | 0.779 |
| The current investment of my company is considered attractive | 70 | 3 | 5 | 4.20 | 0.672 |
| I would recommend the current investment for other investors if they ask for my advice | 70 | 3 | 5 | 4.20 | 0.734 |

Table 4.10shows that the overall average of the investors' responses regarding the investment decision is 4.18. All three items under this variable have consistent mean

showing almost equal importance to continuing the current investment in the next few years, investment attractiveness, and recommendation on current investment.

Table 4.11

*Audit committee independence: Comparison between and non-BFI*

| | | | Mean of independence | | | |
|---|---|---|---|---|---|---|
| | | | Neutral (3) | Agree (4) | Strongly agree (5) | Total |
| BFI | Non-Financial Institution | Count | 0 | 12 | 9 | 21 |
| | | % Within BFI | 0.0% | 57.1% | 42.9% | 100.0% |
| | Bank and Financial Institution | Count | 3 | 20 | 26 | 49 |
| | | % Within BFI | 6.1% | 40.8% | 53.1% | 100.0% |
| Total | | Count | 3 | 32 | 35 | 70 |
| | | % Within BFI | 4.3% | 45.7% | 50.0% | 100.0% |

Table 4.11 shows the cross tabulation between mean independence and bank and financial institution. From the table, it is evident that 57.1% of the respondents from non-financial institution show agreement towards audit committee independence with 42.9% strong agreement towards it. However, there are some (6.1%) respondents from bank and financial institution who are neutral towards audit committee independence, with 40.8% towards agreement and 53.1% towards strong agreement.

Table 4.12

*Audit committee competence: Comparison between and non-BFI*

| | | | Mean competence | | | |
|---|---|---|---|---|---|---|
| | | | Neutral (3) | Agree (4) | Strongly agree (5) | Total |
| BFI | Non-Financial Institution | Count | 0 | 8 | 13 | 21 |
| | | % Within BFI | 0.0% | 38.1% | 61.9% | 100.0% |
| | Bank and Financial Institution | Count | 1 | 16 | 32 | 49 |
| | | % Within BFI | 2.0% | 32.7% | 65.3% | 100.0% |
| Total | | Count | 1 | 24 | 45 | 70 |
| | | % Within BFI | 1.4% | 34.3% | 64.3% | 100.0% |

Table 4.12 shows the cross tabulation between mean competence and bank and financial institution. From the table, it is evident that 38.1% of the respondents from non-financial institution show agreeableness towards audit committee competence with 61.9% strong agreement towards it. However, there are very few respondents from bank and financial institution who are neutral towards audit committee competence, with 65.3% towards strong agreeableness.

Table 4.13

*Audit committee diligence: Comparison between and non-BFI*

| | | | Mean diligence | | | | |
|---|---|---|---|---|---|---|---|
| | | | Disagree (2) | Neutral (3) | Agree (4) | Strongly agree (5) | Total |
| BFI | Non-FI | Count | 0 | 1 | 10 | 10 | 21 |
| | | % Within BFI | 0.0% | 4.8% | 47.6% | 47.6% | 100.0% |
| | BFI | Count | 1 | 6 | 14 | 28 | 49 |
| | | % Within BFI | 2.0% | 12.2% | 28.6% | 57.1% | 100.0% |
| Total | | Count | 1 | 7 | 24 | 38 | 70 |

| | | | | | | |
|---|---|---|---|---|---|---|
| | % Within BFI | 1.4% | 10.0% | 34.3% | 54.3% | 100.0 % |

Table 4.13 shows the cross tabulation between mean diligence and bank and financial institution. From the table, it is evident that some (4.8%) of the respondents from non-financial institution are neutral towards audit committee diligence with equal respective percent (47.6) of agreement and strong agreement towards it. However, 2% and 12.2% respondents from bank and financial institution disagree and are neutral respectively towards audit committee diligence, with 28.6% towards agreement and 57.1%.

### 4.3 Normality Test

Table 4.14

*Shapiro-Wilk Test*

| | Shapiro-Wilk | | |
|---|---|---|---|
| | Statistic | Df | Sig. |
| Independence | .968 | 70 | .070 |
| Competence | .928 | 70 | .001 |
| Diligence | .870 | 70 | .000 |
| Investment Decision Making | .917 | 70 | .000 |

Table 4.14 exhibits Shapiro-Wilk test. The results of the analysis show that the test for audit committee independence is insignificant which means that data set for this variable is normally distributed as p value of 0.70 is greater than 0.05 significance level. On the contrary, audit committee competence, diligence and investment decision making are significant having p-values lower than 0.05, meaning that their respective data sets are not normally distributed.

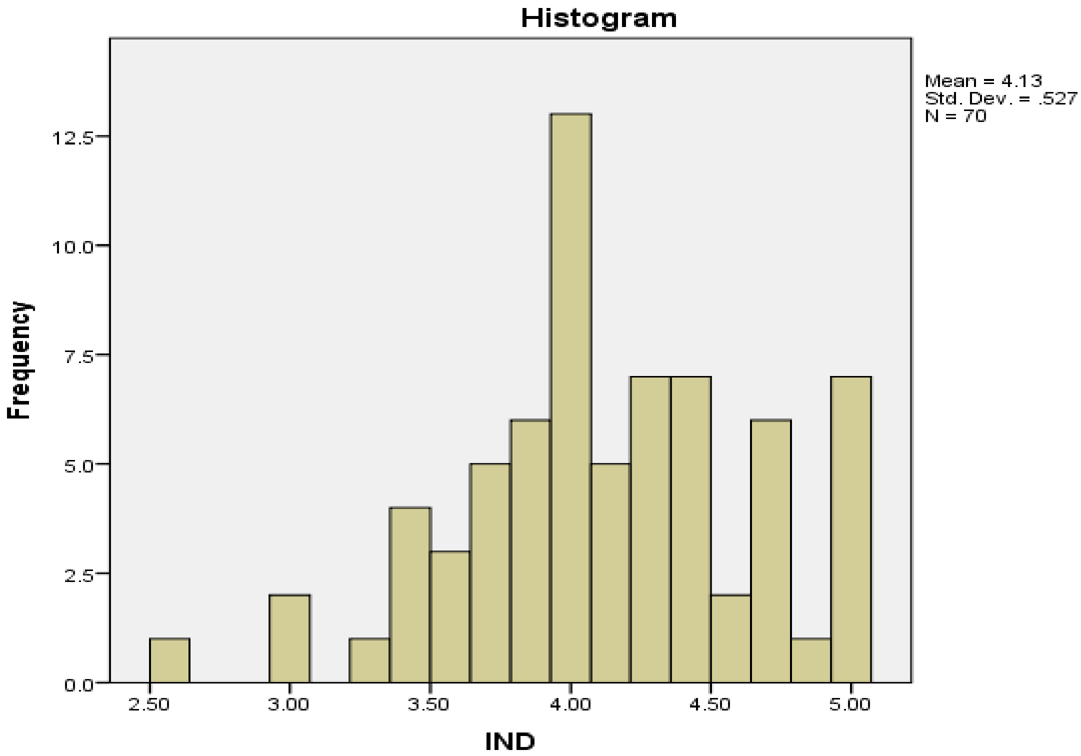



*Figure 4.1.* Histogram of Audit Committee Independence

From figure 4.1, it can also be seen that data of this survey for audit committee independence is fairly normally distributed.

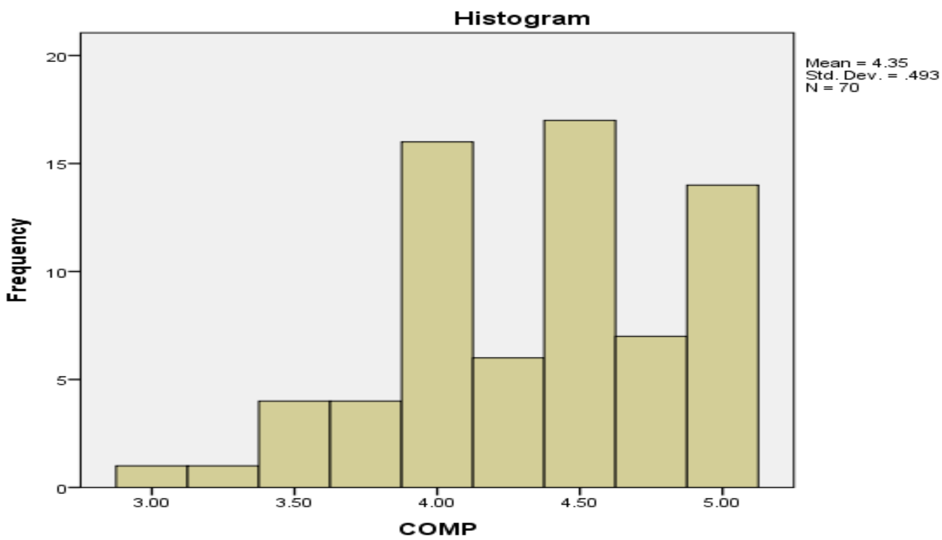



*Figure 4.2.* Histogram of Audit Committee Competence

From figure 4.2, it can also be seen that data of this survey for audit committee competence is left skewed and thus, not normally distributed.

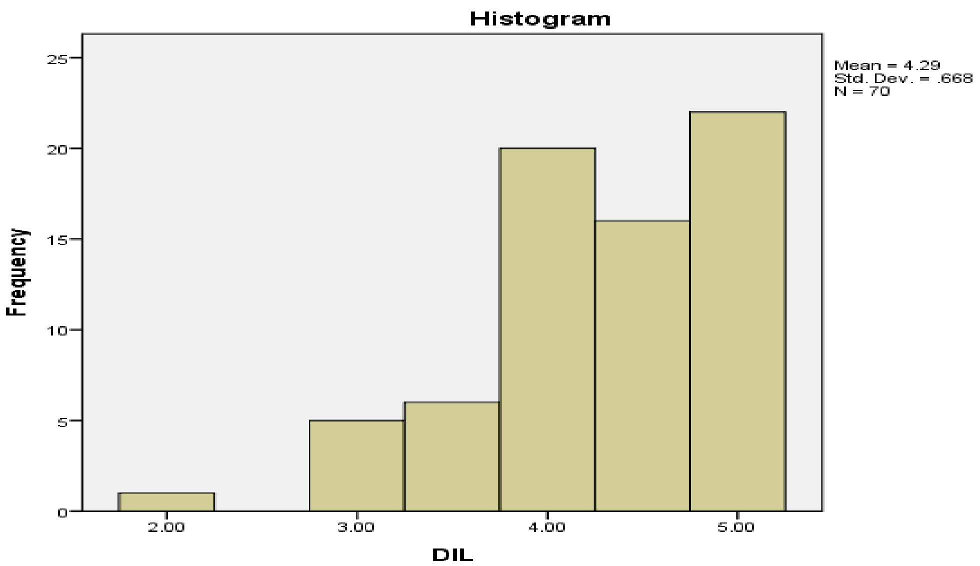



*Figure 4.3.* Histogram of Audit Committee Diligence

From figure 4.3, it can also be seen that data of this survey for audit committee diligence is left skewed and thus, not normally distributed.

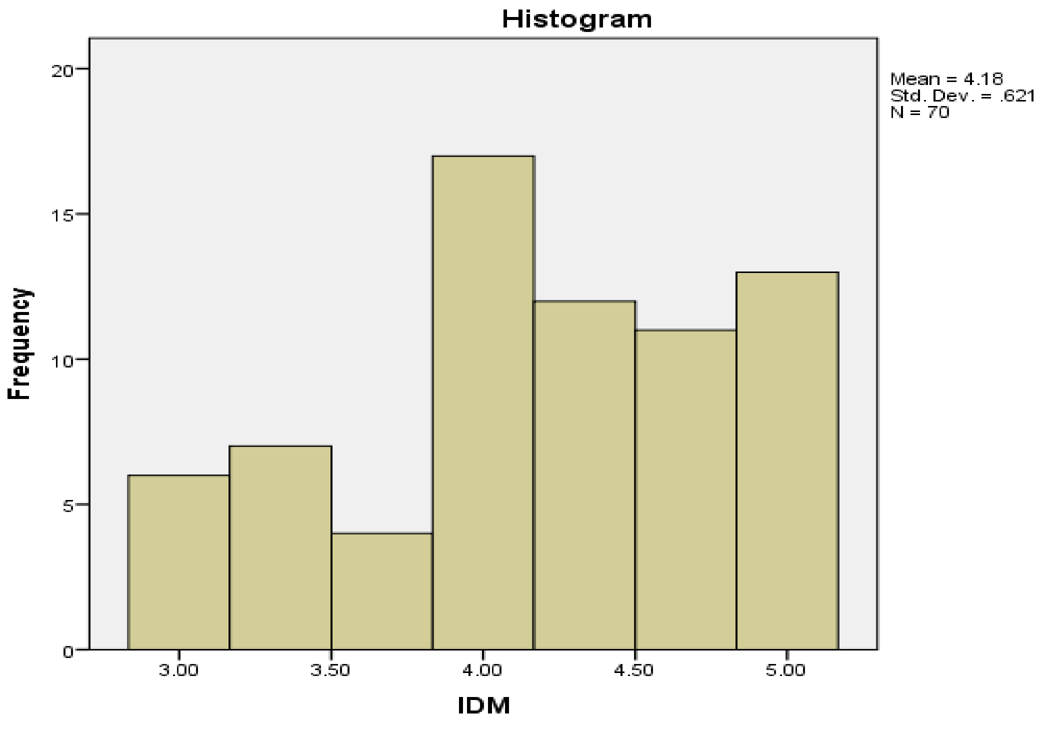



*Figure 4.4.* Histogram of Investment Decision Making

From figure 4.4, it can also be seen that data of this survey for investment decision making is left skewed and thus, not normally distributed.

### 4.4 Measurement Model

The measurement model is the part of the model that examines the relationship between the latent variables and their measures. In other words, measurement models refer to the implicit or explicit models that relate the latent variable to its indicators.

#### 4.4.1 Construct Reliability and Validity

Table 4.15

*Construct Reliability and Validity*

| Items | Loadings | Latent Variable | rho_A | Composite Reliability | AVE |
|---|---|---|---|---|---|
| Ind1 | 0.664 | Audit Committee Independence | 0.86 | 0.877 | 0.507 |
| Ind2 | 0.481 | | | | |
| Ind3 | 0.565 | | | | |
| Ind4 | 0.322 | | | | |
| Ind5 | 0.426 | | | | |
| Ind6 | 0.365 | | | | |
| Ind7 | 0.437 | | | | |
| Com1 | 0.502 | Audit Committee Competence | 0.763 | 0.818 | 0.538 |
| Com2 | 0.596 | | | | |
| Com3 | 0.467 | | | | |
| Com4 | 0.39 | | | | |
| Dil1 | 0.327 | Audit Committee Diligence | 0.963 | 0.876 | 0.78 |
| Dil2 | 0.568 | | | | |
| IDM1 | 0.366 | Investment Decision Making | 0.847 | 0.888 | 0.727 |
| IDM2 | 0.393 | | | | |
| IDM3 | 0.553 | | | | |

Table 4.15 exhibits the construct reliability and validity. The value of rho_A is verified as the value of all the latent variables is above 0.7 (Dijkstra, T.K., & Henseler, J, 2015). Moreover, the value of Composite Reliability which currently has been the new way to measure the reliability is also above the threshold value of 0.7 (Henseler, J., Ringle, C.M., & Sarstedt, M, 2015). Using the same criteria as that used with the individual indicators, and AVE value of 50% or higher means that, on average, a construct accounts for more than half of the variance of its own indicators which has been successfully met, a cutoff point suggested by Fornell and Larcker (1981).

Hence, convergent validity has been proved with the help of factor loadings, rho_A Composite Reliability (CR) and Average Variance Extracted (AVE).

### 4.4.2 Discriminant Validity

Table 4.16

*Fornell-Larcker Criterion*

| Latent Variable | Ind | Com | Dil | IDM |
|---|---|---|---|---|
| Ind | **0.712** | | | |
| Com | 0.673 | **0.733** | | |
| Dil | 0.484 | 0.538 | **0.883** | |
| IDM | 0.682 | 0.568 | 0.523 | **0.853** |

Table 4.16 exhibits Fornell-Larcker Criterion which shows the correlation between the constructs. The square roots of the AVE are located on the diagonal of this table. A construct should share more variance with its measures or indicators than with other constructs in a given model. Thus, the square root of the AVE (in bold) is greater than the correlation between that construct and the rest of the constructs in the model (Fornell&Larcker, 1981; Henseler et al., 2014; Hair, Hult, Ringle, & Sarstedt, 2014).

Table 4.17

*Cross Loadings*

| | Independence | Competence | Diligence | Investment Decision |
|---|---|---|---|---|
| Com1 | 0.502 | **0.832** | 0.412 | 0.455 |
| Com2 | 0.596 | **0.857** | 0.452 | 0.532 |
| Com3 | 0.467 | **0.663** | 0.452 | 0.339 |
| Com4 | 0.39 | **0.532** | 0.248 | 0.29 |
| Dil1 | 0.298 | 0.327 | **0.809** | 0.296 |
| Dil2 | 0.51 | 0.568 | **0.951** | 0.564 |
| IDM1 | 0.486 | 0.386 | 0.366 | **0.789** |
| IDM2 | 0.593 | 0.439 | 0.393 | **0.836** |
| IDM3 | 0.649 | 0.598 | 0.553 | **0.927** |
| Ind1 | **0.754** | 0.493 | 0.339 | 0.664 |

| | | | | |
|---|---|---|---|---|
| Ind2 | **0.713** | 0.37 | 0.298 | 0.481 |
| Ind3 | **0.781** | 0.483 | 0.319 | 0.565 |
| Ind4 | **0.583** | 0.366 | 0.22 | 0.322 |
| Ind5 | **0.686** | 0.476 | 0.334 | 0.426 |
| Ind6 | **0.705** | 0.541 | 0.457 | 0.365 |
| Ind7 | **0.746** | 0.65 | 0.477 | 0.437 |

Table 4.17 exhibits the cross-loadings of the items with the constructs of each other. In table 9 it can be seen that there is no issue of cross-loading. All the cross loadings of each item under a given construct (primary loadings) have a minimum difference of 0.1 with the cross loadings of other items of different construct (secondary loadings). This means that all the items properly measure what they are expected to.

Table 4.18

*Heterotrait-Monotrait Ratio (HTMT)*

| | Independence | Competence | Diligence | Investment Decision |
|---|---|---|---|---|
| Independence | | | | |
| Competence | 0.887 | | | |
| Diligence | 0.586 | 0.698 | | |
| Investment Decision | 0.785 | 0.724 | 0.611 | |

Henseler, Ringle, and Sarstedt (2015) developed simulation studies to demonstrate that a lack of discriminant validity is best detected by another technique called the Heterotrait-Monotrait (HTMT) ratio, developed by them. The results obtained are listed in Table 4.18, which enables verifying that all the HTMT ratios for each pair of factors are less than 0.90. Hence, discriminant validity has been proved with the help of the value of Fornell-Larcker, Cross Loadings, and Heterotrait-Monotrait Ratio.

### 4.4.3 Collinearity Test

Table 4.19

*Collinearity Statistics*

| | VIF |
|---|---|
| Com1 | 1.887 |
| Com2 | 1.767 |
| Com3 | 1.604 |
| Com4 | 1.342 |
| Dil1 | 1.53 |
| Dil2 | 1.53 |
| IDM1 | 1.69 |
| IDM2 | 1.866 |
| IDM3 | 2.518 |
| Ind1 | 1.707 |
| Ind2 | 1.899 |
| Ind3 | 2.022 |
| Ind4 | 1.332 |
| Ind5 | 1.869 |
| Ind6 | 2.191 |
| Ind7 | 2.204 |

Table 4.19 exhibits the multi-collinearity. Since the Variance Inflation Factor (VIF) of each item is below 3, it means that there is no issue of multi-collinearity.

### 4.4.4 Model Fit Indices

To determine the goodness of fit of the current model, Standardized Root Mean Square Residual (SRMR) introduced by Henseler, et al. (2014) has been used. SRMR is the difference between observed correlation and the correlation matrix implied by the model which allows to access discrepancies between observed and expected correlations.

Table 4.20

*SRMR Index*

| | Original Sample (O) | Sample Mean (M) | 95% |
|---|---|---|---|
| Saturated Model | 0.10 | 0.079 | 0.095 |
| Estimated Model | 0.10 | 0.079 | 0.094 |

In a conservative status, Hu & Bentler (1999) considered a value less than 0.10 to show a good fit of model. Table 4.20 shows that value of SRMR is exactly equal to 0.10 which shows the model is fairly good for the study.

### 4.5 Correlation matrix

Table 4.21

*Correlation Matrix*

| | Independence | Competence | Diligence | Investment Decision Making |
|---|---|---|---|---|
| Independence | 1 | | | |
| Competence | .680** | 1 | | |
| Diligence | .464** | .500** | 1 | |
| Investment Decision Making | .638** | .541** | .477** | 1 |
| N | 70 | 70 | 70 | 70 |

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

Table 4.21 exhibits the degree of correlation and significance level of audit committee independence, competence, diligence on investment decision making.

#### 4.5.1 Correlation between Audit Committee Independence and Investment decision making

There exists a high degree of correlation (r=0.638) between audit committee independence and investment decision making. The p-value of audit committee independence is less than 0.01 level of significance which means that there is also a significant relationship between audit committee independence and investment decision making. It means when the degree or level of audit committee independence increases, investment decision making will also increase.

### 4.5.2 Correlation between Audit Committee Competence and Investment decision making

There exists a moderate degree of correlation (r=0.541) between audit committee competence and investment decision making. The p-value of audit committee competence is less than 0.01 level of significance which means that there is also a significant relationship between audit committee competence and investment decision making. It means when the degree or level of audit committee competence increases, investment decision making will also increase.

### 4.5.3 Correlation between Audit Committee Diligence and Investment decision making

There exists a moderate degree of correlation (r=0.477) between audit committee diligence and investment decision making. The p-value of audit committee diligence is less than 0.01 level of significance which means that there is also a significant relationship between audit committee diligence and investment decision making. It means when the degree or level of audit committee diligence increases, investment decision making will also increase.

## 4.6 SEM-Path Analysis

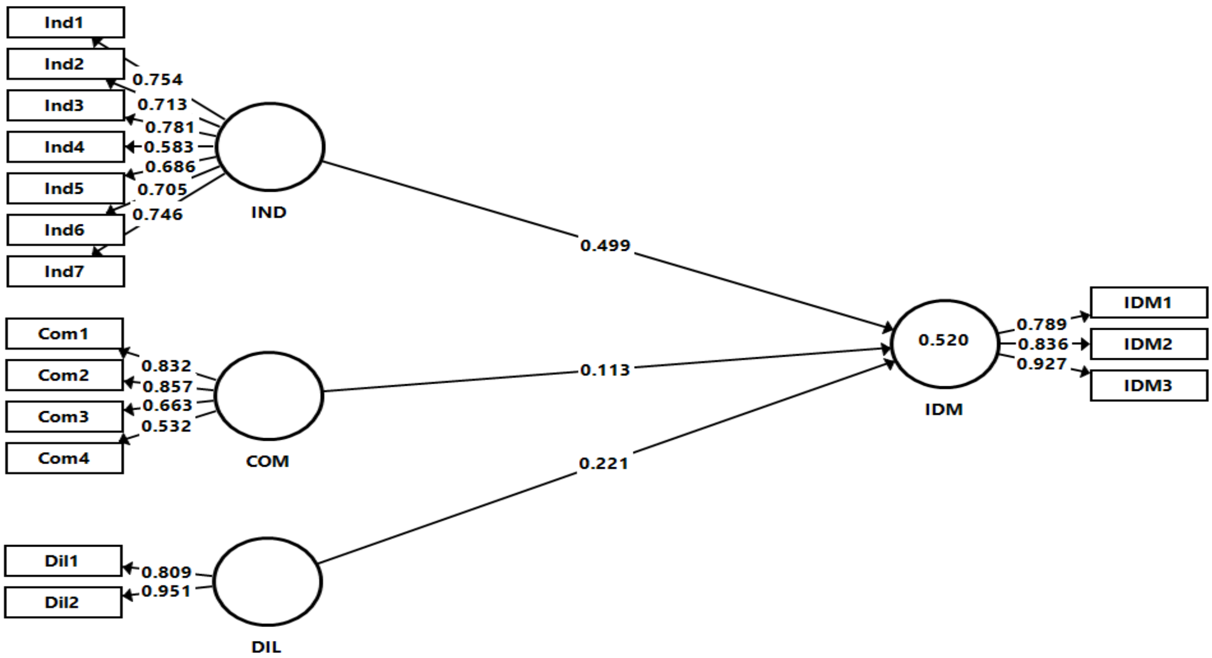



*Figure 4.5.* PLS Model of Study

Figure 4.5 shows the regression coefficients between independent variables, i.e., IND (audit committee independence), COM, (audit committee competence), DIL (audit committee diligence) and the dependent variable, i.e., IDM (Investment Decision Making). It can be observed from the figure that value of $R^2$ is 0.520 which means that IND (audit committee independence), COM, (audit committee competence), DIL (audit committee diligence) collectively explain 52 percent of variance in IDM (Investment Decision Making). The remaining variance can be explained by other variables which are not included in this study.

Table 4.22

*SEM-Path Analysis*

| | Original Sample (O) | Sample Mean (M) | Standard Deviation (STDEV) | T Statistics (\|O/STDEV\|) | P Values |
|---|---|---|---|---|---|
| COM_ -> IDM | 0.111 | 0.124 | 0.134 | 0.831 | 0.4064 |
| DIL -> IDM | 0.219 | 0.22 | 0.112 | 1.962 | 0.0503 |
| IND -> IDM | 0.501 | 0.503 | 0.125 | 3.99 | 0.0001 |

COM= Competence, DIL= Diligence, IND= Independence, IDM= Investment Decision Making

From table 4.22 it can be seen that p-value of DIL (Audit Committee Diligence) and IDM (Investment Decision Making) is greater than 0.05 which means that audit committee diligence has no significant impact on investment decision making at a significance level of 0.05. Similarly, COM (Audit Committee Competence) and IDM (Investment Decision Making) has p-value greater than 0.05, which shows that there is no significant impact of Audit Committee Competence on Investment Decision Making. On the contrary, p-value of IND (Audit Committee Independence) and IDM (Investment Decision Making) is less than 0.05 which shows that audit committee independence has significant impact on investment decision making.

## 4.7 Hypothesis Testing Summary

Table 4.23

*Hypothesis Testing Results*

| Hypothesis | p-value | Result |
|---|---|---|
| H1: Audit committee independence positively effects companies' investment decision | .0001 | Accepted |
| H2: Audit committee diligence effects companies' investment decision | .4064 | Rejected |
| H3: Audit committee diligence effects companies' investment decision | .0503 | Rejected |

Table 4.23 exhibits the hypothesis testing result summary. It can be seen that only H1 has been accepted and that H2 and H3 both have been rejected.

The first hypothesis has been accepted because the p-value which is 0.0001 is less than 0.05 level of significance which states that there is significant impact of audit committee independence on investment decision making.

The second hypothesis has been rejected because the p-value is 0.4064 which is greater than 0.05 which states that there is no significant impact of audit committee competence on investment decision making.

The third hypothesis has also been rejected because the p-value is 0.0503 which is greater than 0.05 which states that there is no significant impact of audit committee diligence on investment decision making.

## 4.8 Findings from Qualitative Analysis

Qualitative interviews were taken from Accountants, Auditors, CFOs and CEOs of the listed companies on NEPSE. Open ended questions on domains of audit committee independence, competence, diligence and investment decision making were asked to support the findings from qualitative analysis because the quantitative analysis contained only 70 samples. The interview responses have been transcribed, phrased, coded and themed for analysis purpose. Patterns across responses of data sets that are important to the description under study and are associated to specific research questions are emphasized, pinpointed, examined and recorded for thematic analysis. The patterns have been segregated into four major themes to adhere to the results from quantitative analysis.

### 4.8.1 Communication Gaps between Audit Committee and Management

When asked about communication gaps between audit committee members and management, majority of the respondents believe that members of Audit Committee have open communication with top level management. However, there are also fewer respondents who feel that there is somewhat hierarchy that they need to follow which restricts them from easy open communication. All of the respondents believe that there should be open communication between audit committee members and management to easily identify the investment opportunities and make investment decisions.

Statements

CFO Organization 1: "*Yes, there is open communication between audit committee members and the management of our organization. I believe that it is one of the reasons of our organizational success. We have always believed in democratic leadership and participative decision making'.*

Auditor Organization 2: "*It is not that easy to answer whether or not there is gap in communication between audit committee members and top-level management. There matters that require immediate response are subject of interest of top-level management itself. But there are times when audit committee has to wait for weekly meetings to deliver certain information to the management. But still, it depends on nature of urgency so we cannot say that there is no open communication".*

Accountant Organization 3: "*Yes, there is open communication which is one of the reasons of our successful investment decisions. However, we do not disclose any information until consensus among us is reached about absolute matter in hand".*

The above statements are representative responses of majority of the respondents. They clearly highlight that there is mostly open communication between audit committee members and management. Open communication invites for participative decision making. Audit committee members are responsible to create, analyze and interpret the financial reports to the management. If there is no open communication, there are likely chances that the investment decisions might not be smooth which may lead unsuccessful investment decisions. Hence, it is one of the major factors that could determine the proper investment and financial decisions.

Apart from these, the respondents who are not absolutely sure whether there is open communication or not, also believe that the communication should be open. They have reasoned financial matters require utmost care and immediate response from the management, who are the actual decision makers in the organization. Hence, open communication is a must.

### 4.8.2 Audit Committee Independence and Investment Decision Making

Almost all the respondents believe that the audit committee members should work independently with nominal or no intervention from management in regard to report manipulation or any kind of alterations that could impact investment decisions. There is significant positive relationship between audit committee independence and investment decision. If audit committee members work independently, they generate the factual reports without any kind of manipulations based on which the investment can or cannot be pursued. However, it has been identified that there is not always independence among audit committee members. There could be possibilities when audit committee members could report biased information on behalf of the management. However, such practices are minimal because auditors could lose their license to practice.

Statements

CFO Organization 1: *"Audit Committee should be independent of everything; everything implying Board of Directors, Management, Investee as well as Investing company. It is so because audit reports are the basis on which we rely on investment decisions and it should not be biased at all".*

Auditor Organization 2: *"Audit committee prepares all the published and unpublished accounting and financial information. The information shows profitability position, position of cash flows, position of assets and liabilities, etc. All these financial statements should be bias free. Therefore, I believe that there should be independency among audit committee members".*

Accountant Organization 3: *"Report produced by an independent audit committee will give true and fair view of the company's financial position. This is essential in financial decision making".*

The three statements above from CFO, Auditor and Accountant from different organizations represent majority of the responses asked under the domain of respondent's perception about audit committee independency. The quantitative analysis showed that there is positive correlation between audit committee independence and investment decision making with significant impact of audit committee independence on investment decision making. The above phrased qualitative responses also support this finding that audit committee independence is one of the factors that contribute to better investment decisions. Hence, all the financial reports and financial statements should be created, analyzed and interpreted with no room for biasness since it would impact the investment decisions significantly.

### 4.8.3 Audit Committee Competence and Investment Decision Making

Audit Committee members should be experts in theirs fields because their reports should follow the principles of GAAP (Generally Accepted Accounting Principles) and NFRS (Nepalese Financial Reporting System) in the context of Nepal. The more the members are competent, the better is the understanding of the financial aspects which ultimately helps for better investment decision making. Hence, there is positive relationship between audit committee competence and investment decision making.

Statements

CFO Organization 1: *"Audit Committee members must be experts in their fields because their reports should follow principles of GAAP (Generally Accepted Accounting Principles) and NFRS (Nepalese Financial Reporting System)".*

Auditor Organization 2: *"A competent audit committee would give true financial statements that show the actual position of the company. This positively enhances financial and investment decision making."*

Accountant Organization 3: *"If audit committee members are not competent, will they even be hired by the organization or retained later? Obviously, investment is done on the basis of their reporting so competency is a must, if you have to ask me".*

The three statements above from CFO, Auditor and Accountant from different organizations represent majority of the responses asked under the domain of respondent's perception about audit committee member's competence. The statistical analysis sunder quantitative analysis showed that there is positive correlation between audit committee competence and investment decision making. The responses above also generalize that audit committee should be competent because decision making on investments is impacted by audit committee member's ability to improve the quality of reporting and maintaining internal controls. Hence, the qualitative analysis supports the correlation results of quantitative analysis between audit committee competence and investment decision making.

### 4.8.4 Audit Committee Diligence and Investment Decision Making

Audit committee diligence has been measured by number of meetings and audit committee size to make good investment decisions. On average, there should be at least 6 to 10 meetings for audit committee members to make good investment decisions. Similarly, the audit committee size should contain at least 3 to 7 members for sound investment decision making.

Statements

CFO Organization 1: *"In my opinion, there should be at least 24 meetings between audit committee and management to make sound investment planning and to get to know about the present scenario too. The audit committee should contain at least 5-6 members for sound analysis and investment decisions".*

Auditor Organization 2: *"The way I see, there should be at least 6 to 12 meetings, minimum a monthly meeting is a must. In regard to audit committee size, it would be appropriate between 3-7 members depending upon the nature and size of business".*

Accountant Organization 3: *"As per our policy standards, once in a month meeting is mandatory among audit committee members, but it is subject to need with management. In my opinion, I would say at least 12 meetings should be made among audit committee members and management with audit committee size being 3-7 on average for better decision making on financial matters".*

The three statements above from CFO, Auditor and Accountant from different organizations represent majority of the responses asked under the domain of respondent's perception about audit committee diligence measured under the items of audit committee meeting frequency and audit committee size. The quantitative analysis showed that there is positive correlation between audit committee diligence and investment decision making. However, the statistical analysis did not show significant impact of audit committee diligence on investment decision making. This can be explained by qualitative analysis. The qualitative analysis showed that the minimum number of meetings between audit committee members and management should be at least 12, which was presented as just 4 times in a year as a construct in audit committee diligence.

Apart from this, the qualitative analysis also showed that the minimum number of members in audit committee should be at least 3 to 7 depending upon the nature and size of the business, which was presented as just 3 members at a minimum as a construct in audit committee diligence. The responses could have differed because the questionnaire has been adapted from study in Bahrain-listed companies, which could be different from that of Nepalese context.

### 4.9 Major Findings

Some of the major findings of the study are as follows:

- The mean scale of audit committee independence is 4.1286 with standard deviation 0.5274 which suggests that average respondents agree with the statement that measured audit committee independence and look for achieving independence through non related members from investee's company, absence of executive directors in audit committee, absence of social connection between AC members and management, etc.
- The mean scale of audit committee competence is 4.35 with standard deviation of 0.4934 which suggests that average respondents agree with the statement that measured audit committee competence and look to be competent through medium financial literacy, financial expertise, industry expertise for improved financial reporting and internal control quality.
- The mean scale of audit committee diligence is 4.2857 with standard deviation 0.668 which suggests that average respondents agree with the statement that measured audit committee diligence and look for at least 6 to 10 meetings in a year and 3 to 7 audit committee members to make good investment decisions.
- The mean scale of Investment Decision Making is 4.1762 with standard deviation 0.621 which suggests that average respondents agree with the statement that measured investment decision making and look to continue with current investment decisions and suggest the same if asked.
- There exists a high degree of correlation (r=0.638) between audit committee independence and investment decision making, moderate degree of correlation (r=0.541) between audit committee competence and investment decision making,

and moderate degree of correlation (r=0.477) between audit committee diligence and investment decision making.

- The p-value of audit committee independence is less than 0.05 which means that there is a significant impact of audit committee independence on investment decision making. On the other hand, the p-value of audit committee competence and audit committee diligence are 0.4064 and 0.0503 respectively which are both higher than 0.05. It means that there is no significant impact of audit committee competence and diligence on investment decision making.

# CHAPTER V

# DISCUSSION, CONCLUSION AND IMPLICATIONS

This chapter is a concluding part of the study which presents the outcomes of the study. It has been divided into three sections. First, it presents the discussion about the confirmation of the major findings of the study. And, the conclusion is drawn on the basis of discussion. Further, implication of the study has been presented.

## 5.1 Discussions

This main objective of this study would be to examine the impact of the audit committee's (AC) independence, competence and diligence on the company's investment decision-making of Nepalese listed companies.

The result showed that respondents are high on the central scale of audit committee competence followed by diligence and independence. The audit committee plays a major role in improving the quality of financial reporting. The availability of independent and competent audit committee increases the credibility of the financial statements (Cohen et al., 2016), which improves the investors' trust in the financial reporting and therefore impacts their investment decision positively (Cohen et al., 2016; Bedard et al., 2014). This could be the reason for respondents being high on the mean scale of audit committee diligence, competence and independence.

The results reaffirm the findings of Al-Hadrami, et al., (2020) which showed that the overall average of the investors' responses regarding the importance of audit committee independence to their investment decision is 3.78. In addition, the average range of responses regarding the seven elements of this variable is between 3.2 and 4. The surveyed investors indicated that the most important item of the audit committee independence that affects their investment decision is the existence of nonrelated audit committee members with an average of 4, followed by the importance of the financial independence of the audit committee with an average of 3.97 out of 5.

The results more or less reaffirm the findings of Al-Hadrami, et al., (2020) which showed that the overall average of the investors' responses regarding the importance of audit committee competence to their investment's decision, which is 3.87. In addition, the average range of responses regarding the four elements of this variable is between 3.78 and

3.98. The investors surveyed indicated that the most important item of the audit committee competence that affects their investment decision is the existence of audit committee members with financial expertise with an average of 3.98, followed by the existence of the required competence to improve the company's internal control with an average of 3.91. The results are also consistent with the source credibility theory states that the main factors that influence an individual's evaluation of the information credibility is source bias (Cohen et al.,2016; Buda & Zhang, 2000; individual's evaluation, 1993; & Birnbaum & Strenger, 1979).

With regard to impact of audit committee independence, competence and diligence on investment decision making, the results showed that there is significant impact of audit committee independence on investment decision making. This is consistent with the results of previous studies from Al-Matari et al., (2012), Amer et al., (2014), Al-Hadrami, et al., (2020), Bhattrai (2017). Their studies too showed significant impact of audit committee independence on investment decision making. This result is consistent with the agency theory which emphasizes the independence of boards and committees in order to reduce the agency costs. On the contrary, this finding is inconsistent with Al Mamun et al. (2013) who discovered that including more executive directors to the committee leads to higher effectiveness and reaching of superior results than those reached by the majority of independence directors. This result also contradicts stewardship theory which states that managers and company's board of directors would work best for the all the stakeholders.

However, this study contradicts in findings from the study of Al-Matari et al., (2012), Amer et al., (2014), Al-Hadrami, et al., (2020), Bhattrai (2017) with respect to impact of audit committee competence on investment decision making. The underlying study showed that there is no significant impact of audit committee competence on investment decision making while the previous studies showed significant impact. This is one of the controversial results. On one hand, it shows there is positive relationship between audit committee competence and investment decision making with higher central tendencies, but on the other hand no significant relationship with path analysis was proved. The insignificance could be the result of fewer samples used in the study. On interpreting the analysis of qualitative responses and correlation coefficients, it can be said that the respondents look up for audit committee of the investee's company to include members with financial literacy, financial expertise, industry expertise and competency to improve internal control quality.

Apart from these, the study shows that there is no significant relationship between audit committee diligence and investment decision making. This is yet again another contradicting result. On one hand, it shows there is positive relationship between audit committee diligence and investment decision making with higher central tendencies, but on the other hand no significant relationship with path analysis was proved. The higher mean scale is consistent with the regulator's requirement of having at least 3 members in audit committee. The insignificant impact is also in the favor of agency theory which suggests that higher number of audit committee members will display poorer results. On the contrary, it is not in favor of resource dependence theory which states that bigger audit committee can achieve better results.

## 5.2 Conclusion

This study aims to investigate the impact of AC independence, competence and diligence on investment decisions. It revealed a significant relationship of AC independence on the investment decisions taken by the decision-makers in the Nepalese listed companies. It indicates the importance of AC independence for the decision-makers in improving the quality of financial reporting through bias-free preparation and reporting of financial statements. The ability to work without intervention from the management would best serve the interests of both audit committee and management. This can lead to the increased investors trust in the investee company's financial reports and thereby favorable investment decisions. Moreover, the majority of the respondents agreed that the audit committee must be financially independent. It suggests that the companies must ensure that their audit committee is financially and socially independent in order to reduce the influence of the management on their work and to strengthen the quality of the committee output.

Similarly, the study showed that audit committee competence is also crucial for better investment decision. Therefore, it is important for the audit committee members to be financially literate and expert in financial and industrial knowledge to create good reports and maintain internal quality in reporting and interpreting. This could help in generation of better and more accurate financial reports which could aid in better investment decision.

Likewise, the study showed that it is important for the audit committee members to conduct meetings at least 4 times in a year with audit committee members being at least 3. Audit committee's meeting frequency is directly linked to financial restatements. The more the meetings, the less is the chance for financial restatements of the company's reports. Therefore, it is important for companies to have diligent audit committee.

Thus, companies must think for presence of non-related members, non-executive directors, and financial independence, financially literate and expert members in the audit committee. Apart from these, audit committee should also have at least 3 members in total with meetings being conducted at least 4 times in a year. This would greatly help in better investment decision making.

## 5.3 Implications

### 5.3.1 Managerial Implications

The findings of this study have been meaningful as there is a significant impact of the independent variable, that is, audit committee independence on the dependent variable, that is, investment decision making. With respect to past studies, some findings have been similar while some are refuting.

The first implication could be that since audit committee independence has positive and significant impact on investment decision making, companies must think for presence of non-related members, non-executive directors, financial independence, and absence of social connection among the members of the audit committee. According to results of analysis and past studies, this will significantly improve the quality of financial and investment decision making.

Secondarily, since audit committee competence and diligence are high on central values with fairly moderate correlation coefficients with investment decision making, which are also supported by qualitative analysis, the companies could also focus for the audit committee members to be expert in financial and industrial knowledge to create good reports and maintain internal quality in reporting and interpreting. Moreover, it would be better for company's investment decisions to conduct if the meetings with audit committee are conducted at least 4 times in a year with audit committee size comprising of at least 3 members.

### 5.3.2 Implications for Future Research

This research contains a sample size of 70where majority of the respondents are auditors and accountants. It also contains qualitative responses from 31 respondents which are presented as themes to adhere to quantitative analysis. Similarly, purposive sampling technique has been implemented to measure the impact of audit committee independence, competence and diligence on investment decision making. Hence, there is a wide opportunity for future research for scholars.

Therefore, the study has further room for more appropriate generalization by increasing the samples in the study. Apart from this, the study includes four constructs, 3 independent variables and 1 dependent variable with a total of sixteen licker scale questions to measure each item as developed by Al-Hadrami, A., Rafiki, A. and Sarea, A. (2020) with addition of one variable adapted from Abbott, L.J., Parker, S., & Peters, G.F. (2004). The future study may contain more items that can better measure the constructs. Likewise, the future studies can incorporate more other variables in the study to improve the fitness of model.

The current study investigated the impact of audit committee independence, competence and diligence on the investment decision as perceived by the decision-maker, so other studies may use more objective measures of the study variables, by developing a self-constructed index over a long period for audit committee independence and audit committee competence, and this will eliminate the subjectivity and potential bias of the investors' perception of AC.

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## APPENDIX

**Questionnaire**

Dear Respondent, I am Rakesh Kumar Ray, an MBA pursuant at School of Management, TU. I am conducting a study on "Impact of Audit Committee's Independence, Competence and Diligence on Investment Decision Making" for my Graduate Research Project. It would be of great help if you can spare few minutes of your time to respond to the questions in this regard. The information will be kept confidential and will be used only for academic purpose. For any feedback and suggestion, feel free to mail me at rakeshroyy19@gmail.com

Thankyou!

**SECTION A**

**Q1. Gender**

A. Male -1
B. Female -2

**Q2. Age group**

A. 18 to 28 -1
B. 29 to 39 -2
C. 40 to 50 -3
D. More than 50 -4

**Q3. Highest education**

A. Up to Intermediate -1
B. Bachelor - 2
C. Master - 3
D. PhD or equivalent – 4

**Q4. Current occupation**

A. Accountant
B. Auditor
C. Chief Finance Officer
D. CEO

**Q5. Are you involved in investment decision making process?**

A. Yes - 1
B. No - 2

## SECTION B

Please read each question carefully and select your level of agreement for the following statement. And tick (√) mark the appropriate number from 1 to 5. Each testimonial is measured by 5- point Likert scale: 1= Strongly Disagree; 2=Disagree; 3=Neutral; 4= Agree; 5=Strongly Agree

| **AC Independence** | | | | | |
|---|---|---|---|---|---|
| **Measurement of AC Independence** | 1 | 2 | 3 | 4 | 5 |
| 1. It is important to our investment decision that the Audit Committee of the investee's company has non related members | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| 2. Our investment decision is affected positively by the existence of non-executive directors in the AC of the investee company. | | | | | |
| 3. Our investment decision is affected positively by the absence of the social connection between the AC members and the management | | | | | |
| 4. Our investment decision is affected positively by the absence of the professional connection between the AC members and the management | | | | | |
| 5. It is important to our investment decision that the AC of the investee company is financially independent | | | | | |
| 6. It is important to our investment decision that AC members do not have any financial interest in the investee company | | | | | |
| 7. It is important to our investment decision that the AC of the investee company includes only independent members | | | | | |

| **AC Competence** | | | | | |
|---|---|---|---|---|---|
| **Measurement of AC Competence** | 1 | 2 | 3 | 4 | 5 |
| 8. It is important to our investment decision that the AC of the investee's company includes members with financial literacy (for example accounting and finance) | | | | | |
| 9. It is important to our investment decision that the AC of the investee's company includes members with financial expertise | | | | | |
| 10. It is important to our investment decision that the AC of the investee's company includes industry expertise that improves the quality of the financial reporting | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| 11. It is important to our investment decision that the AC of the investee's company has the required competency to improve the internal control quality | | | | | |

| AC Diligence | | | | | |
|---|---|---|---|---|---|
| Measurement of AC Diligence | 1 | 2 | 3 | 4 | 5 |
| 12. It is important that Audit Committee has at least 3 members. | | | | | |
| 13. It is important that Audit Committee conducts meeting at least 4 times a year | | | | | |

| Investment Decision Making | | | | | |
|---|---|---|---|---|---|
| Measurement of Investment Decision Making | 1 | 2 | 3 | 4 | 5 |
| 14. I shall continue considering the current investment in the next few years | | | | | |
| 15. The current investment of my company is considered attractive | | | | | |
| 16. I would recommend the current investment for other investors if they ask for my advice | | | | | |

## SECTION C

**Gender**

A. Male -1
B. Female -2

**Age group**

A. 18 to 28 -1
B. 29 to 39 -2
C. 40 to 50 -3
D. More than 50 -4

**Highest education**

A. Up to Intermediate -1
B. Bachelor - 2
C. Master - 3
D. PhD or equivalent – 4

**Current occupation**

A. Accountant
C. Auditor
C. Chief Finance Officer
D. CEO

**Are you involved in investment decision making process?**

C. Yes - 1
D. No - 2

| Interview Schedule | | | | |
|---|---|---|---|---|
| Date: | | | | Company type: |
| No. | Start time | End time | Position | Location |

| | |
|---|---|
| Introductory questions | Can you give me brief introduction of you organization with its core objectives?<br><br>Is there open communication between AC members and top-level management (BOD)? How do you feel about it?<br><br>Do you think financial reports are manipulated by the intervention of top-level management? |
| Importance of Audit Committee Independence | What are your views on Ac independence and financial decision making? |
| Importance of Audit Committee Competence | How, do you think, AC competence impacts financial decision making? |
| Importance of Audit Committee Diligence | In your opinion, what should be the average number of meetings for AC members to make good investment decisions? What about AC size? |
| Impact on investment decision making | How do you think Audit committee independence, competence and diligence has overall impact on investment decision making? |