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The Impact of Audit Committee Characteristics on Environmental and Social Disclosures: Evidence from Turkey

Ali Altug Bicer

Corresponding Author: Department of Accounting and Auditing, Faculty of Business Administration, Istanbul Commerce University, Istanbul, Turkey.

Imad Mohamed Feneir

Department of Accounting, The Higher Institute for Administrative and Financial Sciences, Benghazi, Libya.

Abstract

The main reasons for corporate participation in environmental and social disclosure are stability, development, and continuity through participation in protecting the environment and optimizing the use of available resources. As well as the company practices and participation in society of the most important means to create a good image of the company in the community. There is a rise demand for companies to take accountability for their environmental and societal impacts. A core role of the Audit Committee (AC) is to help the board of directors in overseeing the company's reporting policy and oversees the quality of financial reporting in the company. This study examined the impact of audit committee characteristics on the level of environmental and social disclosures in listed banks in Borsa Istanbul. The results of the study showed that there is no statistically significant relationship between the characteristics of the audit committee and the environmental and social disclosures. Consequently, these characteristics have no effect on the volume or type of disclosure and their inability to predict them.

Key words: *Audit committee (AC), AC Size, AC Meetings, AC Expertise, Environmental disclosure, social disclosure.*

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Introduction

There is a growing public awareness of the social and environmental impact of companies and the role they can play beyond their primary economic functions. This is also accompanied by the awareness of government and businesses that social and environmental attention will not adversely affect their economic growth. The growth in community awareness and interests have an influence on the decision by management to disclose information about social and environmental practices within the corporate annual report.

Over the last two decades, the increase of social activity and the rise in the number of corporate collapses have brought corporate social responsibility (CSR) disclosure to the top of public attention. Nowadays, companies are pressured not only to meet financial targets but also to match and balance multiple bottom lines and manage the concerns of multiple stakeholder (Jamali et al. 2008). CSR disclosure may affect companies' financial performance and their stakeholders by reducing information asymmetry between management and stakeholders. Brown and Dacin (1997) mention that customers who are aware of CSR activities can improve brand value and increase the demand for a company's products. Nevertheless, there are some worries about the quality and quantity of CSR disclosure. Managers use CSR disclosure to raise their reputation instead of reducing information asymmetry between stakeholders and managers (Ball et al. 2000). Choi et al. (2013) also note that managers can strategically use CSR disclosure to hide their opportunistic attitude. Furthermore, studies find that most companies disclose on social and environmental activities that are generally positive rather than negative and harmful.

It is the role of the Audit Committee (AC) is coming. This is its time to enter the picture to stop the opportunism of managers to improve CSR disclosure. Financial researchers have seen the function of AC as a mechanism of accountability where it ensures the quality of financial reporting (Brennan and Solomon, 2008). AC accountability role needs to go beyond optimizing the quality of reporting but also by providing reliable and credible information to all stakeholders. In the same context, and the consequence of financial scandals at prominent firms, interest in audit committees has grown dramatically. The audit committee increases the trusting of the investors in the reliability and objectivity of financial statements increase the efficiency of the corporate governance practice in the related company. Increased international concern has been given to the possible beneficial role of AC. In the UK, the Smith Report (2003) is the AC code of guidance, which designed to assist organization boards in making suitable arrangements for their AC and assist managers serving on AC in the performance of their role.

AC may have an important role to play in addressing environmental and social responsibility issues through determining, managing, and controlling the risks associated with these issues. AC main goals are reviewing the company's internal control and risk management systems and assessing the effectiveness of company risks. AC could help in assessing not only financial risks but also those related to social and environmental risks when auditing financial reports. The AC, as a basic decision-making Board, is expected to control financial and non-financial reporting practices and reduce the information asymmetry between management and stakeholders (Karamanou and Vafeas, 2005). The wider role of AC is more inclined today to assurance that firms take responsibility for long-term economic, environmental and social impact on stakeholders (Kolk and Pinkse, 2010).

The objective of this study is to examine the effect of the audit committee characteristics on the level of CSR disclosure in listed banks in Borsa Istanbul, as well as this study attempts to provide contributions to the literature in two main areas, AC characteristics and CSR disclosure.

Literature Review and The Theoretical Framework

In this section, the theoretical framework of AC and CSR disclosure was shown, by reviewing what is stated in the literature relevant to the two fields of study.

Audit Committee

An audit committee is an important tool in greater the organizational situation and independence of internal auditing. The audit committee is forecasted to be an informed, wise, and constructive superintendent of the financial reporting process (Catikkas and Alpaslan, 2003). Bromark and Hoffman (1992) stated that the key reasoning of the setting up of the audit committee is to facing the permanent defiance's of business environment, also to assist the board of directors and management to deal with those challenges. They also added up the following challenges' as (1) Extend concern regarding company ethics. (2) The rising complexity of accounting standards, transactions, and regulatory requirements. (3) A call for fair disclosure of the quality of the firm's earnings and financial position, and the consequences responsibility of management and the board for complete and fairly disclosure of financial conclusions. (4) Globalization of markets, which has opened new opportunities, increased rivaling and created massive inflation of the information required to make informed decisions. (5) Broadly use of information technology, including microcomputers and networks, satellite transmission, and the input of electronic data interchange, all of that has changed internal control systems.

A core role of the audit committee is to help the board of directors in overseeing the company's reporting policy. Khlif and Samaha (2014) pointed out that the audit committee acts a critical role in meeting investors' needs for relevant, clear, and full information. As a control tool over top management, further, an audit committee assured that there is increased voluntary disclosure to permit an accurately assess of top management's decisions and behaviors and align management and shareholder interests. The Smith Report (2003) also, verify that the audit committee acts a crucial role in observing board activities by optimizing the quality of disclosed information and ensuring the protection of shareholder interests through the release of price-sensitive information. Therefore, the audit committee is anticipated to improve corporate reporting policy.

The audit committee oversees the quality of financial reporting in a company; the audit committee should control a company's basic financial reporting and support the auditors in their encounters with the company management on the audit findings (DeZoort et al. 2003). Prior research has examined the benefits of a strong audit committee such as financial expertise, independence, meeting frequency, and audit committee size on a company's performance and audit quality (Ghafran and O'Sullivan, 2013). In this study, the impact of three main characteristics of the Audit Committee on the social and environmental disclosures will be examined. These characteristics are:

Size of audit committee: Size of the audit committee refers to the number of members in the audit committee. The Malaysian Code of Corporate Governance (MCCG, 2002) and Smith (2003) stated that the audit committee must consist of at least three members. Large audit committees gets more legitimacy and authority. It brings a variety of skills, experiences, and energy hence increasing the likelihood to resolve potential problems in the financial reporting process and finishing the task in a suitable time. On the other hand, some previously studies demonstrated that the larger size of an audit committee, would cause unnecessary discussion and slow in making a decision, as well as weaker communication and decision-making process (Lin et al. 2008). Nevertheless, there is an argument that a larger audit committee is lead to an increase in disclosure due there is a higher potential that an audit committee will include highly ethical members who could influence on the quantity of disclosure (Persons, 2009). Li et al. (2008) find a significant positive link between audit committee size and intellectual capital disclosure. The study argues that larger size audit committee is considered as a powerful monitoring device that is associated with more reliable and higher quality reporting. Magena and Pike (2005) find no significant association between AC size and the range of disclosure in temporary reports in a sample of UK listed companies.

Meetings frequency: An active audit committee enhances its effectiveness where members during their meetings oversee financial statements, reassure their accuracy and improve audit quality (Beasley et al., 2009). Frequent audit committee meetings can be a sign of increased vigilance and monitoring and hence are associated with higher quality and quantity of financial reporting (Chen et al., 2006). Persons (2009) noticed that the more repeat an audit committee meets, the more potentially firms would make voluntary ethics disclosure. Karamanou and Vafea (2005)note that the frequency of audit committee meetings allows directors more time to effectively carry out a monitoring role and improve corporate disclosures such as CSR. In addition, previous research suggested the importance of active ACs and found a positive association between frequent meetings and higher voluntary disclosure (Beasley et al., 2009).

Financial expertise of audit committee: Blue Ribbon Committee (BRC) have defined financial literature by the ability to read and understand essential financial statements, due to the increasing complexity of accounting and auditing information, the expertise of AC acts as a valuable tool in reducing financial misstatements (Abbott et al., 2004). Audit committee expertise improves the quality and reliability of the information offered to the market (Smith, 2003). Results of (Beasley et al. 2009) show notable differences in audit committee members' responses associated with accounting expertise. This supports the argument that auditing expertise enhances reporting quality. Persons (2009) suggested that members of the audit committee with accounting or financial expertise are more likely to uncover any financial misstatements or indecent business transactions because they need to comply with their own professional codes of ethics to maintain their reputation. Further, audit committees with more financial expertise are less likely to allow material misstatements to be waived by company management (Keune and Johnstone, 2012). Several empirical findings of previous studies also indicate a positive association between the financial expertise of audit committees and level of disclosure (Appuhami and Tashakor, 2017).

CSR Disclosure

CSR Disclosure (CSRD) is defined as the delivery process of the environmental and social effects of organizations' economic business to specific interest groups within society and to society as all (Gray et al., 1996). Also Heemskerk et al. (2002) mentioned that CSR report could be defined as a notification process of social and environmental effects caused by firm economic activity to particular interest groups and the organization as a whole. CSRD is the objective description of social and environmental activities so that stakeholders can use it dependably to evaluate the performance of the firm's social responsibility. Governments and intergovernmental bodies as the United Nations, the Organization for Economic Cooperation and Development and the International Labor Organization, have developed announcements, guidelines, principles and other instruments which offer outline the social standards for acceptable conduct of companies. Over the past decade, several national governments in the USA and Europe have approved a series of regulations on social and environmental investments. Actually, many laws and regulations demand companies to participate in some of their CSR activities with the public by the disclosure of non-financial information (Najah and Jarboui, 2013).

Quality CSR report should fulfill four main aspects (Moravcikova et al., 2015):

- **i.** ***Credibility:*** *the credibility of the report can be authorized by the obligation of top management. Also the description of company policy and an introduction of personal responsibilities, methods of data collection and the objectives. Further, the level of major stakeholders' participation influences credibility and it is increased by an independent third party verification.*
- **ii.** ***Completeness:*** *the CSR report includes all business operations and offices in the country, it's completely informed about the major areas that impact of the organization on society and the environment.*
- **iii.** ***Significance:*** *the firm has to maximize the using of qualitative and quantitative indicators to evaluate its social responsibility.*
- **iv.** ***Appropriate form:*** *the form of the report has significant role-play and help to know either the report is clear and moderately long.*

The demands for companies to take accountability for their environmental and societal impacts are rising. The consequence, many companies make voluntary disclosures about the effects of their actions on society and the environment, and how they have managed them, leading to much interest among academics. Organizations expend time and money for voluntary CSR disclosure, so one would expect that firms gain from the decision to release such disclosures otherwise they would not choose to do so. How researchers in a number of ways, with many, investigated firms gain from voluntary CSR disclosure concentrating on the value of information relevant to investments and investors (Bowerman and Sharma, 2016).

A key problem that has bothered the literature has been the absence of in generally accepted theoretical perspective on why companies should participate in social reporting and what its effects will be on the various stakeholder groups. Thus, much of the scholarly discourse in this area was, and continues to be, philosophical in nature, examining the role of social accounting in society and organizations, and dealing with issues relating to the sustainability of the modern corporate environment. Such research raises standard questions regarding the extent to which accounting academics have to engage with and further the dispute on the environmental and societal problems caused by corporations. Some assume that the primary purpose of corporate disclosure is to 'influence perceptions regarding the future financial prospects of the firm in the minds of external, primarily financial, stakeholders' rather than to genuinely attempt to reduce environmental or social damage. There is also evidence that when disclosures are voluntary, firms will only supply a judiciously selected portion of information that presents them in a positive light in a self-congratulatory way, which raises questions about the completeness of corporate social disclosures and a requirement for assurance of such reports (Brooks and Oikonomou, 2017).

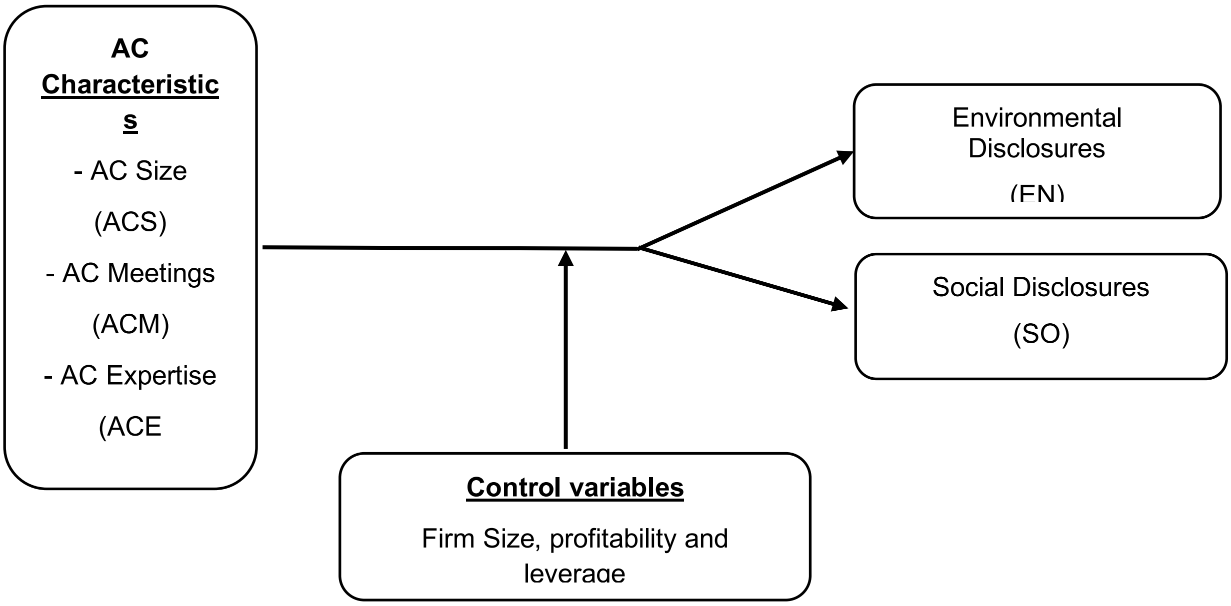

Figure 1: The theoretical framework

Hypotheses

For the investigation, and after reviewing literature related to AC characteristics and CSR disclosure, the hypotheses were developed by relying on the results that have confirmed so far. Therefore, it seems appropriate to set the hypotheses depending on the existence of a relationship between AC characteristics and EN and SO disclosures; this means there is prediction influence of AC characteristics on EN and SO disclosures, in agreement with the prevailing views. This agreement is lead us to the following hypotheses:

(a) Hypotheses for EN disclosures:

H1: Environmental disclosure is related to the size of the audit committee.

H2: Environmental disclosure is related to the number of the meeting of the audit committee.

H3: Environmental disclosure is related to the financial expertise of the audit committee.

(b) Hypotheses for SO disclosures:

H4: Social disclosure is related to the size of the audit committee.

H5: Social disclosure is related to the number of the meeting of the audit committee.

H6: Social disclosure is related to the financial expertise of the audit committee.

Research and Methodology

Sample and Data

The study focuses on thirteen banks these listed in the Borsa Istanbul for financial year-ends on 31 December 2017. These banks provide full and adequate disclosure of financial and non-financial information. Since the number of registered banks are small would not be necessary to withdraw a sample of the study, the population has studied as a whole. The data regarding AC and EN, SO disclosures have been compiled from annual and sustainability reports issued annually by most target banks and through published information about CSR practices on banks' websites.

Measurement of Variables

The study aims to examine the audit committee contribution to environmental and social disclosures, and the following are the methods of measuring the variables of the study:

Independent variables: The characteristics of the Audit Committee (AC Size, AC Meetings, and AC Expertise) were identified as independent variables in the study. AC Size was measured through the total number of AC members. AC Meetings was measured through the total of audit committee meetings in a year. AC Expertise was measured through the percentage of the audit committee members with accounting or financial expertise.

Dependent variables: The CSR disclosure categories (EN disclosure and SO disclosure) were identified as dependent variables in the study. Have been measured like many previous studies by compared annual and sustainability reports with the GRI Sustainability Reporting that offer Reporting Principles and Standard Disclosures (Nekhili et al., 2017) (Bowerman and Sharma, 2016) (Plumlee et al., 2015) (Najah and Jarboui, 2013). GRI is an independent international institution that has leader sustainability reporting since 1997. GRI helps companies and governments globally to understand and report their impact on critical sustainability issues such as human rights, climate change, governance and social luxury (GRI, 2013). This study was conducted in accordance with the latest version of GRI Standards issued in 2016. The information disclosed by banks about EN and SO disclosures were analyzed quantitatively by defining an index to the percentage of the number of items are disclosed to the total number of items should be disclosed.

Control variables: Consistent with the literature related to the subject of the study as well as the nature and sample of the study, three factors were identified as control variables that have an impact in determining the relationship between the AC characteristics and EN and SO disclosures (Firm Size, Profitability, and Leverage). Firm size was measured as the natural logarithm of total assets. For the purpose of statistical analysis, the natural logarithm was used instead of the real number of total assets. Profitability was measured as returns on assets (ROA) = net income/total assets. Leverage was included as one of the control variables and calculated as total Debt / Total Equity.

Models specification

In this study, multiple linear regression analysis is used to address the research question and testing hypotheses. The multiple regression models of the study are estimated as follows:

Model 1:

$EN = \alpha + \beta 1\ ACS + \beta 2\ ACM + \beta 3\ ACE + \beta 4\ Fsize + \beta 5\ ROA + \beta 6\ Lev + \varepsilon$

Model 2:

$SO = \alpha + \beta 1\ ACS + \beta 2\ ACM + \beta 3\ ACE + \beta 4\ Fsize + \beta 5\ ROA + \beta 6\ Lev + \varepsilon$

Where:

EN and SO are Environmental and Social Disclosures, ACS is Audit Committee Size, ACM is Audit Committee Meetings, ACE is Audit Committee Expertise, Fsize is Firm size (log of total assets), ROA is profitability, Lev is leverage and ε is The regression error term.

Result and Discussion

Descriptive Analysis

The summary descriptive statistics of EN and SO disclosures measures and AC characteristics for the sample are presented in Table 1. The means value of the EN and OS disclosures are 23% and 28% respectively in the annual reports of banks with a range from 3% to 59% for EN disclosure and from 8% to 55% for SO disclosure. These results indicate that despite there is evidence of listed banks engagement in CSR disclosure practices, they do not fully disclose all items of the sustainability report (GRI). It is also evident that there is a significant difference in the size of disclosure between banks and can be seen from the big difference between maximum values and minimum values, the reason may be the absence of regulations or laws that specify or oblige banks how disclosure.

Table 1: Descriptive statistics

Variable	Obs.	Mean	Std. Dev.	Min.	Max.
EN	13	0.23	0.19	0.03	0.59
SO	13	0.28	0.19	0.08	0.55
ACS	13	2.38	0.65	2	4
ACM	13	11.46	9.71	3	33
ACE	13	0.65	0.23	0.33	1.00
Fsize	13	18.44	1.38	16.01	19.90
ROA	13	0.01	0.01	0.0034	0.0202
Lev	13	9.57	2.19	6.15	13.6

Table 1 shows that the average size of the audit committees in the banks listed in the Borsa Istanbul is 2.38 (2 or 3 members) with a range from 2 (69%) to 4 (8%) members. This suggests that the majority (69%) of the banks have two members in an AC as the minimum ACS. The study finds that the mean value of ACM 11.46 with a range from 3 to 33. That means there are frequent meetings of the audit committees to follow up on the activities of banks and take the necessary decisions faster. On average 65% of AC members have financial expertise (ACE) including formal qualifications and professional experience in accounting or finance. Depend on the range; the findings also reflect that all of the banks are having at least one member with relevant accounting or finance qualifications and expertise.

Correlation Coefficient

The correlation matrix does not pose any problem of collinearity or multicollinearity when the correlation coefficient values of the explanatory control variables are below the threshold of 0.80 (Kennedy, 2008), 0.90 (Tabachnick and Fidell, 2014), and 0.95 (Gujarati, 2003). Depend on Table 2 below the maximum values of Pearson's coefficient is 0.4868. That mean multicollinearity is not a problem in the study and there will be no unusual effect on regression results.

Table 1: Pearson correlation coefficient

Variables	EN	SO	ACS	ACM	ACE	Fsize	ROA	Lev
EN |	1.0000							
SO |	0.9124	1.0000						
ACS |	-0.1554	-0.1167	1.0000					
ACM |	0.1507	0.0228	0.1146	1.0000				
ACE |	0.3014	0.1651	-0.0387	0.0293	1.0000			
Fsize |	0.4522	0.4868	-0.0960	-0.0089	0.4048	1.0000		
ROA |	0.1949	0.0795	-0.4349	0.4306	0.1258	0.4292	1.0000	
Lev |	-0.3120	-0.2415	0.1886	-0.4817	0.0315	-0.0093	-0.7086	1.0000

From Table 2, can be seen a negative relationship between audit committee size and EN and SO disclosures (-0.1554 and -0.1167 respectively). Other than that, there is a positive correlation between audit committee meetings and EN and SO disclosures (0.1507 and 0.0228 respectively). In addition, a positive correlation exists between audit committee expertise with EN and SO disclosures (0.3014 and 0.1651 respectively). However, all these relationships are not significant at $p<0.05$.

Regression Analysis

Linear regression analysis was used to estimating the relationship between dependent and independent variables. The analysis was applied to both models these were developed to examine the relationship and the influence of the audit committee characteristics on environmental and social disclosures.

Figure 1 shows the results of the regression analysis of the first model of environmental disclosure (EN = α + β1 ACS + β2 ACM + β3 ACE + β4 Fsize + β5 ROA + β6 Lev + ε).

. regress EN ACS ACM ACE Fsize ROA Lev

Source	SS	df	MS
Model	.246284287	6	.041047381
Residual	.188223405	6	.031370567
Total	.434507692	12	.036208974

Number of obs	= 13
F(6, 6)	= 1.31
Prob > F	= 0.3762
R-squared	= 0.5668
Adj R-squared	= 0.1336
Root MSE	= .17712

EN	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
ACS	-.1167162	.0989318	-1.18	0.283	-.3587935	.1253611
ACM	.0046837	.0066441	0.70	0.507	-.0115739	.0209412
ACE	.0906258	.24847	0.36	0.728	-.5173583	.6986099
Fsize	.1132583	.0523345	2.16	0.074	-.0147996	.2413162
ROA	-39.04029	21.21461	-1.84	0.115	-90.95057	12.86999
Lev	-.0759201	.0389805	-1.95	0.099	-.1713021	.0194618
_cons	-.4853319	.7863182	-0.62	0.560	-2.409383	1.438719

Figure 2: Results of linear regression analysis (Model 1)

As Figure 1 appears, the size of the audit committee has a coefficient value with the EN disclosure is -0.1167, which indicates audit committee size is negatively linked with the environmental disclosure. However, this relationship is not significant, as can be seen from the p-value statistics ($p = 0.283 > 0.05$). Further, audit committee meetings have a coefficient 0.0046 and the audit committee expertise has a coefficient 0.0906 this show their positive relationship with environmental disclosure is weak and not significant or influential, as can be seen from the p-value statistics for both (p = 0.507 and 0.728 respectively > 0.05).

Based on these results, the study failed to reject the null hypotheses, and reject hypotheses of study H1, H2, and H3, which predicted a significant relationship between audit committee characteristics and environmental disclosures.

Figure 2 appears the results of the regression analysis of the second model of social disclosure (SO = α + β1 ACS + β2 ACM + β3 ACE + β4 Fsize + β5 ROA + β6 Lev + ε).

. regress SO ACS ACM ACE Fsize ROA Lev

Source	SS	df	MS
Model	.305647661	6	.050941277
Residual	.139029262	6	.023171544
Total	.444676923	12	.03705641

Number of obs	= 13
F(6, 6)	= 2.20
Prob > F	= 0.1802
R-squared	= 0.6873
Adj R-squared	= 0.3747
Root MSE	= .15222

SO	Coef.	Std. Err.	t	P>|t|	[95% Conf.	Interval]
ACS	-.1271376	.0850261	-1.50	0.185	-.3351889	.0809137
ACM	.0033907	.0057102	0.59	0.574	-.0105817	.0173631
ACE	-.0669623	.2135454	-0.31	0.764	-.5894891	.4555644
Fsize	.1454136	.0449784	3.23	0.018	.0353553	.2554718
ROA	-49.4929	18.23272	-2.71	0.035	-94.10675	-4.879048
Lev	-.0891069	.0335015	-2.66	0.038	-.171082	-.0071317
_cons	-.6236711	.6757945	-0.92	0.392	-2.277281	1.029938

Figure 3: Results of linear regression analysis (Model 2)

Through the results shown in Figure 3, can be seen the weak relations between the characteristics of the audit committee and social disclosure. Where the audit committee size has a coefficient value of -0.1271 and the audit committee expertise has a coefficient -0.0669 and both have a negative relationship but not significant with SO disclosure, and this can be proven through the p-value statistics for both (p= 0.185 and 0.764 > 0.05). Audit committee meetings have a coefficient 0.0033 this means it is a weakly positive relationship but not significant, this shows clearly from the p-value statistics (p = 0.574 > 0.05).

Depend on these results, the study failed to reject the null hypotheses, and reject hypotheses of study H4, H5, and H6, which predicted a significant relationship between audit committee characteristics and social disclosures.

Accordingly, the results of the regression analysis tests demonstrated that there is no statistically significant relationship between the characteristics of the audit committee and the environmental and social disclosures. Consequently, these characteristics have no effect on the volume or type of disclosure and their inability to predict them.

Conclusion

The audit committee helps the board of directors in overseeing the company's reporting policy and oversees the quality of financial reporting in a company. In addition, there is demands for companies to take accountability for their environmental and societal impacts are rising. The consequence, many corporations make voluntary disclosures about the effects of their actions on society and the environment, and how they have managed them, leading to much interest among academics.

This study examined the impact of audit committee characteristics on the level of environmental and social disclosures in listed banks in Borsa Istanbul, as well as this study attempts to provide contributions to the literature in two main areas they are the AC characteristics and CSR disclosure. The study identifies AC characteristics such as size, meetings frequency, and financial expertise of members. Based on the Corporate Governance Principles.

Findings from the study rejected hypotheses H1, H2, and H3, which means that there is no significant relationship or effect between audit committee characteristics (audit committee size, audit committee meetings and audit committee expertise) and environmental disclosure. The study also rejected hypotheses H4, H5, and H6, which means that there is no significant relationship or effect between audit committee characteristics (audit committee size, audit committee meetings and audit committee expertise) and social disclosure. Consequently, these characteristics have no effect on the volume or type of disclosure and their inability to predict them.

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