

Audit Committee Characteristics on Intellectual Capital Disclosure: A Study of Sri Lanka

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Abstract

This research seeks to reduce a gap in the extant literature on the relationship between audit committee characteristics and intellectual capital disclosure in Sri Lanka as an example of emerging market. As the internal political climate has been favourable for after the conclusion of the war, it is important to understand how audit committee characteristics impact on intellectual capital disclosure in such an emerging market. This study uses quantitative techniques to assess the audit committee characteristics and intellectual capital disclosure of Sri Lankan firms. A 100-firm sample is randomly drawn from the Colombo stock exchange (CSE)-listed firms. Secondary data for 2016/17 are obtained from the CSE databases and are used to calculate the audit committee characteristics and intellectual capital disclosure measures for the sampled firms. The study reveals that audit committee characteristics such as size, audit committee meetings, audit independence and financial expertise to be significantly and positively related to overall intellectual capital disclosure. Findings suggest that Sri Lanka passes through its post-war-recovery phase, reform of its financial reporting regulatory is essential to sustain economic growth and development. Sri Lanka build on regulatory changes and encourage audit committees to ensure the quality of the overall reporting process to include social, environmental, intellectual as well as financial capital of firm.

Keywords: Audit committee characteristics, corporate reporting, intellectual capital

1.1 Introduction

The current *Theory of the Firm* posits that firms maximise their value by making decisions to maximise the wealth of their stakeholders (Graham, Harvey, & Puri, 2015; Kalyebara & Islam, 2014). In recent years, there has been growing disappointments with traditional financial reporting and its ability provide stakeholders with sufficient information on a firm's ability to create wealth (Bozzolan, Favotto, & Ricceri, 2003). The Corporate Governance Committee (1997, pp.1) asserts that:....'directors are entitled to govern the company, and to supervise and monitor the company's management in order to promote effective management and ensure prudent accountability to the shareholders'. Donaldson (1990) suggests that corporate governance structures include controls, executive incentives, and other schema for monitoring and bonding process of the board of directors. Sound financial disclosure reduces agency problems by bridging the information asymmetry gap that exists between management and shareholders. In contrast, poor financial disclosure often misleads shareholders and has adverse effects on their wealth, as suggested by the wave of recent financial reporting scandals (Karamanou & Vafeas, 2005).

Corporate boards are responsible for monitoring managerial performance in general, and financial disclosures in particular, a task that is delegated to audit committees. It is generally agreed that audit committees play a significant role in corporate governance, particularly in enhancing the board of directors' effectiveness in monitoring management (Klein, 2002; Li, Mangena, & Pike, 2012; SmithReport, 2003; Spira, 2003). Intellectual capital disclosure plays an increasingly important role in supporting competitive advantage and creating firm value (Bollen, Vergauwen, & Schnieders, 2005). The prior literature suggests several board and audit committee attributes as determinants of monitoring performance (Karamanou & Vafeas, 2005; Li, Mangena, & Pike, 2012). In general, the findings of corporate finance literature indicate that audit committees are important in financial reporting process (Li, Mangena, & Pike, 2012). Given the increased importance of intellectual capital disclosure in the financial reporting process but inadequate information on intellectual capital assets in the financial statements of firms, some researchers argue that the relevance of these statements have decreased over time (Francis & Schipper, 1999). Present accounting standards do not require the recognition of intellectual capital in the financial statements and only a relatively low level of firms disclose intellectual capital in their financial reports (FASB, 2001). As a result, there is a growing level of information asymmetry between firms and users of financial statements.

Focusing on intellectual capital disclosure, there are studies investigating the amount and content of the information voluntarily reported in Australia, Sri Lanka and Ireland (Abeysekera & Guthrie, 2005; Brennan, 2001; Guthrie & Petty, 2000). Abeysekera and Guthrie (2005) note that Sri Lankan annual reports lack a framework and a consistent approach for reporting intellectual capital. Intellectual capital disclosure in the developed countries have been comprehensively analysed concerning their financial reporting process (Mangena, Pike, & Li, 2010; Rainsbury, Bradbury, & Cahan, 2008; Guthrie & Petty, 2000; Karamanou & Vafeas, 2005). This research seeks to reduce a gap in the extant literature on the relationship between audit committee characteristics and intellectual capital disclosure in Sri Lanka as an example of emerging market. This study would hopefully benefit academics, researchers, policy-makers and practitioners of Sri Lanka and other similar countries through exploring the impact of audit committee characteristics on intellectual capital disclosure and pursuing strategies to improve the current status of it.

This paper is organised as follows: Section 1.2 presents a review of the empirical studies that investigate the association between audit committee characteristics and intellectual capital disclosure; Section 1.3 addresses research methods; Section 1.4 reports the results and discussion; and Section 1.5 summarises the conclusion.

1.2 Literature Review and Hypotheses Development

Most of the firms around the world progressively rely on intellectual capital in their value creation process rather than on traditional production factors such as physical and financial capital (Vandemaele, Vergauwen, & Smits, 2005). Audit committee characteristics are considered as key determinants of corporate

reporting policy (Li, Mangena, & Pike, 2012). In this section reviews the empirical foundations for the association between audit committee characteristics and intellectual capital disclosure.

1.2.1.1 Audit Committee Characteristics

The literature suggests that the effectiveness of the audit committee is enhanced when the audit committee is well resourced, independent and has members with financial expertise (Mangena & Taurigana, 2007). Therefore, the study develop hypotheses regarding the audit committee characteristics (size, frequency of meetings, independence financial expertise) and intellectual capital disclosure.

1.2.1.1.1 Size of Audit Committee

The key role of audit committee is to assist the board of directors in overseeing corporate reporting policy (Carcello & Neal, 2003). For instance, Agrawal and Chadha (2005) suggest that, in terms of clarity, relevance and completeness of information an audit committee plays a crucial role in fulfilling investors' needs for information. The effectiveness of an audit committee largely arises from the available resources: the number of members forming the committee (DeZoort, Hermanson, Archambeault, & Reed, 2002; Abbott, Parker, & Peters, 2004). The Sri Lankan code on corporate governance follows the listing requirement of Colombo stock exchange (CSE) that audit committee shall comprise of at least three directors. Although, there is no precisely recommended size for an audit committee, most previous studies and regulatory requirements seem to suggest three to five members (DeZoort, Hermanson, Archambeault, & Reed, 2002; Abbott, Parker, & Peters, 2004). There is a question whether larger audit committee size would lead to more effective monitoring. Empirical studies provide mixed outcome on the role of audit committee size in various aspects of organisational endeavours. Some studies find audit committee size to be associated with lower earnings management (Cornett, McNutt, & Tehranian, 2009) and intellectual capital disclosure (Li, Mangena, & Pike, 2012), whilst others fail to find a significant relationship with earnings management (Bedard, Chtourou, & Courteau, 2004) and financial reporting process (Abbott, Parker, & Peters, Audit committee characteristics and restatements, 2004). Based on this discussion, Hypothesis 1 is:

H₁: There is a significant and positive relationship between audit committee size and the level of intellectual capital disclosure.

1.2.1.1.2 Frequency of Audit Committee Meeting

A more active audit committee is expected to provide an effective monitoring mechanism. As a best practice, audit committee meeting should be conducted at least once a year (Saleh, Iskandar, & Rahmat, 2007). However, total number of meetings depends on the firm's term of reference and the complexity of the firm's operations. Karamanou and Vafeas (2005) note that audit committee that meet more frequently would have more time to perform the role of monitoring the corporate reporting process efficiently. Abbott, Parker, Peters, and Raghunandan (2003) argue that regular meetings would make audit committee members more

informed and knowledgeable about relevant accounting and auditing issues. Financial Reporting Council (2008) recommends that audit committee should hold a minimum of three or four meetings a year. The studies conducted in this area, have been inconclusive (i.e. mixed results). Empirical evidence notes that there is a positive relationship between audit committee meetings and financial reporting quality (Abbott, Park, & Parker, 2000). On the other hand, other studies found no association between audit committee meetings and financial reporting quality (Bedard, Chtourou, & Courteau, 2004). Thus, the hypothesis to be tested as follows:

H₂: There is a significant and positive relationship between frequency of audit committee meeting and the level of intellectual capital disclosure.

1.2.1.1.3 Audit Committee Independence

The committee oversees the reporting process as well as the internal control mechanism within an organisation. As in the case of the board of directors, the monitoring function on behalf of shareholders is enhanced as the independence of the committee increases (Saleh, Iskandar, & Rahmat, 2007). Beasley, Carcello, Hermanson, and Lapides (2000) argue that financial statements fraud more likely to occur in firms with less-audit committee independence. Since intellectual capital information plays an important role in the share valuation activities of the stock market (Aboody & Lev, 2000). In the Sri Lankan context, code of best practices (2017) recommends audit committee to have minimum three non-executive directors of whom at least two should be independent. If there are more non-executive directors, the majority should be independent. The UK code (2010) recommends that an audit committee should be comprised of at least three (or in the case of smaller firms, two) members, who should all be independent directors. Studies conducted in this area have yielded mixed results. Some studies find that audit committee independence is positively associated with financial reporting quality (Mangena & Tauringana, 2007), whilst others fail to find a significant relationship (Agrawal & Chadha, 2005; Yang & Krishnan, 2005). Thus, Hypothesis 3 can be stated as follows:

H₃: There is a significant and positive relationship between independence of audit committee and the level of intellectual capital disclosure.

1.2.1.1.4 Audit Committee Financial Expertise

A financial expert within the audit committee is defined as a director having accounting, auditing or finance background/relevant experience (Iyer, Bamber, & Griffin, 2012). Sri Lankan best practices on corporate governance (2017) recommends that at least one audit committee member should have recent and relevant financial experience. Li, Mangena, and Pike (2012) argue that audit committees with financial expertise are likely to be in a better position to understand the capital market implications of providing quality intellectual capital disclosures. Accordingly, Akhtaruddin and Haron (2010) note that there is a significant and positive relationship between the level of voluntary disclosures and presence of financial experts within the audit committee. Whereas, Li, Mangena, and Pike (2012) reveal that no significant association between intellectual capital

disclosures and financial expertise. Based on this discussion, hypothesis 4 is stated as:

H₄ : There is a significant relationship between financial expertise on the audit committee and the level of intellectual capital disclosure

1.2.1.1.5 Control Variables

The potential interaction between audit committee characteristics and intellectual capital disclosure can be influenced by other firm factors including the ownership structure, firm size, profitability and other governance-related indicators such as overall board independence (AhmedHaji, 2015). As a result, in addition to audit committee characteristics, this study controls for other variables such as board independence, listing age and profitability (ROA) according to the prior research (AhmedHaji, 2015; Li, Mangena, & Pike, 2012).

1.3 Research Methods

1.3.1.1 Sample Design

The population of interest in this study is (initially) the 295 listed firms on the CSE, as at February 2016. This study excludes financial, investment and securities sector firms because their unique financial attributes, intensity of regulation, and/or intensive use of leverage are likely to confound the outcomes being studied (Pratheepkanth, Hettihewa, & Wright, 2015). Also, the risk of missing data was minimised by excluding firms that were not listed throughout the review period. After the eliminations 100-firmssample, randomly drawn from the exchange –listed firms (Saunders et al. 2009), was analysed. The sources of the data were the 2016/17 financial reports. The financial reports were chosen for two reasons (Bozzolan, Favotto, & Ricceri, 2003; Lang & Lundholm, 1993) such as they are considered an important source of company information by external users and the disclosure level in financial reports is positively correlated with amount of corpoarte information comunicated to the market and to stakeholders using other media.

1.3.1.2 Audit Committee Characteristics' Measures

The size of audit committee, frequency of audit committee meetings, audit committee independence and audit committee financial expertise are used to measure audit committee characteristics.

Variables	Measures	Symbols
Size of audit committee	Number of board directors on audit committee	SAC
Frequency of audit committee meetings	Number of audit committee meetings held during the financial year (2016/17)	MAC
Audit committee independence	Independence directors on audit committee/ Number of board directors on audit committee	INAC
Audit committee financial expertise	Dummy variables would either take the value of 1 if one or more audit committee members have financial expertise, otherwise it would take the value of 0.	FEAC

1.3.2 IC Disclosure Measures

To measure IC disclosure, the study employs content analysis, a method that has been applied by prior literature in measuring ICD (Beattie & Thomson, 2007; Li, Mangena, & Pike, 2012; Li, Pike, & Haniffa, 2008). The study applies framework tested by Li, Pike and Haniffa (2008), which provides comprehensive list of voluntary IC items divided into three categories such as human, relational and structural items.

	Human Capital	Relational Capital	Structural Capital
1	Number of employees	Customers	Intellectual property
2	Employee age	Market presence	Process
3	Employee diversity	Customer relationships	Management philosophy
4	Employee equality	Customer acquisition	Corporate culture
5	Employee relationship	Customer retention	Organization flexibility
6	Employee education	Customer training & education	Organization structure
7	Skills/know-how/expertise/knowledge	Customer involvement	Organization learning
8	Employee work related competences	Company image/reputation	Research & development
9	Employee work-related knowledge	Company awards	Innovation
10	Employee attitudes/behaviour	Public relation	Technology
11	Employee commitments	Diffusion & networking	Financial dealings
12	Employee motivation	Brands	Customer support function
13	Employee productivity	Distribution channels	Knowledge-based infrastructure
14	Employee training	Relationship with suppliers	Quality management & improvement
15	Vocational qualifications	Business collaboration	Accreditations (certificate)
16	Employee development	Business agreements	Overall infrastructure/capability
17	Employee flexibility	Favourite contract	Networking
18	Entrepreneurial spirit	Research collaboration	Distribution network
19	Employee capabilities	Marketing	
20	Employee teamwork	Relationship with stakeholders	
21	Employee involvement with community	Market leadership	
22	Other employee features		

Source: Li, Pike, and Haniffa (2008)

The scoring of the financial reports against the checklist was performed manually by reading the whole financial reports. Each intellectual capital item was scored based on three presentational formats such as text, numerical and graphical, thus receiving a maximum of three points. This means that a company can score a maximum of 183 points (61 intellectual capital items x 3 formats). After scoring all 61 IC items in the three presentational formats, the IC disclosure score(s) for each company are computed as an index by dividing the sum items disclosed by the total number of items expected. For each firm the study created four disclosure indices to capture the overall intellectual capital (ICDI), human capital (HICDI), relational capital (RICDI) and structural capital (SICDI) (Li, Mangena, & Pike, 2012).

1.3.3 Control Variables Measures

The board independence, listing age and profitability are used to measure the control variable of this study (Li, Mangena, & Pike, 2012).

Variables	Measures	Symbols
Board independence	Independence directors/total directors	IND
Listing age	Number of days listed scaled by 365 days a year)	LAGE
Profitability	Return/total assets	ROA

1.4 Results and Discussion

1.4.1 Descriptive Statistics

The 100 firms of the samples are drawn from a range of industrial sectors. Size of audit committee for the Sri Lankan selected firms (in the descriptive statistics), averaged seven and ranged from two to 12 members. There is no precisely recommended size for an audit committee, most previous studies and regulatory requirements seem to suggest three to five members, preferably with a majority of independent directors (Abbott, Parker, & Peters, 2004; DeZoort, Hermanson, Archambeault, & Reed, 2002). The Sri Lankan code of best practices on corporate governance (2017) follows the listing requirements of CSE Sri Lanka that audit committee shall comprise of at least three directors. Although, Bedard, Chtourou and Courteau (2004) indicate that the larger audit committee, the more likely it is to uncover and resolve potential problems in the financial reporting process, because it is likely to provide the necessary strength and diversity of views and expertise to ensure effective monitoring. This suggests that size of audit committee is an integral factor for firms in delivering meaningful corporate reporting. Table 1, also notes that the frequency of audit committee meetings, averaged five and ranging from a minimum of one to a maximum 11 among sample firms. In particular, meet more frequently would have more time perform the role of monitoring the corporate reporting process efficiently (Karamanou & Vafeas, 2005). However, the total number of meetings depends on the firm's terms of reference and the complexity of the firm's operation. The Sri Lankan firms have a majority (83 percent) of their audit committee being independent directors. Albeit, with averagely 43 percent of directors are independent position in the audit committee.

Table 1 - Descriptive statistics for dependent and independent variables

	Mean	Median	Min	Max	SD
<i>Independent variables</i>					
Size of audit committee _ SAC	7.61	8	2	12	2.16
Frequency of audit committee meetings _ MAC	5.14	5	1	11	2.09
Audit committee independence (%) _ INAC	0.43	0.44	0.00	0.83	0.214
Audit committee financial expertise _ FEAC	0.63	1.00	0	1	0.506
Board independence (%) _ IND	0.37	0.33	0.13	0.88	0.152
Listing age _ LAGE	7.57	7	3	13	2.280
Profitability _ ROA	0.015	0.11	-0.28	0.182	0.218
<i>Dependent variables</i>					
Overall intellectual capital disclosure _ ICDI	0.35	0.32	0.10	0.91	0.159
Human capital disclosure _ HICDI	0.41	0.32	0.12	0.98	0.262
Relational capital disclosure _ RICDI	0.31	0.31	0.00	0.89	0.206
Structural capital disclosure _ SICDI	0.29	0.26	0.06	0.93	0.204

The Sri Lankan code of best practices on corporate governance (2017) recommends audit committee to have minimum three non-executive directors of whom at least two should be independent. If there are more non-executive directors, the majority should be independent. Consequently, this study documents that independent directors have a larger influence on audit committee similar to existing studies (Ahmed Haji, 2015). The results also show that 63 percent of the audit committee in the sample firms have members with financial expertise. The Sri Lankan code of best practices on corporate governance (2017) mentions that the audit committee to have at-least one member has recent and relevant experience in financial reporting and control. Prior studies note that financial experts within the audit committee curb internal control weaknesses (Krishnan, 2005) and ensure high financial reporting quality (Bedard, 2004). The most of the selected Sri Lankan firms have a majority (88 percent) of their board being independent directors. 13 percent of firms have minimum independent directors on board, with averagely 37 percent of directors are independent position in the boards directors. The Sri Lankan code of best practices on corporate governance (2017) requirement requires board directors consist at least three independent directors or such number of independent directors equivalent to one third of total number of directors, whichever is high. Prior studies suggest that the number of independent directors on Boards of UK firms has increased considerably. Conyon (1994) examined the corporate governance changes in UK and the study consisted of 400 large UK firms in the Times 1,000 companies between 1988 and 1993. In India, the Birla committee 2004 requires the Board of Directors of a company to have a mix with not less than half of the being independent. It is consistency with Sri Lankan code of best practices rules of the listing rules of the CSE. This study reveals that sample firms have averagely seven years' experience, ranging from a minimum three to 13 years' experience whilst average profitability is 1.5 percent. The mean index for overall intellectual capital disclosure is 0.35 (minimum from 0.10 to maximum 0.91) which implies that 35 percent of items were disclosed. The study observes that human capital disclosure, relational capital disclosure and structural capital disclosure is 0.41, 0.31 and 0.29 respectively. These results indicate that Sri Lankan firms, on average, are aware of the importance of intellectual capital disclosure. The firms appear to provide slightly greater human capital disclosure (ranging from 0.12 to

0.98) than both with relational capital disclosure and structural capital disclosure. This results diverge from Abeysekera and Guthrie (2005) who conclude that the most reported accounting category was relational capital and the second most reported was human capital. These outcomes also sharply contrast with Bozzolan, Favotto, and Ricceri (2003) who reveal that disclosure by Italian firms mainly occurs with regard to relational capital disclosure. Brügger, Vergauwen and Dao (2009) who concludes that disclosure by Australian firms mainly occurs with regard to structural capital disclosure. Vandemaele, Vergauwen and Smits (2005) indicate that firms in Netherlands, Sweden and UK are disclosing more about external structure compared to other ICD categories. Consequently, this study concludes that there seems to be an awareness of the importance of intellectual capital, the reporting practices are far from systematic. There is no established and mutually agreed framework for intellectual capital disclosure within Sri Lankan firms similar to existing studies (Bozzolan, Favotto, & Ricceri, 2003).

1.4.2 Regression Analysis

Table 2 shows that the predictions of the three proxies for intellectual capital disclosure are strong.

Table 2 – Regression results

	Model 1 ICDI	Model 2 HICDI	Model 3 SICDI	Model 4 RICDI
Constant	3.025 (0.000)	1.382 (0.170)	3.075 (0.003)	1.877 (0.064)
SAC	2.066 (0.030)	1.809 (0.074)	1.319 (0.091)	2.756 (0.007)
MAC	2.450 (0.010)	0.661 (0.510)	2.734 (0.036)	0.399 (0.691)
INAC	2.415 (0.039)	2.128 (0.050)	2.171 (0.045)	2.218 (0.028)
FEAC	2.881 (0.041)	1.550 (0.034)	3.827 (0.000)	0.772 (0.442)
IND	2.329 (0.007)	0.137 (0.891)	2.223 (0.029)	2.374 (0.02)
LAGE	2.679 (0.007)	2.137 (0.024)	1.994 (0.049)	2.065 (0.05)
ROA	2.150 (0.034)	1.788 (0.050)	2.516 (0.049)	1.166 (0.03)
R	0.310	0.394	0.381	0.321
R Square	0.296	0.115	0.145	0.103
F	3.397	1.111	2.235	2.511
Sig	0.002	0.038	0.068	0.001

Specifically, the R^2 values indicate that 29.6, 14.5, and 42.8 percent of the variability in, respectively, overall intellectual capital disclosure, human capital disclosure and relational capital disclosure of Sri Lankan firms can be explained by the audit committee characteristics. The F-statistics and significance levels (sig) show that these three models generate statistically significant outcomes. In most cases, the regression results in Table 2, the coefficients of those variables

are significantly and positively related to intellectual capital proxies. Size of audit committee is found to be significant at the 5% on the overall intellectual capital disclosure and relational capital disclosure while there is no significant impact on human capital disclosure and structural capital disclosure.

Empirical studies provide mixed results on the role of size of audit committee in various aspects of intellectual capital disclosure. While a number of studies found size of audit committee to be a significant determinant of financial reporting quality (Li, Mangena, & Pike, 2012; Cornett, McNutt, & Tehranian, 2009). Other studies reported insignificant impact on the financial reporting process (Abbott, Parker, & Peters, 2004). The significant positive association between audit committee size and overall intellectual capital disclosure, as well as structural capital disclosure, indicates that firms are able to share different knowledge and expertise about the potential benefits of releasing information towards hidden values of a firm. Frequency of audit committee meetings is found to have significant and positive effect on overall intellectual capital disclosure and structural capital disclosure. These results imply that frequency of audit committee meetings is an important factor in enhancing intellectual capital disclosure in order to reduce information asymmetry.

These results are consistent with corporate governance recommendations (eg., UK code, 2010) that audit committee should meet frequently. More frequent meeting would mean high-level oversight of all corporate reporting issues, including intellectual capital disclosures. This is in line with the observations by Li, Mangena, and Pike (2012) in the UK. The results, however, are not in line with the findings by Rahman and Mohamed (2006) who found no association between audit committee meetings and financial reporting quality. As result, audit committees seem to have become aware of the recent public attention towards their commitment in discharging their roles effectively, which could have resulted in an improved role of audit committees in corporate reporting quality. The audit committee independence has a significant and positive impact on all intellectual capital disclosure measures.

This result is consistent with prior research including Mangena, Pike, and Li (2010). These results are inconsistent with Agrawal and Chadha (2005) and Yang and Krishnan (2005), who fail to detect a significant relationship. The coefficient of audit committee financial expertise is found to be significantly related to overall intellectual capital disclosure, human capital disclosure and structural capital disclosure while no significant impact of audit committee financial expertise on relational capital disclosure at 0.05 significance level. These results indicated that financial experts within the audit committee curb internal control weakness (Krishnan, 2005; Zhang, Zhou, & Zhou, 2007) and ensure high financial reporting quality (Bedard, 2004). Board independence has a positive and significant impact on all measures of intellectual capital disclosure except human capital disclosure. It can be interpreted that increase in board independence has a beneficial effect on intellectual capital disclosure. In all coefficients, the controlling variable listing age has a positive and significant impact on intellectual capital disclosure which indicates that the length of time a firm has been listed on a CSE could be relevant in explaining the variation of disclosures. The positive and significant impact of ROA on intellectual capital disclosure indicates that ROA would be the result of continuous investment in intellectual capital and firm may

engage in higher disclosure of such information to signal the significance of their decision in investing in it for long-term growth in the value of the firm.

1.5 Concluding Remarks

As a summary, this study investigates the impact of audit committee characteristics on intellectual capital disclosure in Sri Lanka as an emerging country with the aim to update of existing literature in this area. Intellectual capital disclosure is an appropriate approach for firms to meet stakeholders' intellectual information needs. Intellectual capital disclosure could help to decrease information asymmetry, to decrease the cost of capital and to improve reputation (Brüggen, Vergauwen, & Dao, 2009).

This research aspirations and intent of this study are summarised in the following hypotheses that are first presented in literature review and a hypotheses development section:

H₁: There is a significant and positive relationship between audit committee size and the level of intellectual capital disclosure

The effectiveness of an audit committee largely arises from the available resources: the number of members forming the committee (DeZoort, Hermanson, Archambeault, & Reed, 2002; Bedard, Chtourou, & Courteau, 2004; Abbott, Parker, & Peters, 2004). The size of audit committees range from two to 12 members with a mean score of 7.61. This is in line with Sri Lankan code of best practices on corporate governance (2017). The study finds size of audit committee to be significantly and positively related to overall intellectual capital disclosure and relational capital disclosure though there is an insignificant and positive impact on human capital disclosure and structural capital disclosure. These findings confirm by: Lin, Li and Yang (2006); Cornett, McNutt, and Tehranian (2009) but contrary to a study by Bedard (2004). On balance, this study confirms the H₁ assertion of: *There is a significant and positive relationship between audit committee size and the level of intellectual capital disclosure*

H₂: There is a significant and positive relationship between frequency of audit committee meeting and the level of intellectual capital disclosure

A more active audit committee is expected to provide an effective monitoring mechanism. Since, the level of audit committee activity reflects good governance (Saleh, Iskandar, & Rahmat, 2007). Financial Reporting Council (2008) states that formal meetings of the audit committee are the heart of its work and sufficient time should be allowed to enable the audit committee to undertake as full a discussion as may be required. The results show that the frequency of audit committee meetings ranges from one to 11 meetings, with a mean score of 2.09 meetings. Financial Reporting Council (2008) recommends that audit committee should hold a minimum of three or four meetings a year. The findings of significant impact frequency of audit committee meetings on overall intellectual capital disclosure and structural capital disclosure are consistent with prior studies including Dalton, Daily, Johnson, and Ellstrand (1999) However, these outcomes contrast with Rahman and Mohamedm (2006) who found that no relationship between the frequency of audit committee meetings and financial reporting quality. Overall, these results affirm the H₂ assertion that: *There is a significant*

and positive relationship between frequency of audit committee meeting and the level of intellectual capital disclosure.

H₃: There is a significant and positive relationship between independence of audit committee and the level of intellectual capital disclosure

The single most cited feature of an effective audit committee as an essential monitoring governance mechanism is its independence (Abbott, Parker, & Peters, 2004; Bronson, Carcello, Hollingsworth, & Neal, 2009), with the sample firms' audit committee independence ranging from zero percent to 83 percent, with a mean score of 43 percent. The study observes that audit committee independence is significantly and positively associated with intellectual capital disclosure indices. The notion to favour independent audit committees is based on the assumption that the independent directors play a supervisory role and have no relationship with the inside management (Carcello & Neal, 2003). These findings are consistent with studies conducted by Mangena and Taurigana (2007). However, the findings diverge from Agrawal and Chadha (2005) and Yang and Krishnan (2005) who fail to detect a significant relationship. These results support the H₃ assertion that: *There is a significant and positive relationship between independence of audit committee and the level of intellectual capital disclosure*

H₄: There is a significant relationship between financial expertise on the audit committee and the level of intellectual capital disclosure

The Sri Lankan code of best practices on corporate governance (2017) mandates listed firms to have at least one audit committee member who has recent and relevant experience in financial reporting and control. The average score of financial expertise within the audit committee of the sample firms is 63 percent, with further analysis showing that only one firm didn't meet the requirements embedded in the Sri Lankan code of best practices (2017) for firms to have at least one financial expert within their audit committee structure. The relationship between audit committee financial expertise and overall intellectual capital disclosure, human capital disclosure and structural capital disclosure is positive and significant at the 0.05 significance level. These results are consistent with a study by Krishnan (2005) and Zhang, Zhou, & Zhou, 2007 which report that a significant positive association between the presence of financial experts within the audit committee and the level of voluntary disclosures. In contrast, Rahman and Mohamed (2006) find no relationship between the presence of financial experts and financial reporting quality. These results support the H₄ assertion that: *There is a significant relationship between financial expertise on the audit committee and the level of intellectual capital disclosure.*

In terms of the control variables, the study finds that board independence is positively and significantly associated with intellectual capital disclosure indexes except human capital disclosure. The findings also demonstrate that listing age and ROA is positively and significantly associated with intellectual capital disclosure indexes.

The findings of this study provide number of interesting implications for academics, researchers, policy-makers and practitioners. The findings suggest that the role of audit committees can be extended to ensure the quality of non-financial information and not just the financial reporting process. Policy makers in

Sri Lanka should, therefore, build on regulatory changes and encourage audit committees to ensure the quality of the overall reporting process to include social, environmental, intellectual as well as financial capital of firm. Concurrently as Sri Lanka passes through its post-war-recovery phase, reform of its financial reporting regulatory is essential to sustain economic growth and development. In terms of theoretical implications, the findings seem to support the grounds of both agency and legitimacy theories in regulatory reforms settings. Agency theory propounds that the audit committee function offers a monitoring role that can potentially enhance the quality of corporate reporting, with legitimacy theory suggesting that firms adopt different disclosure and governance strategies to respond to changes in the market place. The limitation is the difficulties inherent in discovering and adjusting for variations in the intellectual capital disclosures, business scope, and/or financing portfolio across firms. Specially, the intellectual capital disclosures may actually be influenced by variables other than those considered in this study. The difficulties from accounting principles differing between firms have been greatly mitigated over the past decade by the increasing adoption and use of International Financial Reporting Standards (IFRS). Future research should consider including many countries across the emerging to developed continuum, so as to support more generalised conclusions. In addition to this, longitudinal study might be more able to validate findings.

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