

THE EFFECT OF BOARD DILIGENCE ON THE AUDIT COMMITTEE EFFECTIVENESS DURING THE COVID-19 CRISIS: EMPIRICAL EVIDENCE FROM FRENCH COMPANIES

Ibtissem Kaabi *

* International Finance Group Tunisia (IFGT); Faculty of Economic Sciences and Management of Tunis, Tunis El Manar University, El Manar, Tunisia

Contact details: Faculty of Economic Sciences and Management of Tunis, Tunis El Manar University, Campus Universitaire, B.P. 248 El Manar II 2092, Tunisia



Abstract

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The purpose of this research is to investigate the effect of board diligence on the audit committee's effectiveness throughout the COVID-19 pandemic. Using a sample of the top 164 non-financial French companies listed on CAC All-Tradable during 2020. The paper employs the ordinary least squares method to look at the relation between audit committee effectiveness score and board activity during the health crisis. The results indicate that board activity positively affects the effectiveness of the audit committee during the COVID-19 crisis. We find a significant positive association at the 1 percent level between company size and audit committee effectiveness scores related to companies in the medical sector. However, factors such as firm age and leverage had no impact on effectiveness. We recall that this line of research is very little explored in the world and that our study is the first to have addressed this issue in the French context. This result cements the notion to professionals, managers, and stakeholders who deem that the board of directors is a pillar of success and resilience, as it is considered the most relevant governance mechanism in critical situations.

Keywords: Board of Directors Activity, COVID-19 Pandemic, Audit Committee, Effectiveness, France

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1. INTRODUCTION

The coronavirus, like a natural disaster, has provided an excellent opportunity to reactivate the importance of the function and effort of governance structures in effective crisis management, as was the case previously during the 2008 financial crisis. Indeed, corporate governance bodies are looking for answers to their concerns about how to organise work effectively in the current situation

recognised by the rapid changes related to the business environment and the new challenges of work. In this emergency situation, the efforts of the board of directors and the effectiveness of its audit committees in overcoming this crisis are paramount, especially with regard to their role in controlling risks and establishing effective internal control.

Appreciating the proactive French model which has been actively involved in overcoming crises both

through agreements and partnerships with the World Health Organization (WHO) (Decree No. 2020-243 of March 12, 2020¹) and through the promulgation of rules of governance and crisis management (Law No. 2020-290 of March 23, 2020, on Emergency Declaration and Measures²). This law has given the board greater flexibility in terms of its activities, as it is the body responsible for monitoring and advising. The quality of these two functions will certainly be decisive in the struggle against the crisis.

In view of these new changes in French board activity and the lack of studies on this point, our study attempts to answer a critical question:

RQ: What is the effect of French board activity on the audit committee's effectiveness during the COVID-19 crisis?

The remainder of this paper is structured as follows. Section 2 reviews the relevant literature. Section 3 presents the methodology applied to the study. Section 4 provides the results and discusses the findings. Section 5 concludes the paper.

2. LITERATURE REVIEW

Since the financial scandals, the board of directors has been in the spotlight of the investor community, which still expects it to assume the greatest responsibility in terms of oversight, risk management, and value creation. This idea was strongly supported by agency theory, as the board is likely to have a generative role in the organization and its relationships with stakeholders (Jensen & Meckling, 1967). Particularly, its activity is determined by the number of meetings organized during the year. In this sense, Yatim et al. (2006) found that boards that meet usually have a greater probability of being diligent and effective in carrying out their function.

Indeed, to be effective, the board's mission must be supported by the continuous and effective work of its committees where the audit committee plays the most critical function in crisis management. Indeed, the audit committee mainly prepares the work of the board of directors and intervenes to strengthen managing risk and internal auditing (Saada, 1998).

Numerous research studies indicate that the assessment of the effectiveness of the audit committee is not always proportional to its mission of risk mitigation but can be determined by its characteristics (Persons, 2009). In fact, it is crucial to emphasise that the vast expanding body of investigation on audit committees examines their effectiveness by analysing their characteristics, namely, size (Pincus et al., 1989; Allegrini & Greco, 2013; Madi et al., 2014), autonomy (Carcello & Neal, 2003), gender (Chen et al., 2016; Adams & Ferreira, 2009; Mercier-Suissa et al., 2018; Oradi & Izadi, 2019), meetings (Menon & Williams, 1994; Xie et al., 2003), expertise (Bedard et al., 2004; McDaniel et al., 2002; Beasley & Salterio, 2001). Thus, Alhababsah and Yekini (2021) highlight the importance of other non-financial types of expertise that can have a significant effect on audit quality and, consequently, effectiveness, namely legal and industrial expertise.

Furthermore, good interaction between the board of directors members and committees seems to be an adequate solution to overcome the most difficult hurdles. In this respect, Cai et al. (2015) noted that the most advantageous governance mechanism combinations are more effective in minimizing expenses and defending stakeholder goals in a company. They explain that corporate governance effectiveness is accomplished via various channels and that the success of a specific mechanism is dependent on the effectiveness of another one.

It is essential to highlight the fact that Aljaaidi et al. (2021) conducted the most and only recent study on the direct impact of board activity on audit committee effectiveness index based on a sample of 195 firms-observations that focus on industrial companies listed on the Saudi Stock market from 2015 to 2017. These researchers discovered a significant positive correlation between board activity and effectiveness score. Consequently, there is complementarity between the board of director's functions and the effectiveness of the monitoring committee. Hence, the idea of the board's supporting internal role during the crisis, as recommended by Deloitte (2020a), is affirmed.

In their study of 176 non-financial French listed companies during the period 2004-2008, Maraghni and Nekhili (2014) found a positive relationship between board meetings and audit committee meetings. This result is also supported by Thiruvadi (2012). Contrary to Braswell et al. (2012) and Al-Najjar (2012), they confirmed a negative association between these two variables. However, Jensen (1993) denies the latter claim and argues that the number of meetings is insignificant because the time spent exchanging opinions between outside directors and management is usually organised according to an agenda prepared by the director.

Accordingly, the Financial Reporting Council (FRC, 2018) emphasizes the prominent role of the board chair in encouraging board members to collaborate and participate in committees by sharing their knowledge, skills, and experiences. Moreover, the chair must guarantee that both the board and its committees will keep having meetings according to a regular schedule in accordance with the gravity of the situation. Indeed, solidarity is the primary rule in such critical cases. Hence, the battle against the health crisis requires more shared work as well as a fluid interaction between the board and audit committees which allows for rapid decision-making by board members. Similarly, the FRC (2018) attests that boards can reduce the risk of making wrong choices by investing time in their decision-making processes and procedures that involve the participation of committees and the reception of feedback and professional advice, if needed, from important stakeholders.

Indeed, the health crisis has challenged boards in their meeting agendas and the way they operate, especially with the emergence of new work instructions, such as the case of Law No. 2020-290 in France. Evidently, in these circumstances, the manner in which the board should meet is a new and urgent matter (Deloitte, 2020b, 2020c). As a result, board members' interactions with one another or with committees have become increasingly virtual through meetings conducted

¹ <https://www.legifrance.gouv.fr/jorf/id/JORFTEXT000041721661>

² <https://www.covidlab.org/item/law-no-2020-290-emergency-declaration-and-measures/>

over the phone, video conference, Skype, or other social networking platforms. In this regard, Deloitte (2020c) affirmed that several boards hold regular telephone or teleconference meetings, and the virus is forcing many boards to hold virtual meetings as frequently as needed. Thus, this remote meeting puts extra pressure on the chair to ensure that all participants contribute and are heard since they will act as moderators.

Moreover, in rigorous previous literature, we note that communication methods (virtual or face-to-face meetings) affect interaction procedures and decision quality (Mobius & Rosenblat, 2006). Thus, Cai et al. (2023), in their interesting comparative study dealing with remote board meetings and board surveillance effectiveness of Chinese firms, revealed that distant meetings are correlated with higher board meeting participation behaviour, greater sensitivity to director-forced turnover performance, greater supervisory proposals, and more effective investments, compared to face-to-face conversations. They found that meetings held remotely improve board supervision effectiveness by facilitating status equality among directors and relieving conformity pressure. Equally, they confirm in their study that directors who are present in distant meetings are more likely to express their views on issues concerning the supervisory process, especially when these issues are related to a serious conflict of interest between participants, compared to directors who meet face-to-face. According to the current literature on board activity and audit committee effectiveness (Vafeas, 1999; Maraghni & Nekhili, 2014; Aljaaidi et al., 2021), this study aims to examine the effect of board diligence on audit committee success. Hence, the following hypothesis can be stated:

H1: There is a positive correlation between the audit committee's effectiveness and board activity throughout the COVID-19 crisis.

3. DATA AND METHODOLOGY

3.1. Data

The final sample included 164 non-financial French-listed firms in 2020, which are concerned by the new regulations enacted by France in times of crisis. We used data from 2020 because we intended to evaluate our research during the COVID-19 period, which was officially declared as the year of a global health emergency started on March 11, 2020, by the WHO. Most empirical studies relating to coronavirus were conducted during this year (Khatib & Nour, 2021), which means that annual reports for the following years are not available at the time of the preparation of this study. Moreover, these French companies belong to various industries, such as gas and oil, industrials, consumer goods, health care, consumer services, basic materials, and telecommunications. The data of this research in terms of board meetings, audit committee size, meeting, size and gender, firm age, firm age as well as firm leverage were manually selected from the annual reports of the considered firms as shown in Table 1. This table describes the sample-choosing procedure. After removing 74 companies with missing and invaluable data, our usable sample size was 164.

Table 1. Sample choosing procedure

<i>Sample details (year 2020)</i>	<i>Total</i>
Total non-financial companies listed on CAC All-Tradable	238
Firms with missing and incomplete corporate governance and financial details	54
Firms applying L823-20 instructions (the functions of the audit committee are the role of the board)	20
Final sample	164

3.2. Methods

Referring to the data deduced by Aljaaidi et al. (2021), our study employs the ordinary least squares (OLS) method to look at the association between audit committee effectiveness and board activity during the health crisis.

An analysis of the residuals was performed using the skewness-kurtosis test (normality) and the homoscedasticity test to verify the assumption of the OLS method. Therefore, the equation for our model is as follows:

$$ACE_S_i = \beta_0 + \beta_1 B_AC + \beta_2 \ln F_SIZE + \beta_3 F_AGE + \beta_4 INDUSTRY + \beta_5 LEV + \varepsilon_i \quad (1)$$

where, the dependent variable is the audit committee effectiveness index (ACE_S) is measured by a composite index of the audit committee including (size, meeting, gender, and three areas of expertise, namely industrial, medical, and financial) (Aljaaidi et al., 2021).

The independent variables are:

- Board activity or meeting (B_AC) is determined by the number of meetings (virtual/face-to-face) held in 2020 (Khatib & Nour, 2021).
- Firm age (F_AGE) is the number of years since the company was founded (Oradi & Izadi, 2019).
- Firm size (F_SIZE) is measured by the natural logarithm of a company's total assets (Oradi & Izadi, 2019).
- $INDUSTRY$ is a dummy variable: if the company operates in the healthcare sector, it takes 1 and 0 otherwise (Alhababsah & Yekini, 2021).
- Leverage (LEV) is the total debt divided by the total assets ratio (Oradi & Izadi, 2019).
- ε is the error term of the model.
- β_0 is the model's constant, and $\beta_1, \beta_2, \beta_3, \beta_4,$ and β_5 are the coefficients to be estimated from the model.

4. RESULTS AND DISCUSSION

Table 2 reports the descriptive statistics results. For the 164 companies, the means of ACE_S and B_AC are 2.43 and 9, respectively. This states that the French board held an average of nine meetings in 2020. We note that the average number of meetings is high compared with the number recommended by French governance codes AFEP-MEDEF (at least one meeting per quarter). This is probably a result of the challenges that were encountered during the health crisis year.

Thus, concerning company characteristics, the mean value of company size (F_SIZE) was 14.24. Furthermore, the mean value of age (F_AGE) since

a firm was established is 48 years, and it ranges from 1 to 355 with a standard deviation of 45.55079. This variable always reflects the company's degree

of maturity (Wijana et al., 2013). Among the sample firms, 18% are related to the health sector and total liabilities represent 45% of total assets (*LEV*).

Table 2. Descriptive statistics

<i>Variables</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>Minimum</i>	<i>Maximum</i>
<i>ACE_S</i>	2.432934	0.8866245	0.4166667	6.555542
<i>B_AC</i>	9.054878	4.152393	3	30
<i>F_SIZE</i>	14.24136	2.50696	3.912023	18.56683
<i>F_AGE</i>	48.66463	45.55079	1	355
<i>INDUSTRY</i>	0.1829268	0.3877906	0	1
<i>LEV</i>	0.4525909	0.2867712	0	2.823764

Table 3. Multicollinearity statistics of assessing variance inflation factor

<i>Variables</i>	<i>Variance inflation factor (VIF)</i>
<i>B_AC</i>	1.11
<i>F_SIZE</i>	1.43
<i>F_AGE</i>	1.26
<i>INDUSTRY</i>	1.13
<i>LEV</i>	1.01

Table 4. Correlation matrix of independent variables

<i>Variables</i>	<i>B_AC</i>	<i>F_SIZE</i>	<i>F_AGE</i>	<i>INDUSTRY</i>	<i>LEV</i>
<i>B_AC</i>	1.0000				
<i>F_SIZE</i>	0.2821	1.0000			
<i>F_AGE</i>	0.1037	0.4410	1.0000		
<i>INDUSTRY</i>	0.0531	-0.2860	-0.2186	1.0000	
<i>LEV</i>	0.0499	-0.0426	0.0440	0.0476	1.0000

Moreover, to uncover potential multicollinearity issues, the correlations among independent variables were reviewed and VIFs were measured. As shown in Table 3, the VIFs for each independent variable were less than 2 showing no multicollinearity among variables.

We also carried out a correlation evaluation among all the factors present in our model to assess

multicollinearity. By reading the correlation matrix between the independent variables (Table 4), we noticed that all values were lower than 0.5, which indicates that the problem of multicollinearity was not raised. It should be pointed out that multicollinearity becomes an issue if the correlation between the variables exceeds a certain threshold namely 0.7 (Shahwan, 2015).

Table 5. Model estimation

<i>Variables</i>	<i>Coefficient</i>	<i>t-value</i>	<i>p-value</i>
Constant	-0.1403	-0.36	0.720
<i>B_AC</i>	0.0545	3.64	0.000***
<i>F_SIZE</i>	0.1438	5.07	0.000***
<i>INDUSTRY</i>	0.4340	2.69	0.008***
<i>F_AGE</i>	0.0007	0.55	0.585
<i>LEV</i>	-0.1838	-0.89	0.375
R ²		0.3026	
Adjusted R ²		0.2804	
F-statistics		13.63	
p-value		0.000***	

Note: *** Significant at a 1% level.

Table 5 shows the regression results. As demonstrated in this table, the F-value is high and significant which indicates that our regression model is significant at the 0.01 level. We additionally observed that the R-square value shows that 30.26 percent of the fluctuations in the dependent variable (*ACE_S*) could be explicated by the independent variable.

The results revealed a positive correlation between the board of directors' activity and the audit committee's effectiveness, showing that the coefficient of the variable *B_AC* has a significant and positive relationship with *ACE_S* at the 1% threshold, which validates our study hypothesis.

This positive correlation can be explained by the diligence of French boards of directors has enabled them to enhance the effectiveness of audit

committees through the complementarity of these two internal mechanisms, which play a vital role in protecting the interests of the company against crisis-related risks, including health crises. Thus, although the board delegates some of its functions to the audit committee, its functioning remains a determining factor in its efficiency

As recommended by France's new emergency legislation, the board of directors has succeeded, through its meetings (face-to-face and virtual), in taking an interest not only in management but also in accounting aspects and the impact of COVID-19 on financial reporting, which is the vocation of the audit committee, to make its decisions increasingly relevant through the shared search for solutions to crisis situations. Indeed, it seems that group work is crucial to the engagement's success.

This work is characterised by the sharing of ideas, knowledge, and expertise in order to accomplish tasks efficiently and to overcome the most difficult periods more easily (Lin & Hwang, 2021). Thus, previous research has demonstrated that the mutual benefits of knowledge exchange are efficient at encouraging and enhancing the transfer of knowledge in order to attain reciprocal long-term cooperation (Bock et al., 2009).

Consequently, it can be concluded that the key factor of success for an organisation during the COVID-19 crisis is the complementarity among the board, the audit, and the management, where the board of directors plays the role of a spokesperson to support and reassure the stakeholders on how the team is managed in that difficult predicament and how to best communicate during the crisis at hand (Deloitte, 2020c). Therefore, our results align with the findings of Aljaaidi et al. (2021) and the agency theory which affirms the vital role of the board in the survival of the company. Thus, they confirm that both board activity and the audit committee effectiveness index provide a symbiotic function as an internal corporate governance mechanism.

Conversely, in terms of control variables, data analysis revealed that there is no significantly positive relationship between firm age, leverage, and audit committee effectiveness score. This result contradicts those of Aljaaidi et al. (2021), who confirm the existence of a beneficial relationship between the age of the company and the effectiveness of the audit committee and a negative correlation between debt and this efficiency, particularly in the context of Saudi Arabia.

The relationship between firm size and audit committee effectiveness is positive and significant at the 1% threshold. It appears that in times of crisis, the importance and complexity of large companies require more effort from audit committees to encourage them to be more relevant in terms of size, presence of women, and frequency of meetings. In the same context as French companies, this result is also supported by Maraghni and Nekhili (2014), and further cemented by numerous empirical studies confirming the positive association between firm size and committee diligence (Menon & Williams, 1994).

Within the scope of our results, we find that there is a positive correlation between firms in the healthcare sector and audit committee effectiveness. Indeed, we can justify our results by the fact that some risks related to the healthcare sector, especially during the COVID-19 pandemic, require increased efficiency and competence from audit committees (such as the increased number of meetings), as noted by Raghunandan and Rama (2007).

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5. CONCLUSION

This study aimed to examine the impact of board activity, measured through the number of distant and face-to-face meetings, on the audit committee effectiveness among 164 non-financial French listed companies in 2020.

In accordance with agency theory and the results of other researchers, this study confirms the presence of a significant and positive correlation between board activity and the effectiveness of audit committees during the most critical periods.

Furthermore, our research result revealed and once again proved the vital role of the board in strengthening the effectiveness of the audit members by making the right decisions to guarantee the efficiency of the way in which the firm is managed and controlled forming the notion of corporate governance.

Thus, this result emphasizes the possibility that, if deemed necessary, the board may provide the necessary funds for the audit committee to obtain accounting and legal advice from external experts.

Additionally, the overall results of our study provide empirical evidence showcasing that the board plays a dominant position in the governance system through its positive interaction to improve the effectiveness of the committee. Conversely, the literature has been extended by a similar study to cover a developed country context, such as the case of French companies.

This study can also be understood as an analysis of the work of the boards that managed to operate under the new instructions put in place by the French government. Consequently, it can be concluded that French economic policy has made every effort to help listed companies overcome the health crisis with less damage.

This study, inevitably, has limitations that create a path for future research. First, the measurement of our score was limited to four characteristics: size, expertise, gender, and meetings. In fact, it will be useful to incorporate other characteristics in the calculation and evaluation of the audit committee effectiveness score, such as age and tenure. Second, thanks to the future availability of annual reports for the years 2021-2022, it will be interesting to examine our research question pre-, peri-, and post- the health crisis of COVID-19 through a comparative study. Finally, future research can address other contexts, especially since COVID-19 had an impact on several areas, namely management and governance. It can also shed light on its impact on the reliability of financial reporting and even external audit engagement.

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