The impact of an audit committee’s independence and competence on investment decision: a study in Bahrain

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Abstract

Purpose – This study aims to investigate the impact of the audit committee’s (AC) independence and competence on the company’s investment decision-making in Bahraini-listed companies.

Design/methodology/approach – A quantitative method is used, and cross-sectional data are collected through a self-administered questionnaire survey. A stratified random sample technique is adopted with a total of 409 respondents from 39 listed companies. A descriptive analysis is used to identify the characteristics of the respondents, while the correlation analysis and linear regression analyses are used to test the model and explain the relationship between variables.

Findings – It is found that the AC independence and AC competence have a positive and significant influence on investment decision-making.

Originality/value – The AC’s independence and competence are importantly crucial for the decision-makers in improving the quality of financial reporting, internal control and audit. This may lead to the increase in investors’ trust on financial reports and thereby making favorable investment decisions.

Keywords Audit committee, Independence, Competence, Investment decision, Bahrain

1. Introduction

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

An effective corporate governance mechanism would improve the quality of supervising the management actions and activities (Dechow et al., 2010). One important composition of corporate governance is an audit committee. This committee is formed from firms’ boards of directors (BoD) to oversee the activities of the company’s management and ensure the compliance with the firms’ regulation in general and the financial guidelines in particular. In the United States, the
accounting scandals occurred in the last decade such as the Enron scandal that had increased the urge for more robust regulations to protect users of the financial information. The initial step to improve this protection was provided by the Blue Ribbon Committee (BRC) report issued in 1999. This report offered several recommendations mainly to improve firms’ audit committees’ (AC) effectiveness and to strengthen their independence. Later in 2002, Sarbanes-Oxley Act modified a range of ACs’ requirements and added more responsibility to this committee. These requirements call for more independent and competent AC. With that, AC members should not have any relationship with the management and should include nonexecutive and nonrelated members. The existence of this important feature will ultimately result in a better financial reporting control and monitoring (Koh et al., 2007). Moreover, the AC’s competence improves the company’s ability to prevent and detect any fraudulent activities and strengthen its internal control (Zhang et al., 2007; Hoitash et al., 2009). Bedard et al., (2014) found that the most important characteristics of AC which have a positive relationship with AC’s effectiveness are AC’s independence and competence.

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

The Gulf Cooperation Council (GCC) countries are considered the major providers of the global energy among these countries with Bahrain considered to be the center of the (GCC) countries due to its stable economic and political environments with advanced free market economy. Based on the index of the Economic freedom (2017) [1], Bahrain is considered a financial hub in the Middle East and North Africa, that has been ranked 44th in the world and 4th in the Middle East and North Africa. Bahrain has a well-organized stock exchange market which was established in 1987 and was replaced later in 2010 by Bahrain Bourse (BHB). BHB has 44 listed companies by the end of 2016 (BHB, 2016). Starting from 2002, the Central Bank of Bahrain (CBB) replaced the Ministry Of Commerce in issuing BHB’s regulations and overseeing the bourse’s activities. In 2011, CBB issued the corporate governance code (CGC) in which the audit committee was the most important article. Therefore, all Bahraini-listed companies were mandated to establish the AC to ensure the quality of financial reporting and provide the investors with more helpful and useful information.

Given the significance of the investor’s trust in the financial reporting quality that may affect his investment decision, it is important to explore into any factor that may affect this trust and subsequently, the investment decision. This study aims to investigate the impact of AC independence and competence on the company’s investment decision-making in Bahraini-listed companies.

This paper provides a unique investigation of the influence of the audit committee’s independence and competence on the investment decision in one of the emerging markets. Therefore, it is expected that this study will fill the gap of the literature regarding the impact of AC independence and competence on investment decisions in a developing country. This study makes a number of contributions as follows: (1) different dimensions of AC effectiveness have been used and compared to previous studies that focused on their relationship with the quality of financial reporting, internal control and external and internal auditing; (2) the employment of decision-makers in Bahraini-listed companies compared to the two Cohen’s studies that used experimental studies on MBA students; (3) the study is done in a developing country with a different topic, whereas other studies only emphasized the AC subject and its relationship with AC characteristics; therefore, this study complements the literature with an addition of the most important characteristics of AC (independence and
competence) toward investment decision-making. This will also provide the basis for further research in developing countries on investment decision-making.

In order to achieve the study’s aim and objectives, a quantitative method is used, and the cross-sectional data are collected through a self-administered questionnaire survey. A stratified random sample technique is adopted with a total of 409 respondents from 39 listed companies. The findings revealed a positive significant impact of the AC’s independence and competence on the investment decisions.

2. Literature review

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

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

2.1 AC independence

The absence of any relationship between AC members and the management is considered an important indication about the independence of AC (BRC, 1999). An independent AC is crucial to be demonstrated by the stakeholders to increase their trust in the credibility of the financial reporting; thus, it is called an effective AC. This is asserted by Abbott et al. (2004) that the independence of AC improves the credibility of the financial information. Therefore, some studies indicated that more qualitative audit services are requested by a more independent AC (Abbott et al., 2003; Carcello et al., 2002).

Most of the previous studies had focused on investigating the relationship between AC independence and its effectiveness. For example, Bedard et al., (2014) carried out a comprehensive review of the literature based on 83 analyses investigating the association between AC effectiveness and its independence. It is found that 47 (53%) had a positive relationship between AC independence and its effectiveness, while 35 (42%) showed no significant relationship. Similarly, Klein (2002) found that the proportion of independent members (nonexecutive) had a positive significant relationship with AC effectiveness. However, some studies did not find any significant relationship between AC independence and its effectiveness (Lin et al., 2006; Waweru and Riro, 2013).

Other studies investigated the association between AC independence and the quality of financial reporting. For instance, Lary and Taylor (2012) conducted a study among Australian-listed companies and revealed a significant relationship between the
independence of AC and its effectiveness. It indicates that the more independent the AC, the less incidence and severity of the financial restatement. Meanwhile in Bahrain, Desoky and Khasharmeh (2016) surveyed the listed companies’ financial managers, internal auditors, accountants and other employees, and they found that financial reporting quality is positively associated with the AC’s independence. The same result was found in Belgium by Valminck and Sarens (2015) who found a significant positive relationship between the financial statements’ quality and AC independence. Additionally, Bruyneels and Cardinaels (2014) found that the existence of any social or professional association between AC members and the management negatively affects the quality of financial reporting.

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

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

**H1.** AC independence is positively associated with companies’ investment decision.

### 2.2 Audit committee (AC) competence

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

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

Several studies found that AC competence is significantly associated with the production of qualitative financial reports (Dezoort, 1999; McDaniel et al., 2002; Abbott et al., 2004; Carcello et al., 2006; Kamolsakulchai, 2015; Kusnadi et al., 2015; Desoky and Khasharmeh, 2016; Kibiya et al., 2016). A recent study in Nigeria by Kibiya et al. (2016) on the impact of AC characteristics on the financial reporting quality of listed companies (n = 505) in the period of 2010–2014 found that one of the variables which has a significant impact on the quality of financial reporting is the existence of financial experts in AC.

Moreover, other studies focused on the importance of AC competence to the quality of the internal audit function (Goodwin, 2003; Raghunandan et al., 2001; Goodwin and Yeo, 2001). A study by Goodwin (2003) in Australia and New Zealand companies revealed that AC members with financial literacy (accounting and finance) have an important influence on the relationship between AC and the function of internal audit.
With regard to the quality of internal control, Krishnan (2005) found a positive relationship between the number of AC members possessing financial experience and the quality of internal control. Likewise, Krishnan and Visvanathan (2007) found an inverse relationship between the financial experience of AC members and fraudulent practices in the firms investigated. Meanwhile, Abbott et al. (2002) did not find any significant relationship between AC competence (having financial expertise) and financial report misstatements. Similarly, Yang and Krishnan (2005) and Lin et al. (2006) found no significant relationship between AC competence and the quality of financial reporting.

Accordingly, most of the previous studies made an assertion on the positive relationship between the competence of AC (financial and industry expertise) and the quality of financial reporting, that will be valued by investors (Cohen et al., 2016). Investors will assess the financial reporting produced as being more reliable if they believe in the competence of the AC; hence it will affect their investment positively. This expectation led to the following hypothesis:

\[ H2. \ AC \text{ competence is positively associated with companies’ investment decision.} \]

2.3 Hypothesized research model

Based on the literature review discussed, Figure 1 shows the study’s hypothesized research model:

(1) This model can be expressed as follows:

\[
\text{IDM} = \alpha + \beta_1 \text{ACIND} + \beta_2 \text{ACOM} + \varepsilon
\]

where: IDM : investment decision-making; ACIND : audit committee independence; ACCOM : audit committee competence and \( \varepsilon \) : random error.

2.4 Variables’ definitions and measurement

The current study consists of two independent variables, namely AC independence and AC competence, and one dependent variable, namely investment decision. The following table shows the definition of each variable:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC independence</td>
<td>The absence of any social or professional relationship with the management</td>
</tr>
<tr>
<td>AC competence</td>
<td>Audit committee possesses members with financial literacy and industrial expertise</td>
</tr>
<tr>
<td>Investment decision</td>
<td>Investors’ decision to invest in companies</td>
</tr>
</tbody>
</table>

Table 1. Variables definition

Figure 1. Hypothesized research model
3. Research method
This exploratory study used the survey method to achieve its objectives. The respondents of this study are CEOs, CFOs, accountants, internal auditors and other individuals such as treasurers, controllers, financial analysts and portfolio managers that at least possess the required financial knowledge and are involved in the investment decision-making process. Those respondents were obtained from 44 listed companies in Bahrain Stock Exchange (BHB). A stratified sampling technique was used, and 650 self-administrated questionnaires were distributed. However, 451 questionnaires were returned from 39 listed companies, and 5 listed companies had refused to participate in this study. Upon checking the returned questionnaires, 42 questionnaires were excluded because respondents left more than 25% of the items unanswered (Sekaran, 2005). Accordingly, the final number of useable questionnaires for further analysis was 409. The collected data was analyzed using a descriptive analysis, correlation analysis and linear regression analysis using SPSS 25.

3.1 Development of the study instrument
The questionnaire of the study was developed based on the recommendation of the Blue Ribbon Committee (1999) report, and it was guided by the literature. The first part of the questionnaire is the demographic profile of the investment decision-makers in Bahraini-listed companies. The second part contains the questions related to the independence and competence of AC. A pilot test was conducted among 10 MBA students and 30 investment decision-makers in Bahraini-listed companies before the final survey was distributed on the study sample. This test was conducted to ensure the readability, correctness and the relevance of the questionnaire items. Accordingly, some items were modified, and some suggestions were incorporated in the final questionnaire.

4. Findings
4.1 Reliability of the study’s questionnaire
The Cronbach’s alpha coefficient (α) value was used to test the reliability of the instrument. As seen in Table 2, the Cronbach’s alpha coefficient (α) values for the study constructs are more than (0.7) indicating the existence of the internal consistency among the study variables (Hair et al., 2010).

4.2 Demographic profile
Table 3 shows the demographic profile of 409 respondents who are involved in the investment decision-making in Bahraini-listed companies. There are 224 males (54.8%), and 185 (45.2%) females. With regard to the occupation, most of the respondents are accountants (33.3%), followed by internal auditors (23.2%), portfolio managers (10.5%), financial analysts (10.3%), CFOs or financial managers (6.1%) and CEOs (1.2%). In terms of education, the majority of the respondents hold bachelor and master degrees with the percentages of 57.2%, and 39.1%, respectively. Meanwhile, 36.2% of the respondents have 10–15 yrs financial experience, and 29.1% of them have 16–20 yrs of experience. Additionally, 62.8% of the respondents hold financial professional certificates (CPA, CMA, ACCA, CIA, CFA and other

<table>
<thead>
<tr>
<th>Construct</th>
<th>No. of items</th>
<th>α</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC independence</td>
<td>7</td>
<td>0.773</td>
</tr>
<tr>
<td>AC competence</td>
<td>4</td>
<td>0.803</td>
</tr>
<tr>
<td>Investment decision-making</td>
<td>3</td>
<td>0.709</td>
</tr>
</tbody>
</table>

Table 2. Reliability test
professional certificates). This gives an indication that most of the respondents have good financial background to understand the topic of the study and to provide useful information that may influence the results of the study.

4.3 Correlation analysis

Table 4 demonstrates the correlation matrix of AC independence (ACIND), AC competence (ACCOM) and investment decision-making (IDM). The results depict the level of correlational significance between the two independent variables and the dependent variable. At 1% significance level, IDM is significantly correlated with the two independent variables. The highest correlation is between AC competence (ACCOM) and investment decision-making (IDM) with a correlation coefficient of 0.625, followed by AC independence (ACIND) with a correlation coefficient of 0.555 with INDM. Accordingly, it can be concluded that companies’ investment decision-making has a significant relationship with both independent variables, AC independence and competence.

4.4 Regression analysis

The results of the regression analysis regarding the impact of AC independence and competence on the investment decision are shown in Table 5. The model summary discloses
that $R$-square is 0.678. It means that both independent variables explain 67.8% of the variation in investment decision-making.

Table 6 shows the ANOVA analysis summary table. This analysis reveals that when $F = 428.189$, significance is 0.000, which indicates that the study model is acceptable.

Table 7 presents the regression coefficient of the influence of AC independence and competence on investment decision-making. The regression formula adopts the unstandardized coefficients, where the beta values ($\beta$) of regression coefficients are 0.442 and 0.451 for AC independence (ACIND) and AC competence (ACCOM), respectively. Hence, the formula of the regression model is as follows:

$$
IDM = 0.4 + 0.442 \text{ACIND} + 0.451 \text{ACCOM}
$$

<table>
<thead>
<tr>
<th>AVGIND</th>
<th>AVGCOM</th>
<th>AVGINV</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pearson correlation</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Significance (2-tailed)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$N$</td>
<td>409</td>
</tr>
<tr>
<td>AVGCOM</td>
<td>Pearson correlation</td>
<td>0.030</td>
</tr>
<tr>
<td></td>
<td>Significance (2-tailed)</td>
<td>0.540</td>
</tr>
<tr>
<td></td>
<td>$N$</td>
<td>409</td>
</tr>
<tr>
<td>AVGINV</td>
<td>Pearson correlation</td>
<td>0.555**</td>
</tr>
<tr>
<td></td>
<td>Significance (2-tailed)</td>
<td>0.000</td>
</tr>
<tr>
<td></td>
<td>$N$</td>
<td>409</td>
</tr>
</tbody>
</table>

Table 4. Correlations matrix

Note(s): **Correlation is significant at the 0.01 level (2-tailed)

<table>
<thead>
<tr>
<th>Model</th>
<th>$R$</th>
<th>$R$ Square</th>
<th>Adjusted $R$ square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0.824$^1$</td>
<td>0.678</td>
<td>0.677</td>
<td>0.29416</td>
</tr>
</tbody>
</table>

Table 5. Model summary$^2$

Note(s): 1. Predictors: (constant), AVGCOM, AVGIND
2. Dependent variable: AVGINV

<table>
<thead>
<tr>
<th>Model</th>
<th>Sum of squares</th>
<th>df</th>
<th>Mean square</th>
<th>$F$</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Regression</td>
<td>74.104</td>
<td>2</td>
<td>37.052</td>
<td>428.189</td>
<td>0.000$^1$</td>
</tr>
<tr>
<td>Residual</td>
<td>35.132</td>
<td>406</td>
<td>0.087</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>109.236</td>
<td>408</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 6. ANOVA$^2$

Note(s): 1. Predictors: (constant), AVGCOM, AVGIND
2. Dependent variable: AVGINV

<table>
<thead>
<tr>
<th>Model</th>
<th>Unstandardized coefficients</th>
<th>Standardized coefficients</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$B$</td>
<td>Standard error</td>
</tr>
<tr>
<td>1. (Constant)</td>
<td>0.400</td>
<td>0.118</td>
</tr>
<tr>
<td>AVGINV</td>
<td>0.442</td>
<td>0.023</td>
</tr>
<tr>
<td>AVGCOM</td>
<td>0.451</td>
<td>0.021</td>
</tr>
</tbody>
</table>

Table 7. Regression coefficients$^1$
The results above validate the study hypotheses (H1, H2), which means that the AC independence and AC competence have a positive and significant influence on investment decision-making.

5. Discussion

The source credibility theory states that the main factors that influence an individual’s evaluation of the information credibility are source expertise and source bias (Cohen et al., 2016; Buda and Zhang, 2000; Eagly and Chaiken, 1993; and Birnbaum and Strenger, 1979). Source expertise represents the competence of the information provider – that individuals perceive information more credible when the source possesses the required expertise or competence. Source bias represents the source trustworthiness, in other words, information is more trusted when the source information is less prone to be independent. Investors are too sensitive to the credibility of the information source, that incompetent or biased source would impact their decision. According to the above discussion, the researches in the current study predicted that the AC competence (source expertise) and independence (source bias) would affect the investment decision of the investors.

The AC plays a major role in improving the quality of financial reporting. The availability of independent and competent AC increases the credibility of the financial statements (Cohen et al., 2016), which improves the investors’ trust in the financial reporting and therefore impacts their investment decision positively (Cohen et al., 2016; Bedard et al., 2014).

Drawing on this, the study surveyed 409 decision-makers in Bahraini-listed companies involved in the investment decisions. Table 8 summarizes the investors’ responses regarding the impact of the AC independence on the investment decision as follows:

Table 8 below shows that the overall average of the investors’ responses regarding the importance of AC independence to their investment decision is 3.78 out of 5 (about 75.6%). In addition, the average range of responses regarding the seven elements of this variable is between 3.2 and 4. The surveyed investors indicated that the most important item of the AC independence that affects their investment decision is the existence of nonrelated AC members with an average of 4 out of 5 (about 80%), followed by the importance of the financial independence of the AC with an average of 3.97 out of 5 (about 79.4%). This indicates that the independence of AC is viewed as an important factor that affects the investment decision made by investors. This might be due to the fact that investors perceive
the credibility of the financial statements depending on the existence of independent AC, which affects their investment decisions.

Table 9 below shows the overall average of the investors’ responses regarding the importance of AC competence to their investment’s decision, which is 3.87 out of 5 (about 77.4%). In addition, the average range of responses regarding the four elements of this variable is between 3.78 and 3.98. The investors surveyed indicated that the most important item of the AC competence that affects their investment decision is the existence of AC members with financial expertise with an average of 3.98 out of 5 (about 79.6%), followed by the existence of the required competence to improve the company’s internal control with an average of 3.91 out 5 (78.2%). This indicates that AC competence is viewed as an important factor that affects the investment decisions made by investors. AC that includes more qualified members is seen by investors as a highly effective committee unlike AC with less or no competence, and this leads to better investment decisions.

The results of the current study are consistent with the source credibility theory, that the decision makers are giving the AC independence (source bias) and competence (source expertise) high importance that impacts their investment decisions. The results are consistent with the study of Cohen et al. (2014, 2016).

6. Conclusions and recommendations
This study aims to investigate the impact of AC independence and competence on investment decisions. It revealed a significant relationship of AC independence and competence on the investment decisions taken by the decision-makers in the Bahraini-listed companies. Thus, it indicates the importance of AC independence and competence for the decision-makers in improving the quality of financial reporting, also the quality of internal control and audit. This may lead to the increased investors’ trust in the investee company’s financial reports and thereby favorable investment decisions.

The significance of the two variables of AC, independence and competence, is importantly highlighted and is to be included in the annual report as part of the corporate governance section. It is found that 33% of investment decision-makers in the listed companies do not know whether or not the AC of the investee companies has nonexecutive members. Accordingly, it seems that there is a lack of communication between the investors and the investee companies; therefore, companies must make clear such information in the company’s website or in other platforms. Moreover, the majority of the respondents agreed that the AC must be financially independent. Thus, the companies must ensure that their AC is financially independent in order to reduce the influence of the management on their work and to strengthen the quality of the committee output. Additionally, it is important to include only independent members, and this must be highlighted clearly in the companies’ annual report.

![Table 9.](image)

**Table 9.** summarizes the investors’ responses regarding the impact of the AC’s competence on investment decisions

<table>
<thead>
<tr>
<th>Questionnaire items – AC competence</th>
<th>Average response out of 5</th>
</tr>
</thead>
<tbody>
<tr>
<td>It is important to our investment decision that the AC of the investee’s company includes members with financial literacy (for example accounting and finance)</td>
<td>3.81</td>
</tr>
<tr>
<td>It is important to our investment decision that the AC of the investee’s company includes members with financial expertise</td>
<td>3.98</td>
</tr>
<tr>
<td>It is important to our investment decision that the AC of the investee’s company includes industry expertise that improves the quality of the financial reporting</td>
<td>3.78</td>
</tr>
<tr>
<td>It is important to our investment decision that the AC of the investee’s company has the required competency to improve the internal control quality</td>
<td>3.91</td>
</tr>
</tbody>
</table>

*Overall average: 3.87*
The results of the study have implications for policymakers and future studies. BHB may request from the listed companies to disclose clearly in their annual reports the social and financial independence of AC and the qualifications of the AC members because this type of disclosure is still a voluntary one. BHB may add a requirement to include the representative of the shareholders in the firm’s AC. Moreover, BHB may mandate the listed companies in Bahrain to hire members in the AC that have the required financially literate background and financial experience. This would improve the companies’ financial disclosure of the firm and reduce financial misstatements. The existence of competent AC that comprises highly qualified members would improve the quality of the external and internal auditing.

Another important implication of the current study’s results is that companies’ board of directors must consider the impact of the AC independence and competence on investor decisions by ensuring that the nominated and appointed AC members do not have any social or financial relationship with the management and they have the minimum qualifications to be part of this committee.

Apart from the importance of the current study, it has some limitations that can be overcome by other studies, as follows: first of all, the current study is limited to one developing country (Bahrain), and including other developing and developed countries might make the results more generalizable. The current study investigated the impact of AC independence and competence on the investment decision as perceived by the decision-maker, so other studies may use more objective measures of the study variables, by developing a self-constructed index over a long period for AC independence and AC competence, and this will eliminate the subjectivity and potential bias of the investors’ perception of AC.

Note

References


Blue Ribbon Committee (1999), Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, New York Stock exchange and National Association of Securities Dealers, New York, NY.


Appendix 1
Section (1)

Please respond to the following items by circling the appropriate number

1. Gender?
(a) Male (b) Female

2. Current occupation?
(a) CEO (b) Chief Financial officer (c) Accountant (f) Internal Auditor (g) Financial analyst
(h) Portfolio Manager i) other………………………………………..

3. Level of education?
(a) High school and under (b) Bachelor (c) Masters or equivalent (c) Ph.D. or equivalent (e.g: DBA)

4. Years of experience?
(a) Less than 10 (b) 10-15 (c) 16-20 (d) More than 20

5. Professional Certificate?
(a) No (b) Yes, please specify …………………………………………..

6. Are you involved in the investment decision process?
(a) Yes (b) No

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Section (2)
Using a rating scale of 1–5, please circle the number that indicates your level of disagreement/agreement with the following statements. So if you “strongly disagree”, circle number 1. If you “strongly agree”, circle number 5. Circle other numbers as appropriate for other levels of agreement and disagreement.

<table>
<thead>
<tr>
<th>Item</th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Not sure</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. It is important to our investment decision that the AC of the investee’s company has nonrelated members</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>2. Our investment decision is affected positively by the existence of nonexecutive directors in the AC of the investee company</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>3. Our investment decision is affected positively by the absence of the social connection between the AC members and the management</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>

(continued)
<table>
<thead>
<tr>
<th>Item</th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Not sure</th>
<th>Agree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>4. Our investment decision is affected positively by the absence of</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>the professional connection between the AC members and the management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. It is important to our investment decision that the AC of the</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>investee company is financially independent</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. It is important to our investment decision that AC members do</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>not have any financial interest in the investee company</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>7. It is important to our investment decision that the AC of the</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>investee’s company includes only independent members</td>
<td></td>
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</tr>
<tr>
<td>8. It is important to our investment decision that the AC of the</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>investee’s company includes members with financial literacy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(for example Accounting, and Finance)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. It is important to our investment decision that the AC of the</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>investee’s company includes members with financial expertise</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. It is important to our investment decision that the AC of the</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>investee’s company includes members with financial expertise</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. It is important to our investment decision that the AC of the</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>investee’s company includes the industry expertise that improves</td>
<td></td>
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<td></td>
</tr>
<tr>
<td>the quality of the financial reporting</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>12. I shall continue considering the current investment in the next</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>few years</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. The current investment of my company is considered attractive</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>14. I would recommend the current investment for other investors if</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>they ask for my advice</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Corresponding author**
Adel Sarea can be contacted at: asarea@ahlia.edu.bh

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