

## The Impact of Board Size and Audit Committee Characteristics on Financial Performance in Foreign Exchange Banks: Evidence from Indonesia

Samsul Bahari

Universitas Muhammadiyah Buton  
e-mail Correspondensi: [samsul120182@yahoo.com](mailto:samsul120182@yahoo.com)

### ABSTRAK

Konsep tata kelola perusahaan telah memainkan peran penting, terutama dalam proses penyampaian laporan keuangan. Namun, literatur mengungkapkan temuan yang tidak konsisten mengenai dampak karakteristik tata kelola perusahaan terhadap kinerja keuangan. Meskipun telah banyak penelitian mengenai tata kelola perusahaan, namun masih terdapat kekurangan bukti, terutama pada industri perbankan, khususnya pada bank-bank devisa di Indonesia. Penelitian ini bertujuan untuk menyelidiki pengaruh ukuran dewan komisaris dan karakteristik komite audit, yaitu ukuran komite audit, frekuensi rapat komite audit, dan keahlian komite audit, sebagai komponen integral dari tata kelola perusahaan, terhadap kinerja keuangan. Jenis penelitian ini adalah penelitian kualitatif deskriptif yang menggunakan data yang diperoleh dari laporan tahunan yang diterbitkan oleh Otoritas Jasa Keuangan (OJK) dan situs web 38 bank devisa di Indonesia dari tahun 2007 hingga 2021. Temuan penelitian menunjukkan bahwa ukuran dewan komisaris menunjukkan hubungan negatif yang tidak signifikan dengan kinerja keuangan yang diukur dengan Return on Assets (ROA) dan Return on Equity (ROE). Selain itu, hasil penelitian mengenai ukuran komite audit dan frekuensi pertemuan menunjukkan tidak adanya hubungan yang signifikan dengan kinerja keuangan yang diproksikan dengan ROA dan ROE. Namun, keahlian komite audit menunjukkan hubungan negatif signifikan dengan kinerja keuangan yang diukur dengan ROE, dan tidak signifikan dengan ROA. Temuan ini akan membantu manajemen dalam mengambil keputusan yang tepat dalam mengoptimalkan ukuran dewan komisaris dan karakteristik komite audit untuk memenuhi kebutuhan dan kepentingan semua pemangku kepentingan dalam perusahaan. Secara keseluruhan, penelitian ini menekankan perlunya perbaikan berkelanjutan dalam praktik tata kelola perusahaan untuk pertumbuhan dan perkembangan yang berkelanjutan.

**Kata kunci:** Financial Performance; Return on Assets; Return on Equity.

### ABSTRACT

*The concept of corporate governance has played an important role, especially in the process of submitting financial reports. However, the literature reveals inconsistent findings regarding the impact of corporate governance characteristics on financial performance. Despite numerous studies on corporate governance, there remains a lack of evidence, particularly in the banking industry, specifically concerning foreign exchange banks in Indonesia. This study aims to investigate the influence of board size and audit committee characteristics, namely audit committee size, frequency of audit committee meetings, and audit committee expertise, as integral components of corporate governance, on financial performance. The type of this research is descriptive qualitative research that utilized data obtained from the annual reports published by the Financial Services Authority (OJK) and the websites of 38 foreign exchange banks in Indonesia from 2007 to 2021. The research findings indicate that board size exhibits a non-significant negative relationship with financial performance measured by Return on Assets (ROA) and Return on Equity (ROE). In addition, the results regarding audit committee size and frequency of meetings show no significant relationship with ROA and ROE proxied financial performance. However, audit committee expertise shows a significant negative relationship with financial performance as measured by ROE, and not significant with ROA. These findings will assist management in making informed decisions regarding optimizing board size and audit committee characteristics to meet the needs and interests of all stakeholders within the company. Overall, this research emphasizes the need for continuous improvement in corporate governance practices for sustainable growth and development.*

**Keywords:** Kinerja Keuangan; Return on Assets; Return on Equity.

## INTRODUCTION

Developing an effective corporate governance system is crucial to the success of any organization. By implementing a strong governance structure, companies can reduce the risk of financial crises and management disputes (Gompers et al., 2003). Corporate governance acts as a gateway to building relationships between company employees, shareholders, and other stakeholders, significantly influencing the economy by providing investor confidence and reducing investment-related risks, thereby facilitating corporate performance (Shleifer & Vishny, 1997). The board of directors represents a crucial oversight mechanism for financial control within companies. The main task of the board is to improve the financial and non-financial position of the company. As a result, board size can be considered as an important factor in determining a company's financial performance (Jensen, 1993). The significance of board size in corporate governance is the subject of much debate, and empirical studies on corporate governance, particularly regarding board size and financial performance, research results are still conflicting (Palaniappan, 2017).

Understanding of the concept of an audit committee varies greatly depending on its objectives, functions and responsibilities. According to Al-Thuneibat (2006), that the audit committee in its formation consisted of non-executive directors, while Arens et al. (2009) define it as a group of individuals selected from the board members who are responsible for maintaining the independence of the auditors. Overall, the audit committee oversees the financial reporting process, audit procedures, internal control systems, and compliance with laws and regulations. The recent crisis, mainly caused by financial mismanagement, suspicious financial transactions, and increasing cases of fraud, has highlighted the significant impact on the performance and characteristics of audit committees (Eichenseher & Schields, 1985). As a result, attention to the role of the audit committee has grown in recent years as a key mechanism in implementing corporate governance to improve integration between management and the board (Hamdan & Mushtaha, 2011). It has been suggested that a knowledgeable audit committee helps in enhancing excellent company performance (Zabri et al., 2016)

Considering the legal context of corporate governance in Indonesia, all banking companies are obligated to comply with corporate governance requirements. In Indonesia, the corporate governance mechanisms have been supervised by the Financial Services Authority (OJK) since 2015. The governance requirements are mandatory for banking companies in Indonesia, based on the guidance of the Banking Law and the Banking Financial Supervisory Agency in Indonesia.

Although there have been previous studies extensively investigating the audit function, there is limited research on key characteristics such as audit committee size, frequency of meetings, and audit expertise, particularly in the context of the foreign exchange banking sector in Indonesia. Similarly, inconsistencies in results have been found concerning different proxies for financial performance under varying regulatory settings. Thus, investigating the impact of board size and audit committee characteristics on corporate financial performance is of paramount importance. Furthermore, this is crucial as there is a scarcity of evidence concerning Indonesia's context, especially in the foreign exchange banking sector, which could fill the existing literature gap.

Ultimately, this research contributes to the corporate governance literature by providing valuable insights to enhance the role and effectiveness of audit committees in the Indonesian banking sector. The implications of the research findings will influence policymakers in designing connected governance mechanisms in a developing market context.

Although there have been previous studies that investigated audit committee functions extensively, research on the main characteristics of audit committees such as audit committee size, meeting frequency, and audit expertise is still limited, particularly in the context of the foreign exchange banking sector in Indonesia. Similarly, inconsistencies in results have been found regarding different proxies for financial performance under various regulatory settings. Thus, investigating the impact of board size and audit committee characteristics on a company's financial performance is of utmost importance. In addition, this is important due to the lack of evidence regarding the Indonesian context, particularly in the foreign exchange banking sector, which can fill the gaps in the existing literature.

Ultimately, this research contributes to the corporate governance literature by providing valuable insights for enhancing the role and effectiveness of audit committees in the Indonesian

foreign exchange banking sector. The findings of this research are very important because they will have a direct impact on the design of governance mechanisms in emerging markets. Policy makers need to carefully consider the implications of these findings to create systems that are effective and efficient in addressing the unique challenges and opportunities presented by the context.

## LITERATUR REVIEW

### **Understanding the Concept of Corporate Governance**

There is no single definition of Corporate Governance (CG) that can be universally applied to all situations and jurisdictions. However, there are several generally accepted definitions. The most commonly used definition is "the system by which companies are directed and controlled" (Cadbury Committee, 1992). According to Weerasinghe and Ajward (2017), corporate governance is a broad term that encompasses specific issues concerning the governance of a company, arising from the interaction between shareholders, the board of directors, senior management, and other stakeholders. Although corporate governance is broadly defined as the mechanisms that control, direct, and investigate a company's activities by promoting fairness, transparency and corporate accountability for the purpose of creating wealth for shareholders, for the purposes of this study, the focus will be broader. a definition that includes a set of policies, structures, practices, laws, and procedures that define an owner's control and management of resources (Onuorah et al., 2016).

In addition, Paulinus et al. (2017) proposes that the governance structure, integrating internal and external mechanisms, guides the organization towards its key goals while realizing the interests of its stakeholders. Alzoubi (2014) identified the board of directors as a strong key control element in any organization to oversee management practices, where shareholders invest to pursue their interests in a fair way. equal. This investment is evident in the structure of the Board of Directors, the two CEOs, the quality of the audit committee, the remuneration of the members of the Board of Directors, the percentage of shares owned by the members of the Board of Directors, etc.

### **The Role of Board of Directors (BOD) and Audit Committee (AC) in Corporate Governance**

The functions of the board of directors are to protect the rights and interests of shareholders, and ultimately become a supervisory mechanism as they evaluate the performance of directors and replace them when their performance fails to meet the interests of shareholders (Al-Faroue et al., 2019). Therefore, the board of directors is the one who decides the company's strategy. According to Topal and Dogan (2014), the board strives to maximize market value and financial performance through its decisions. The main role of the board of directors is to strengthen corporate governance by performing an important role in monitoring and advising on resource allocation (Ntim, 2015).

As a consequence, consequently, an effective board function is reported to be able to improve the quality of financial reporting as evidenced by a decrease in the level of earnings management performance (Safari, 2017). As reported by Jensen (1993), factors such as the board of directors, board structure and culture contribute significantly to the success or failure of an organization. Therefore, board size, increasing the effectiveness of the oversight role and minimizing agency problems, are important issues that continue to be studied and investigated.

Financial performance is defined as the extent to which a business is conducted over a specified period of time, reporting gains and losses as measured by the assets, values, and liabilities of the organization. Likewise, it refers to the financial strength of the organization and represents the leadership performance of the organization's management (Matar & Eneizan, 2018). According to Heremans (2007), describing financial performance is the use of financial indicators to determine the extent to which objectives are achieved, contributing to the allocation of available economic resources and supporting bank products with investment opportunities. When reviewing audit committees, they seek to improve the quality of the internal audit function by detecting and preventing fraud within the organization.

In line with agency theory, the audit committee plays a crucial role in enforcing corporate governance standards and enhancing firm value.

Previous literature has shown that audit committee effectiveness can be measured by characteristics such as size, expertise and frequency of audit committee meetings (Kusnadi et al.,

2016). . Consistently, agency theory also shows that audit committees play an important role in applying corporate governance principles and increasing corporate value. Therefore, in recent years, the role of the audit committee has received more attention as the main mechanism of corporate governance to improve the quality of board investigations (Hamdan & Mushtaha, 2011). Thus, a good audit committee focuses on increasing the efficiency and competitiveness of the company, especially in dealing with changes in the business environment that are beyond the company's control (Herdjiono & Sari, 2017).

### **Concept of Financial Performance**

Financial performance can be defined as the extent to which a business operates during a specific period, communicating general profits and losses computed using the organization's assets, values, and liabilities. Similarly, it refers to the financial strength of entities and represents the managerial leadership performance of the organization (Matar & Eneizan, 2018).

According to Heremans (2007), financial performance describes the use of financial indicators to determine the extent to which goals are achieved, contribute to the allocation of accessible economic resources, and support the Bank's investment opportunities.

Managers can communicate their thoughts on the impact of business procedures and financial conditions when evaluating money and running a business (Ali, 2014). Organizational capacity also has an impact on financial performance. Return on investment, earnings growth, earnings per share (EPS), dividend yield and market capitalization are all used to measure financial performance (Tudose, 2012).

Santos and Brito's (2012) research on subjective financial performance measurement models shows that financial performance is limited by conceptualization. Agency theory is defined in two aspects: economic perspective (Ross, 1973) and institutional perspective (Mitnick, 1973). The costs associated with the lack of consensus on goals between the two have been suggested by Ross (1973) and explored in more detail by Jensen & Meckling (1976). The separation of ownership and management gives managers the opportunity to act in their own self-interest by maximizing their wealth and power at the owner's expense (Fama, 1980; Jensen & Meckling, 1976). Because the relationship is not harmonious, it creates what is called an agency conflict or a conflict of interest between the agent and the principal. In addition, five dimensions of financial performance were identified: financial performance, customer satisfaction, employee satisfaction, social performance, and environmental performance. In addition, this study considers ROA and ROE as measures of financial performance. Despite the emergence of more sophisticated techniques such as Internal Rate of Return (IRR), Cash Flow Return on Investment (CFROI), which have emerged, ROE has proven to be a reliable method. This emphasizes the profitability of the organization for its shareholders, but on the other hand, ROE has the potential to obscure many potential problems. Organizations can use financial strategies to artificially manage healthy ROE and thereby cover up poor business performance. On the other hand, ROA prevents potential distortions caused by financial strategy errors (Zábojníková, 2016). Therefore, by considering the information from this empirical literature, the researcher uses ROA and ROE as financial performance indicators to examine the effect of board size and audit committee attributes on the performance of foreign exchange bank financial services in Indonesia.

### **Theoretical Background**

The concept of corporate governance (CG) stems from a number of theories. Two main and related theories that are considered to explain agency conflict and the need for corporate governance are the agency theory and stakeholder theory, which can be considered as the main theories among many others, such as resource dependency theory and management theory. Agency theory is the dominant theory because it is considered as the origin of the concept of corporate governance. However, all of them can be considered as different lenses to view the CG concept from different points of view. the CG perspective one sees determines the most relevant theory. Agency theory is defined in two aspects: economic perspective (Ross, 1973) and institutional perspective (Mitnick, 1973). The costs associated with the lack of consensus on goals between the two have been suggested by Ross (1973) and explored in more detail by Jensen & Meckling



(1976). The separation of ownership and management gives managers (representatives) the opportunity to act in their own self-interest by maximizing their wealth and power at the expense of the owners (heads) (Fama, 1980; Jensen & Meckling, 1976). Because the relationship is not harmonious, it creates what is called an agency conflict or a conflict of interest between the agent and the principal. This is called the "agency problem". Therefore, companies try to limit these agency problems through strong and effective corporate governance policies such as incorporating independent non-executive directors into the board of directors, establishing audit committees to ensure fair management and creating separate positions for CEO and chairman (Uwuigbe et al., 2018; Weerasinghe et al., 2017). Therefore, such adequate control mechanisms must be built in tandem with good corporate governance to guide the behavior of managers and compel them to act in the best interest of shareholders.

Review the stakeholder theory propounded by Freeman, highlighting the different stakeholder groups within a company and recommending how management should serve the interests of all of these parties. This theory suggests that companies have a social responsibility to restructure their corporate governance framework, regardless of the relationship between owners and managers, and to identify each stakeholder group (Paulinus et al., 2017). In stakeholder theory, the principal-agent problem extends because it involves the interests of many fiduciaries as central to business continuity. Compared to agency theory, this theory presents corporate governance from a holistic perspective, as a control mechanism designed for efficient business operations (Manawaduge, 2012). According to Weerasinghe et al. (2017), corporate governance best practices, from the perspective of stakeholder theory, should protect the interests of various stakeholders, not just shareholders.

Resource dependency theory views the firm as an open system, dependent on external organizations and the environment (Pfeffer & Salancik, 1978). Boards are seen as a means of managing external dependencies (Pfeffer and Salancik, 1978), reducing uncertainty in the business environment (Pfeffer, 1972) and reducing transaction costs associated with interdependence environments (Williamson, 1984) by linking the organization to the outside environment. Therefore, directors are considered as part of the organization and its environment. Regarding board size, this theory argues that a large board will produce superior business results because of the diverse abilities, knowledge and experience that contribute to board discussion. In addition, large board sizes can also provide diversity which helps organizations secure important resources and reduce environmental risks (Dakhlallah et al., 2020). Indeed, the larger the board, the more limited the resources the company has through relationships with people in the same or different industries (Kalsie & Shrivastav, 2016).

Management theory offers an opponent to agency theory, which states that "managers are inherently trustworthy individuals and therefore act as good stewards of the resources assigned to them." entrusted to them" (Donaldson and Davis, 1991, 1994; Donaldson, 1990). Donaldson and Davis (1991) state that "managers are intrinsically motivated by a need for achievement and responsibility", and once granted responsibility, autonomy,

### **Empirical Evidence on Board Size and Financial Performance**

The relationship between board size and its impact on financial performance is considered one of the most controversial issues in corporate governance (Isik & Ince, 2016). Based on previous research, some studies found a positive relationship, while others found a negative relationship. Larger boards are generally considered to be more experienced in controlling the actions of top management because it is more difficult for the CEO to dominate boards with more members (Mak & Rousch, 2000). AL-Farooque et al. (2019) identified a significant positive effect of board size on financial performance in an investigation of board influence, audit committee characteristics, and ownership structure on financial performance with market-based financial performance of public companies in Thailand. They also show that training highly competent, experienced managers will help address organizational problems and improve financial performance. This finding is consistent with a number of previous studies which also support the idea that as the number of experienced board members increases, it increases the diversity and

independence of the board, which ultimately has a positive impact on financial performance (Ciftci et al., 2019; Tornyeva & Wereko, 2012).

However, greater board presence does not necessarily lead to better financial performance. When the board of directors consists of many directors, this can lead to unstable communication between directors in making decisions. Additionally, it has been argued that when board sizes exceed seven or eight members, they tend to be less efficient and easier for the CEO to control. In addition, having a large board of directors can lead to poor monitoring and supervision of operations, which ultimately leads to poor financial performance (Jensen, 1993). In addition, large boards are believed to be ineffective in conditions of over-maintenance, and as the number of members increases, they will create greater difficulties in planning, coordinating work, decisions, and regular meetings. On the other hand, the best trick is to avoid imbalances and facilitate effective decision making. The larger the board, the more likely it is to support stakeholders and the less likely it is to make decisions that benefit multiple members (Shao, 2010).

Planiappan (2017) found that board size is an important variable and has a negative relationship between board size and financial performance. This observation corroborates the findings of O'Connell and Cramer (2010) who also prove it by revealing that board size has a significant negative effect on financial performance on the Irish stock market. Research by Onuorah et al. (2018) further confirms that a smaller number of members of the Board of Directors will encourage cohesion and cooperation between the board and management, which will improve the quality of financial reporting. Furthermore, an empirical study based on 122 companies cited in Nigeria also strengthens this argument that board size has a strong negative impact on financial performance (Ujunwa, 2012). These results are also in line with empirical studies from Norway, et al (2014) in the context of non-financial companies registered in Singapore, where they also found that board size had a significant negative effect on financial performance after controlling for financial performance, after controlling for endogeneity issues. . On the other hand, a study conducted by Assenga et al. (2018) concerning the effect of board characteristics on the financial performance of issuers in Tanzania did not find a negative relationship between board size and financial performance. Furthermore, several authors also agree with this opinion, indicating that there is no significant relationship between board size and financial performance (Ferrer & Banderlipe, 2012; Garba & Abubakar). , 2014). Therefore, in conclusion, conflicting findings have been drawn from the previous literature in favor of larger and smaller board sizes

### **Empirical Evidence on Audit Committee Characteristics and Financial Performance**

When exploring previous research, there is an inconsistent relationship between audit committee size and financial performance because some studies find a positive relationship while others find a negative relationship between audit committee size and financial performance as reported by (Al-Matar et al., 2014). According to Tornyeva and Wereko (2012), audit committee size is a key determinant of financial performance. Using data from the United States, Qin (2007) finds that larger audit committees, combined with the financial expertise of their members, leads to better quality results, which in turn result in more effective financial results. To further support this claim, several studies have also confirmed by identifying a significant positive relationship between audit committee size and financial performance (Abeygunasekera et al., 2021; Al-Farooque et al., 2019; Rahman et al., 2019; Rahman et al., 2019; Rahman et al., 2019; al., 2019). In addition, using data from family and non-family businesses, Al-Okaily and Naueihed (2019) show that audit committee size is positively and significantly related to financial performance, while not significantly. in a family company.

Contrary to the evidence above, Al-Matari et al. (2012) disagree that a larger audit committee leads to improved financial performance by identifying an inverse relationship between audit committee size and financial performance. Similarly, Afza and Nazir (2014) also reported a significant negative relationship between audit committee size and financial performance, indicating that the presence of a larger audit committee leads to higher audit effectiveness and lower results. Meanwhile, Bouaine and Hrichi (2018), Romano et al. (2012), Al-Okaily and Naueihed (2019) argue that audit committee size has no significant relationship with financial performance.

Likewise with the frequency of audit committee meetings, according to the recommendations of the OJK GCG guidelines (2015) is that audit meetings must be held at least three times during the current financial year with intervals of less than four months. Finally, the audit committee is responsible to the board of directors and must report to the board of directors any conflicts of interest, suspected fraud and violations, as well as alleged violations of laws and regulations. According to empirical evidence, it is said that more frequent meetings make it easier for the audit committee to prepare quality financial reports in a shorter period of time compared to audit committee meetings that are less frequent (Ionescu, 2014). More frequent meetings are considered a favorable indicator for the audit committee to achieve its objectives effectively (Bédard and Gendron, 2010). Alzoubi (2019) found that earnings management tends to decrease when meetings between internal audit and the audit committee take place regularly. However, under agency theory, it should be noted that the frequency of audit committee meetings can only benefit the organization if the benefits derived from the additional meetings are greater than the costs incurred for those meetings (Bouaine & Hrichi, 2018). Research by Xie et al. (2003) revealed that regular audit committee meetings are more likely to lead to increased transparency of company results, thereby increasing firm performance by increasing firm profits. Similarly, the study by Aanu et al. (2014) and Alqatamine (2018) also found that more audit meetings lead to positive financial performance. Likewise, Sultana (2015) has shown that regular audit committee meetings are positively correlated with conservative accounting, which ultimately improves financial performance.

Empirical studies conducted by Al-Okaily and Naueihed (2019) and Zraiq and Fadzil (2018) identified a positive relationship between the frequency of audit committee meetings and the financial performance of non-family firms. On the contrary, the findings of Rabeiz and Salameh (2006) confirm that an increase in the number of audit committee meetings alone does not necessarily improve financial performance because it is also necessary to ensure the quality of these meetings. However, Bansal and Sharma (2016) found the frequency of audit committee meetings did not have a significant effect on financial performance. Furthermore, based on a sample of manufacturing companies listed on the Dhaka Stock Exchange, Rahman et al. (2019) revealed that there is a significant negative relationship between audit committee meetings and company performance. These results are further supported by another study by Balagobei & Velnampy, (2018); Hsu & Petchsakulwong, (2010).

Given the recent global financial crisis and past corporate scandals, the need for skilled and qualified audit committee members has been widely highlighted (Güner et al., 2008). Currently, any regulatory presence around the world must include an audit committee to have at least must have one financial specialist audit committee member with relevant experience in accounting, auditing, or financing (Ahmed Haji & Anifowose, 2016 and DeFond & Zhang, 2014). According to Ahmed Haji (2015), the presence of finance or accounting specialists in audit committees can reduce disputes between management and external auditors and increase financial and non-financial disclosures. according to Carcello et al. (2006) that the audit committee has financial and non-financial professionals will reduce abnormal accruals.

Most empirical studies show that auditors' financial expertise can affect the quality of results and increase the speed of financial information systems (Kallamu & Saat, 2015; Dinu & Nedelcu, 2015; Velte, 2017). Dakhlalh et al. (2020) found that the financial expertise of audit committee members has a positive and significant relationship with financial performance. Furthermore, research by Al-Okaily and Naueihed (2019) states that the knowledge of audit committee members has a positive relationship with financial performance in England and is not significant for the financial performance of family companies. For this reason, improving financial performance depends on controlling the company. Chaudry et al. (2020) found that the expertise of the audit committee chairperson on financial oversight has a significant positive effect on financial performance, while the expertise and experience of the audit committee has no significant positive effect on financial performance

However, Bouaine and Hrichi (2019) in their research on the impact of audit committees and their characteristics on financial performance in French companies, found evidence that auditors'

financial expertise has no impact on ROA and ROE. Consistent with the findings above, Chan et al. (2011) found no direct impact of the audit committee's financial expertise on firm value. Furthermore, they explain their findings by justifying that firm value is affected by compliance with all corporate governance code requirements related to audit committee attributes. Likewise with Farhan et al. (2017), and Carcello et al. (2011) also showed an insignificant relationship between audit committee competence and financial performance.

### **Hypotheses Development**

The presence of a large board size alone does not lead to better financial performance (Jensen, 1993). Most of the literature (Kyereboah et al., 2006; Palaniappan, 2017; Shao, 2010; Ujunwa, 2012; Planiappan, 2017; Onuorah et al., 2018) supports the argument that a smaller board size is preferred over a larger one. Therefore, based on the supporting arguments in the literature, the first hypotheses are developed as follows:

H1a: There is a negative relationship between board size and financial performance, as measured by ROA (Kyereboah et al., 2006; Palaniappan, 2017).

H1b: There is a negative relationship between board size and financial performance, as measured by ROE (O'Connell & Cramer, 2010; Palaniappan, 2017).

Based on the previous literature, the audit committee is considered as an internal governance mechanism that can improve the quality of financial reporting and company performance. In this regard, the audit committee has three main characteristics that need attention, namely; Audit committee expertise, audit committee size, and audit committee meetings. Therefore, in this study, we consider audit committee size (measured by the number of audit committee members), audit committee expertise (measured as the proportion of audit committee members with relevant financial experience) and audit committee meeting frequency (measured by the number of audit committee members). audit committee held annually) has a positive impact on financial performance in terms of ROA and ROE. However, as stated in the literature review section, there are also several studies that show the opposite situation. Therefore, we believe it is necessary to test these three hypotheses to find a relationship between board size, audit committee attributes and firm performance. Therefore, with the support of the literature, the following hypotheses were devised:

H2a: There is a positive relationship between the number of audit committee members and financial performance as a proxy for ROA (Abeygunasekera et al., 2021; Hasan, Mollla & Khan, 2019).

H2b: There is a positive relationship between the number of audit committee members on financial performance which is proxied by ROA ROE (Hasan et al., 2019; Zábajníková, 2016).

H3a: There is a positive relationship between the frequency of audit committee meetings and financial performance as a proxy for ROA (Alabdullah & Ahmed, 2020; Zraiq & Fadzil, 2018).

H3b: There is a positive relationship between the frequency of audit committee meetings and financial performance as a proxy for ROE (Alabdullah & Ahmed, 2020; Zábajníková, 2016).

H4a: There is a positive relationship between audit committee expertise and financial performance as a proxy for ROA (Aanu et al., 2014; Chaudhry et al., 2020).

H4b: There is a positive relationship between audit committee expertise and financial performance, which is proxied by ROE (Aanu et al., 2014; Zábajníková, 2016)

## **RESEARCH METHODOLOGY**

### **Sampling and Data Collection**

This study adopts a quantitative research approach. The motivation behind selecting the banking sector as the research focus can be attributed to the well-regulated nature of the banking industry (ojk) and the significant role of banks in the country's economy. In accordance with corporate governance (CG) requirements in Indonesia, banking companies are required to provide details of board composition and audit committee meetings in their annual financial reports. Therefore, data and information were collected from the annual reports of selected foreign



exchange banks in Indonesia from 2017 to 2021 to study the effect of these variables over the past few years. The research sample was selected using purposive sampling, namely 38 foreign exchange banks.

### Specification Model

To investigate the influence between board size, audit committee characteristics, and financial performance, we decided to use the Multiple Panel Regression Model using the Ordinary Least Square (OLS) method with eviews 9.0 software, following the approach taken by Palaniappan (2017) and Zábajníková (2016). This model will clearly show the effect of board size and audit committee characteristics (independent variable) on financial performance (dependent variable).

$$ROA_{i,t} = \alpha + \beta_1 BS + \beta_2 ACS + \beta_3 ACMF + \beta_4 ACE + \beta_5 FS + \varepsilon$$

$$ROE_{i,t} = \alpha + \beta_1 BS + \beta_2 ACS + \beta_3 ACMF + \beta_4 ACE + \beta_5 FS + \varepsilon$$

Where,

$\alpha$  = Constant

BS = Board size for company i in year t

ACS = Audit committee size for company i in year t

ACMF = Audit committee meeting frequency for company i in year t

ACE = Audit committee expertise for company i in year t

FS = Firm size for company i in year t

ROA = Return on Assets for company i in year t

ROE = Return on Equity for company i in year t

$\varepsilon$  = Error term

Prior to obtaining the final results, the regression analysis was carried out with diagnostic tests, namely Normality, Multicollinearity, and Autocorrelation. Then determine the selection of the best model using the Fixed Effect Model (FEM) or Random Effect Model (REM), through the Chow and Hausman tests, and based on the findings of the Hausman Test, the probability value is greater than 0.05 for both the ROA and ROE models.

## FINDINGS

### Descriptive Statistics

The descriptive analysis presented descriptive statistics (mean, median, and mode), measures of variability (standard deviation or variance, minimum and maximum values, kurtosis, and skewness) for all independent, dependent, and control variables identified, as shown in Table 1.

Table 1. Deskriptive Statistics

	BS	ACS	FRKA	COMP	ROA	ROE
Mean	6.952128	3.867021	11.16489	3.457447	0.941170	3.633351
Median	6.500000	3.500000	10.00000	3.000000	0.980000	5.355000
Maximum	16.00000	10.00000	30.00000	8.000000	5.500000	23.49000
Minimum	3.000000	3.000000	4.000000	1.000000	-14.75000	-95.44000
Std. Dev.	2.616861	1.191942	5.896563	0.999089	2.113386	13.35828
Skewness	0.684270	1.986628	1.108616	1.794925	-3.154413	-3.702909
Kurtosis	3.150112	8.210256	3.895032	8.204589	21.27893	22.52716

The research sample consisted of 190 observations from 38 foreign exchange banks in Indonesia during the period 2017 to 2021. Based on the results in the table above, the dependent variables ROA and ROE each have an average value of 0.941170 and 3.633. The minimum values of ROA and ROE are -14.7500 and -95.4400, while the maximum values of ROA and ROE are 5.5000 and 23.4900. Regarding board size, the average number of directors is 7 and the maximum number of directors is 16. Descriptive statistics show that the average size of an audit committee is 4 people, with a minimum of 3 people and a maximum of 10 people. In accordance with the corporate governance code of ethics, the minimum number of audit committee members cannot be less than 3 people, and the information presented in Table 1 shows that all foreign exchange banks have complied with this requirement. In addition, these results indicate that all foreign exchange banks have complied with the Code of Best Practice recommendations regarding the frequency of

audit committee meetings, which is at least four times a year. Similarly, foreign exchange banks in Indonesia comply with corporate governance regulations, which state that at least one member of the audit committee must have recent and relevant experience in financial reporting and control, as shown in Table 1.

### Analysis Approach Selection Model

The model analysis approach can be conducted by selecting the appropriate tests, namely the Chow Test, Hausman Test, and Lagrange Multiplier (LM) Test. The results of these tests are presented in Table 2.

Table 2. Estimation Approach Tests Model

	Estimation Approach Tests Model		Value	Conclusion
Uji Chow	H0: Common effect model Ha: fixed effect model	H0: accepted if cross-section $F > 0,05$ Ha: rejected if cross-section $F < 0,05$	0,000	
Uji Hausman	H0: Random effect model Ha: fixed effect model	H0: accepted if probabilitas $> 0,05$ ha: rejected if bila probabilitas $< 0,05$	0,0150	FEM
Uji Lagrange Multiplier (LM)	H0: Common effect model Ha: fixed effect model	H0: accepted if Breusch-Pagan $> 0,05$ Ha: rejected if Breusch-Pagan $< 0,05$	0,000	

Source: Reviews 12 Analysis Results

Based on the results of the model analysis tests, it is concluded that the fixed effect model (FEM) is the appropriate model for this research.

Table 3. Correlation Analysis

	BS	ACS	FRKA	COMP	ROA	ROE
BS	1	0.48142068...	0.50164041...	0.50953820...	0.26786187...	0.29072893...
ACS	0.48142068...	1	0.26258961...	0.84169061...	0.10183279...	0.12287077...
FRKA	0.50164041...	0.26258961...	1	0.28486202...	0.14414365...	0.18278674...
COMP	0.50953820...	0.84169061...	0.28486202...	1	0.11918493...	0.13146562...
ROA	0.26786187...	0.10183279...	0.14414365...	0.11918493...	1	0.94586616...
ROE	0.29072893...	0.12287077...	0.18278674...	0.13146562...	0.94586616...	1

Table 3 describes the results of the correlation analysis between the characteristics of corporate governance and financial performance at Indonesian foreign exchange banks. The results of the analysis did not find multicollinearity problems. Board size (board size) shows a positive correlation (0.2678) with financial performance as measured by ROA and board size depicts a positive correlation (0.2907) with financial performance as measured by ROE. This shows that the more directors, the better the financial performance.

The results of the correlation analysis between audit committee size and financial performance as measured by ROA show a positive relationship (0.1018) between the two variables. Likewise, the relationship between audit committee size and financial performance as measured by ROE shows a positive correlation (0.1228) with a p-value of 0.5769, greater than 0.05 at the 5% significance level.

The results of the analysis of the frequency of audit committee meetings have respective coefficients of 0.1441 and 0.1827 which indicate a weak positive relationship with financial performance as measured by ROA and ROE at a significance level of 5%.

Based on the results of correlation analysis, the audit committee expertise variable shows a weak positive relationship with financial performance, with a coefficient of 0.1191 when measured by ROA and a weak positive relationship of 0.1314 when measured by ROE. The p value of 0.8416 is greater than 0.05 at the 5% significance level.

## Regression Analysis

Table 4. Regression Analysis for ROA

Variabel	Coefficient	T Statistics	PProb
C	11,2323	4,376673	0,0000
BS	-0,006023	-0,127558	0,8987
ACS	0,068009	0,616198	0,5387
FRKA	0,002578	0,168496	0,8664
COM	-0,167611	-1.223673	0,2231
R-square	0,832742		
Adjust R-square	0,784295		
SE of regression	1,271475		
Prob (F statistic)	0,00000		
Durbin-Watson	1,809328		

Table 5. Regression Analysis for ROE

Variabel	Coefficient	T Statistik	PProb
C	-0,745860	-0,050750	0,9596
BS	0,245238	2,105127	0,0370
ACS	0,403242	0,518415	0,6050
FRKA	0,330746	6,442063	0,0000
COM	-1,470120	-1,663657	0,0983
R-square	0,821772		
Adjust R-square	0,770147		
SE of regression	8.545552		
Prob (F statistic)	0,000000		
Durbin-Watson	1,953452		

Regression results show that board size does not have a significant negative effect on ROA , but has a significant positive effect on ROE . This finding is inconsistent with previous empirical studies by Guest (2009), Martin and Herrero (2018), O'Connell and Cramer (2010), Palaniappan (2017), Razil et al. (2019), found a significant negative relationship between board size and financial performance as measured by ROA and ROE. However, this finding is supported by research by Al Farooque et al. (2019), Cifci et al. (2019), where they found a positive relationship between board size and financial performance

The second overall finding states that there is a positive but not significant relationship between audit committee size (ACS) and financial performance as measured by ROA (0.068009) and ROE (0.403242). This finding is in line with Qeshta et al. (2021), Bouaine and Hrichi (2019), Zraiq and Fadzil (2018), Romano et al. (2012). The reason behind the insignificant impact is due to an increase in the professional honorarium for members of the audit committee. The larger the composition of the audit committee can lead to an increase in compensation for them which ultimately has no significant impact on financial performance. This indicates that the effect of audit committee size on financial performance cannot be proven. However, this finding contradicts the findings of Abeygunasekera et al. (2021) and Tornyeva and Wereko (2012).

Regarding the frequency of audit committee meetings (ACMF), the results of the study found that the frequency of audit committee meetings had an insignificant positive relationship with ROA (0.002578), and had a positive and significant effect with ROE (0.330746). This finding is in line with and consistent with an empirical study by Aanu et al. (2014), Amer et al. (2014), Bansal and Sharma (2016) and Bouaine and Hrichi (2019). contrary to the results of research by Rabeiz and Salameh (2006), Abeygunasekera et al. (2021), Alqatamin (2018), and Rahman et al. (2019).

The final results in this study found that audit committee expertise had no significant effect on ROA (-0.167611), but had a significant negative effect on ROE (-1.470120). This finding is in line with the findings of Bouaine and Hrichi (2019), Chaudhry et al. (2020), and Qeshta et al.

(2021). Findings regarding the impact of audit committee expertise on ROE are consistent with existing literature, namely, Zájbojnřková, 2016; Al-Matari et al., 2012; Nuhu et al., 2017 which confirms a significant negative relationship between audit committee expertise and financial performance measured by ROE.

### **DISCUSSION**

The effect of board size on financial performance shows a negative impact that is not significant. The findings of this study have been accepted by most previous studies, the need for optimal board size that can improve the company's financial performance. One of the most accepted reasons is when the board consists of more members, it becomes difficult to manage the company causing a decrease in the overall performance of the company. Another justification is that larger boards do not work effectively due to a lack of communication, collaboration on emerging decision-making issues (Guest, 2009). Especially in the foreign exchange banking sector in Indonesia, because of its unique business model, which is comprehensively regulated by the Financial Services Authority (OJK). Therefore, the board of directors needs to oversee the business closely, among others, in formulating monetary policy, valuing assets, and making decisions regarding problem loans. Thus, having fewer board members is more effective, easier to manage, and more accountable in the banking sector than having many directors. Therefore, this research empirically highlights the global and Indonesian context to establish a theoretical relationship between board size and the financial performance of foreign exchange banks in Indonesia.

Findings related to the characteristics of the audit committee illustrate the various and contradictory results on financial performance. The conclusion regarding the audit committee variable has been confirmed by most of the previous researchers. However, for most of the variables (audit committee size, frequency of audit committee meetings, and measured by ROA), there is no significant relationship with financial performance. However, audit committee expertise shows a negative impact on financial performance, emphasizing the importance of audit committee members having financial experts. The requirement for audit committee members to have expertise arose as a consequence of previous financial crises and corporate scandals. In the context of foreign exchange banks, the main function of the audit committee is to monitor financial performance and ensure the integrity of financial reporting. Audit committee expertise is an integral component of audit committee members. Directors will make more efficient and specialized decisions because the audit committee has their technical expertise, experience and knowledge of companies and the banking industry when they come from auditing accounting and finance backgrounds. In addition, the presence of audit committee accounting or finance experts will help prevent accounting misreporting, reduce the possibility of litigation against companies, and reduce regulatory attention to companies. Because management and investors are concerned about the impact of corporate governance on financial performance, this study provides evidence of a significant negative impact between board size and financial performance. Likewise, audit committee expertise shows a positive impact on financial performance.

In conclusion, the smaller the board size, the higher the financial performance proxied by ROA and ROE, in line with the expertise of banking specialists in Indonesia. This study also provides policymakers with better insight into the various characteristics required by audit committees, which can be incorporated into future policy implementations to protect shareholder wealth, safeguard stakeholder interests, encourage capital flows, and encourage foreign direct investment. into financial and non-financial companies and the economy

### **CONCLUSION**

The results of the study show that board size has a negative but not significant relationship to Return on Assets (ROA) and Return on Equity (ROE). Furthermore, findings regarding audit committee size indicate that both audit committee size and audit committee meeting frequency have an insignificant relationship with return on assets (ROA) and return on equity (ROE). However, audit committee expertise showed a significant negative relationship with ROE, and ROA was not significant. Overall, this research highlights the importance of corporate governance mechanisms that may be useful to policy makers in designing the future. Furthermore, the research findings will be very useful for the management in making the right decisions regarding optimizing



the size of the board and the characteristics of the audit committee to protect the interests and demands of various company stakeholders.

Apart from the contributions mentioned above, this research itself has some limitations and constraints. First, the research period is limited from 2017 to 2021 to be carried out under COID 19 conditions. Second, the sample is limited to only 38 foreign exchange banks which represent the entire population. Therefore, it is advisable to further research the topic of corporate governance and financial performance for other sectors and investigate whether corporate governance will affect company performance. In addition, we recommend extending the research period and using more proxies to demonstrate corporate governance, and we recommend a cross-country study for a more comprehensive analysis.

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