

# The Role of Foreign, Family Ownership and Audit Committee in Evaluating the Company as a Going Concern: Evidence from Jordan

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## Abstract

This study discusses the association between foreign, family ownership and audit committee on the going concern evaluation among Jordanian listed companies for the years 2011 and 2012. The data reveal through using OLS regression that there is a negative and not significant relationship between foreign ownership and going concern evaluation, while a negative significant relationship with family ownership. In addition, this study also finds a positive and significant relationship of audit committee with the going concern evaluation. The results also show that most of the Jordanian companies have violated some of Corporate Governance requirements. For instance, approximately 43% of Jordanian firms did not have an audit committee. This study shows valuable insights to the understanding of factors that may affect going concern evaluation among Jordanian firms. Therefore, the findings of this study provide important conclusions for investors, regulators and policymakers and academics to shed the light on the mechanisms that ensure the continuity of companies.

**Keywords:** Going concern, foreign ownership, family ownership, audit committee, Jordan.

## 1. Introduction

The going concern refers to the corporate that has the necessary resources to continue its operating indefinitely. If a corporate is not a going concern, it refers the corporate has gone bankrupt. This term also known as value of Going Concern (Blay& Geiger, 2013). It is also defined traditionally by Malaysian International Accounting MIA (2008) as “an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or seeking protection from creditors pursuant to laws or regulations”.

When the firm faces any financial distress and suffers losses and thus inability to fulfil its liabilities, the role of financial ratios becomes even more urgent in evaluating the ability of the company to continue. This leads to protect the interests of the users of financial statement and help them in making their investment decisions. Ultimately, this could also protect the social and economic stability in general. Furthermore, if the accountant does not provide the necessary information, the investors and financial analysts will not be able to evaluate the firms' going concern and may not offer the right decision in allocating their investments.

Jordanian economy relies heavily on the financial aids from overseas countries and taxes from Jordanian firms. Such reliance is due to the lack of natural resources and raw materials. Over the last decades, particularly in 1989, Jordan suffered a severe economic crisis resulting in the decrease of financial strength and bankruptcy of many companies which then lead to the decrease of exchange rate of Jordanian Dinar (from 1JD = USD3.35, to USD1.41 after the crisis) in addition to the increase rates of unemployment in the country. In addition, the bankruptcy of Petra Bank led to the loss of JD 200 million (USD 670 million) (Asfor, 2003).

Jordan also could not escape from corporate mischief and misconduct. This is evident from the collapse of Shamayleh Gate crisis in 2006 in which this crisis generated the attention the policy makers in promoting the foundations and principles of corporate governance system as well as the importance of the external auditor's in the Jordanian economy. In addition, several Jordanian companies tricked a number of Jordanian banks in order to obtain credit facilities: totalled over one billion USD that sparked financial scandals, the absence of corporate governance system among the Jordanian firms has encouraged such scandals. Thus, Jordan has displayed an important interest in consolidating the corporate governance pillars through sponsoring a series of economic, legislative as well as financial reforms that suggested to enhance the level of accountability and transparency as well the rule of law in the country's economic system. Recently, all these corporate governance mechanisms are viewed as paramount to create conducive environment to protect the interests of shareholders and those who hold interests in losing enterprises, as well to offer a stable national economy along with the suitable climate of investment (Jordanian Forum for Economic DevelopmentJFED, 2003).

The findings of this study are useful in obtaining more comprehensive and being familiar of the relationship of corporate governance with the going concern evaluation of the Jordanian companies. As a result, more information about the regulatory bodies and relevant parties in Jordan, such as Jordan Securities Commission is obtained, which can aid in evaluating the

existing corporate governance in the Jordanian firms and making sure of the expected outcome.

## **2. Hypotheses Development**

This study offers three major hypotheses to test the association between the foreign, family ownership and the audit committee with the going concern evaluation. The following sections illustrate these relationships in detail.

### ***2.1 The Relationship between Foreign, Family Ownership and Going Concern Evaluation***

Wei, Mallinckrodt, Larson and Zakalik (2005) discovered that there is a positive association between foreign ownership and the company's value. Bagaeva, Kallunki & Silvola (2008) did not detect any justification for the hypothesis that companies are owned by foreign owners that have been reported to get more earnings better than the companies which are owned by non-foreigners. Nevertheless, it has been reported that the Russian companies that are owned by foreign owners report their earnings with an accurate recognition of financial profits compared to the others. Jaing and Kim (2004) described that foreign ownership has a correlation of the lower level of information asymmetries and with higher level of corporate transparency.

Mohandi and Odeh (2010) found that companies with higher percentage of foreign ownership correlate positively with the quality of financial statements in Jordan. Aydin, Sayim & Yalama(2007) found that there is a positive association among foreign ownership and a firm performance. They argued that foreign ownership enhances a firm performance better than domestically owned. On the contrary, Klai and Omri (2011) found a negative association among foreign ownership and financial reporting quality. Similarly Ali, Salleh and Hassan (2008) found a negative direction in the relationship between firms that owned by foreigners and discretionary accruals in Malaysia.

As for the family ownership, previous studies on predictors of going concern opinion are plenty (e.g., Knechel & Vanstraelen, 2007; Shafie, Hussin, Yusof & Hussain, 2009; Boone, Khurana, & Raman, 2010). However, there is only one known study sought to assess the association between family control and the audit report which is by Ballesta and Garcia-Meca (2005). The study was conducted using firms listed in the Madrid Stock Exchange during 1999 to 2002. Specifically, the study investigated the effect each of ownership concentration, board size, board ownership and family members on audit report. Result of the multivariate logistic regression indicated that, among others, the more family members in the board of directors, the more likely the firms to get qualified audit opinion. This study is an extension of Ballesta's work as it ascertains the effect of family control on the going concern opinion decision in the context of Jordan.

Ballesta and Garcia-Meca (2005) in Spain found a positive impact of family ownership on the going concern opinion issuance. The findings showed that auditor can maintain his independence and provide quality audit even though they operate in situations where family owners are very dominant. The findings did not support agency theory explanation which suggests that high degree of family control is associated with lower level of board

independence and makes auditors more likely to issue going concern opinion. Future studies could explore this association between family control and going concern opinion issuance by adopting other measure for the family control concept and use a larger sample.

Thus, based on the results of prior mentioned studies which claimed that foreign ownership improves the financial report quality, as well as family owners enhance qualified audit report, the first two hypotheses are suggested as follows:

*H1: There is a positive relationship between the foreign ownership and going concern evaluation.*

*H2: There is a positive relationship between the family ownership and going concern evaluation.*

## **2.2 The Relationship between Audit Committee and Going Concern Evaluation**

Al-Shareif (2008) contended that there is a significant connection among incomes' quality and independence of audit committee in Jordan. Ismail, Iskandar and Rahmat(2008) explained that audit committee with multiple directorship often has a positive correlation with the quality of reporting. Meca and Ballesta(2009) deduced that autonomous audit committee represents an efficient means in moderating earning management practices. Wan-Hussin and Haji-Abdullah (2009) looked into the connection between audit committee and the quality of financial statements in Malaysia, and discovered that the presence of a large audit committee has a positive correlation with the quality of financial reporting. In a similar research, Rainsbury, Bradbury and Cahan(2009) examined the link among the quality of audit committee and financial report quality; it was argued that there is no noteworthy link among an audit committee quality and financial reporting the quality. The results indicated that there is less expectation from regulators and decision-makers even with the formation of a high quality audit committee.

Al-Khabash and Al-Thneibat (2008) revealed that the level of corporate governance is low particularly with the lack of an audit committee. They found a significant and positive association with the earning management practices. Furthermore, Ismail, Dunstan and Zijl (2010) discovered that the size of the audit committee has a positive association with the earnings' quality. Lin and Hwang (2010) further explained that earning management has a adverse relationship with the presence as well the frequency of audit committee meetings. On the contrary, Wenyao and Qin (2008) deduced that the presence of an audit committee did not limit the propensity of the earnings' management.

According to the above discussion and the results of previous studies, this study proposes a positive relationship between audit committee and going concern evaluation. Therefore, the third hypothesis is proposed as follows:

*H3: There is a positive relationship between audit committee and going concern evaluation.*

### 3. Methodology

#### 3.1 Sample and Data Collection Technique

There are three sectors in Amman Stock Exchange; these sectors are namely financial, industry and service sector. This study focuses only in the industry and service sector, because there are more companies suffered from bankruptcy in these sectors. Further, these sectors have the same regulation that issued by Amman Stock Exchange. This study uses data for 2010 and 2011. The final sample was 226 firms after excluding firms that did not have the necessary data. Secondary data is collected using the annual reports of firms listed on Amman Stock Exchange.

#### 3.2 Research Framework

This study employs regression mode to examine the relationship between foreign and family ownership along with audit committee and going concern evaluation. This section demonstrates the research framework of the study and provides also research model to be tested.

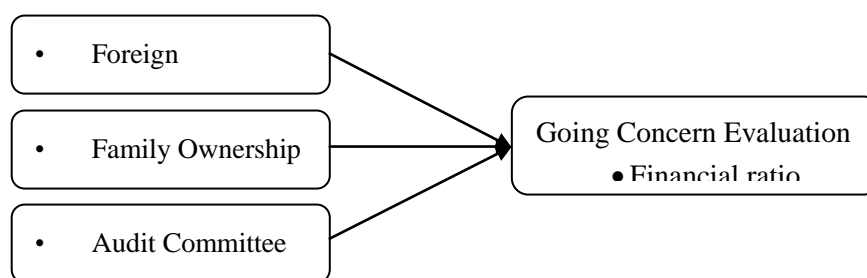


Figure 1

Consequently, this study develops the following regression model which employs to fulfil the research objectives:

$$ZScore = \beta_0 + \beta_1 FOROW_{it} + \beta_2 FAMOW + \beta_3 AC_{it} + \epsilon_{it}$$

Where:

FOROW = Foreign ownership was calculated as the percentage of shares owned by foreigners to the total number of company's shares (Klai&Omriche, 2011).

FAMOW = Family ownership is calculated as the percentage of shares held by families to total number of firm's shares (Alkhalaf, 2012).

AC = Audit committee is measured as a binary variable where '1' denotes a firm that has audit committee, and '0' otherwise (Gulzar& Wang, 2011).

This study also uses the financial ratios in evaluating the company's going concern, these financial ratios representative by Altman Model (1968). Hence, this study uses five of Altman's ratios to determine the Z score;

$$ZScore = 1.2 \frac{WC}{TA} + 1.4 \frac{RE}{TA} + 3.3 \frac{EBIT}{TA} + 0.6 \frac{MV}{BV} + 1.0 \frac{SA}{TA}$$

Where:

Z score = Firms' financial condition (strong, moderate and weak)

WC/TA = Working capital ÷ total asset

RE/TA = Retained earnings ÷ total asset

EBIT/TA = Earnings before interest and tax ÷ total asset

MV/TA = Market value of share ÷ book value of debt

SA/TA = Sales ÷ total asset

Altman has divided the firms into three levels which are strong, moderate and weak based on the Z score percentage. In detail, strong level if Z rate is > 2.99, moderate level when Z rate is between 1.811 and 2.98, while the weak level when Z rate is < 1.811.

## 4. Results

### 4.1 Descriptive Analysis

As presented in Table 1, the mean value of going concern is 73.40%. This ratio refers that almost 73% of Jordanian firms received report with going concern. The mean value of foreign ownership is 8.92%, whereas the minimum value is 0%. These findings suggest that the Jordanian government and the policy makers should follow a new strategy to encourage the foreign investors to allocate part of their investment in Jordan. The average value of family ownership is 5.62%.

As presented in Table 1, the results show that 58.8 %, of Jordanian firms have an audit committee. This finding is lower to the findings of Abu-Haija (2012) who reported an average value of audit committee among Jordanian listed firms of 48.2%. This difference is based on the period of study which was from 1997 to 2006. On the other hand, 43% of Jordanian firms do not comply with the Code of Corporate Governance (2009) which require the Jordanian firms to create an audit committee.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
GC	226	-4.41	2.97	.7340	.95386
FOROW	226	.00	.92	.0892	.18542
FAMOW	226	.00	.60	.0562	.13284
AC	226	.00	1.00	.5885	.49320

#### 4.2 Correlation Analysis

Based on the Pearson Correlation Matrix, there is a positive coefficient between going concern and audit committee, while a negative coefficient with foreign and family ownership. On the other hand, the result also shows that the foreign ownership has a negative coefficient with family ownership and audit committee. As for family ownership, this study finds a negative correlation between family ownership and audit committee.

Table 2: Pearson Correlation Matrix

Variable	FOROW	FAMOW	AC	GC
<b>FOROW</b>	1			
<b>FAMOW</b>	-.107	1		
<b>AC</b>	-.046	-.173**	1	
<b>GC</b>	-.105	-.203**	.267**	1

#### 4.3 Hypotheses Testing

This study suggests three main hypotheses were developed and offered in previous sections. Table 3 shows the results of multiple regression analysis. Table 3 illustrates that the research model is significant ( $F= 9.082$ ,  $Sig = 0.00$ ). All of the independent variables contribute by explaining 9.7% from the total variance of going concern evaluation ( $Adjusted R^2 = .097$ ).

For the first hypothesis, Table 3 shows that the direction of the relationship between foreign ownership and going concern evaluation is negative but not significant ( $T = -1.773$ ,  $P = .078$ ). The result is supported by Wei, *at el.*, (2005) who discovered that foreign ownership contributes positively with the firm value. Hence, hypothesis H1 is not supported.

For the second hypothesis H2, Table 3 shows that there is a negative and significant



relationship between family ownership and going concern ( $T = -2.693$ ,  $P = .008$ ). This direction of the relationship is not consistent with our expectation. While based on the significant level compared with .05, this study supports the hypothesis (H2).

This study expected a positive association between audit committee and going concern. The result shows a positive and significant direction of the relationship between audit committee and going concern ( $T = 3.600$ ,  $P = .000$ ) as shown in Table 3. This result is consistent with our prediction. Thus, hypothesis (H3) is accepted.

Table 3: OLS Regression Results

Variables	B	Std. Error	Beta	T	P value
FOROW	-.582	.328	-.113	-1.773	.078
FAMOW	-1.252	.465	-.174	-2.693	.008
AC	.449	.125	.232	3.600	.000

DV            Going Concern

R2            = .109

Adj R2       = .097

F value      = 9.082

Sig          = .000

## 5. Conclusion

This paper contributes in enhancing our comprehension regarding the relevance of the agency theory in explaining the going concern evaluation within the context of the Jordanian business environment. Overall, the outcome of our study showed valuable insights and understanding not only in respect to the association between corporate governance mechanisms/going concern evaluation, but also to the individual dynamics of corporate governance mechanisms and going concern evaluation and quality of financial figures which lead to high quality of financial reports. This study opens more prospects for more in-depth studies by adding new variables which in turn contribute to explain companies going concern. This study suggests some factors for the future studies such as earnings management, the role of the external auditor and accounting conservatism.



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