



# THE EFFECT OF AUDIT COMMITTEES ON THE EFFICIENCY OF INVESTMENT DECISIONS IN THE IRAQI STOCK MARKET / AN ANALYTICAL STUDY IN THE IRAQI STOCK MARKET

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<p><b>Received:</b> 1<sup>st</sup> October 2022 <b>Accepted:</b> 4<sup>th</sup> November 2022 <b>Published:</b> 10<sup>th</sup> December 2022</p>	<p>The research aims to introduce the audit mechanism and explore the current role of audit committees in the Iraqi banking sector and contribute to the study of the relationship of audit committees and investment decisions in addition to identifying the concept and types of investment decisions and the laws, regulations and instructions applied in that. From the period 2015-2018, which numbered three banks, and the research found that the commitment to implement audit committees in joint stock companies is one of the basic things that investors put in their priorities when starting to make investment decisions, especially in light of the development of the economic system and the intensification of competition between companies for investment. Those that have effective audit committees have a competitive advantage to attract capital more than those that do not have audit committees through the confidence of investors in them.</p>

**Keywords:** Audit , Audit committees, efficiency, investment, investment decisions

## 1. INTRODUCTION

Business has developed greatly with the development of technology and globalization, which led to the development of the labor market and the country's economy. This development had a significant impact on the growth of local and international trade and opened new horizons for the international economy through local and foreign investment, but this requires economic units to have a great degree of rigor and the imposition of accurate standards and controls (Wong, Geoffrey, 2012:25). To make the financial statements of those economic units transparent and devoid of the usual methods of fraud, since most of the economic units seek to manipulate their financial statements to make the company look good to local and foreign investors. Hence the interest in auditing and the importance of having an audit committee that gives an opinion on the financial statements after checking them and making sure of their validity. The information contained therein, as the world witnessed in the past periods the collapse of major international companies and their bankruptcy as a result of the non-compliance of those companies with accounting standards and transparency in presenting the accounting information contained in the financial statements. Management of these companies and members of their boards of directors holding them directly responsible for the failure of their institutions. (Kafi, 2013: 20). Hence, the research came to shed light on the importance of audit committees in attracting local and foreign investments and the extent to which companies listed in the Iraq Stock Exchange adhere to the accounting laws and regulations imposed on them. Therefore, the research aims to indicate the extent of commitment of companies listed in the Iraq Stock Exchange Accounting legislation imposed on them and the importance of audit committees in attracting investments.

## 2. THE CONCEPT OF AUDIT COMMITTEES

The audit committee (or audit committee) is an operating committee of the board of directors charged with overseeing the financial reporting and disclosure of any US public company. The members of the committee shall be

selected from among the members of the Board of Directors of the company, with a chairman for the committee being selected from among the members of the committee itself. A qualified audit committee is essential for any US public company to be listed on the stock market. Audit committees are usually empowered to have access to the consulting resources and expertise necessary to perform their responsibilities (Knappy, 1987:20). The role of audit committees continues to evolve as a result of the enactment of the Sarbanes-Oxley Act of 2002. Many audit committees oversee regulatory compliance and risk management activities. Nonprofit organizations may also have an audit committee. At the international level, the Audit Committee is a committee of the Board of Directors responsible for overseeing the financial reporting process, selecting the independent audit committee member, and receiving audit results both internally and externally. The Committee assists the Board of Directors in achieving the objectives of the corporate/institutional management of the company and supervising its responsibilities related to the financial reports of the entities, the internal control system, the risk management system, and the internal and external audit functions (Wong, Geoffrey, 2012:25). Its role is to provide advice and recommendations to the Board of Directors within the scope of its terms of reference based on the decree establishing the company.

The terms of reference and requirements of the audit committee differ from one country to another, but they may be affected by the economic and political unions that are able to issue legislation. The EU Directives are applied throughout Europe through national legislation. Although specific legal requirements may differ from country to country in Europe, the source of legislation for corporate governance issues is often at the EU level and within non-mandatory supranational corporate governance regimes. The audit committee is defined as "the committee of administrators and representatives of shareholders in institutions whose specific responsibility is to review the annual financial statements before submitting them to the board of directors (Kafi, 2013: 20).

### 3. THE EFFICIENCY OF INVESTMENT DECISIONS

There have been many writings in this field. A team of writers believes that the investment decision "is considered one of the most important and dangerous decisions for the project, because it contains a large financial commitment and can only be reversed with a great loss." Another group defined the investment decision as: "That decision that requires a certain amount of money that the enterprise will risk if it does not accept an investment proposal." (Johnson, 2003,: 16.) One of the writers defined the long-term investment decision as "associating or allocating a known amount of the company's funds and resources and sacrifice at the present time based on a prior rational approach to analysis, division and comparison in order to achieve or obtain appropriate returns that are expected to occur over the course of Relatively long future periods of time" (Suleiman, 2006, p. 144) and another defined investment decision as "the decision that involves allocating a known amount of the company's funds at the present time over a long period of time with the aim of making a profit in the future, which is subject to different degrees of Risk and uncertainty" (Ismail, 2014,: 325). Another believes that the investment decision "includes a huge financial commitment for a long period of time with the intention of obtaining a return in the future" and another defines the new investment project as "creating a new production unit, which entails commitment to a group It is clear from the previous definitions that there are multiple views of the book on the concept and importance of the investment decision (Report Smith, 2003: 6)

### 4. SCIENTIFIC BASES AND PRINCIPLES FOR INVESTMENT DECISION MAKING

The investor faces three situations that require him to make a decision, and the nature of the decision he takes in these situations depends on the nature of the relationship between the price of the investment instrument on the one hand, and its value on the other (Al-Sartawi ,2013,16)

- **The purchase decision:** when the market price (X) is less than the value of the investment instrument (Q), as the investor sees it i.e. ( $x > s$ ), which creates an incentive for him to buy that instrument in pursuit of capital gains from a rise he expects in its market price in the future. The foregoing results in the generation of purchasing pressure in the market on that instrument, which leads to raising its market price in the direction that Reduces the difference between price and value. (Fri, 2011, 325).
- **The decision not to trade:** It follows from the previous situation resulting from purchasing pressures that the market mechanism responds to these pressures, so the price continues to rise to a point where the market price (x) is equal to the value (s), and here the market becomes in a state of equilibrium imposed on those who had incentives Buying stop buying, as well as those who had incentives to sell also stop selling, so the investment decision in this case is not to trade where ( $x = s$ ) because the investor at this point is in a situation where he has hopes for future capital gains, just as he has Also, if temporarily, the risk of a price drop in the near future, unless the prevailing conditions change. (Thomas, & Emerson, 2000: 77).
- **Selling decision:** After the state of equilibrium that passes in the market when the price is equal to the value, the market dynamic works, creating additional desires in it to buy that tool from a new investor and within the scope of his decision model, any investor sees that (x) at that moment is still less than ( s), which requires a new price for that instrument more than (s) and thus the price rises above the value ( $x < s$ ), thus creating an incentive for others to sell, so the investor's decision at that time is a decision to sell. This creates a new circumstance that is reflected in the market mechanism to a point where the supply of the instrument becomes more than the demand for it, and the market price of the investment instrument tends to fall again, and thus the cycle revolves.

**5. AN INTRODUCTORY OVERVIEW OF THE RESEARCH SAMPLE BANKS**

For the purpose of achieving the objectives of the research and proving its hypotheses, the researchers chose a sample from the Iraq Stock Exchange to be a sample and it is represented in three banks included in it, which are as follows:

▪ **Kurdistan Bank**

The bank was founded on 03/13/2005 in Erbil as a private joint stock company with a percentage of (100%) with a capital of (50,000,000,000) fifty billion Iraqi dinars, and was listed in the Iraq Stock Exchange on 01/11/2006 with a capital of (50,000,000,000) fifty billion dinars. As for the capital listed on 06/30/2018 with a capacity of (400,000,000,000) four hundred billion Iraqi dinars, as the bank aims to practice banking business.

▪ **Sumer Commercial Bank**

The bank was founded on 05/26/1999 in Baghdad as a private joint stock company with a rate of (100%) with a capital of (400,000,000) four hundred million Iraqi dinars, and it was listed in the Iraq Stock Exchange on 09/04/2004 with a capital of capacity. (6,000,000,000) six billion Iraqi dinars, and the capital listed on 06/30/2016 capacity is (250,000,000,000) two hundred and fifty billion Iraqi dinars, as the bank aims to practice banking business.

▪ **The Iraqi Middle East Investment Bank**

The Iraqi Middle East Investment Bank was established in 1993 with a capital of 400000000 dinars according to the incorporation certificate numbered M / U / 2521 on 7/7/1993 and authorized the practice of banking on 9/28/1993 It was able to open its doors for banking business on 8/5/1994. During 2013, its capital was increased, reaching 250 billion dinars in 2013, as the bank aims to carry out banking business.

**6. ANALYTICAL STUDY OF THE RESEARCH SAMPLE BANKS**

**First: Measuring the independent variable Audit Committee:**

After the sample was selected and data was collected from the annual reports of the banks, the study sample, the effectiveness of the audit committee in banks was measured in the study sample through its five dimensions (the independence of the audit committee, financial or accounting experience, the percentage of the committee members owning the shares of the company, the size of the audit committee, and the frequency of its meetings ) using the survey form to collect data, which is as follows:

➤ **Independence of the Audit Committee:**

The first independent variable, which is a dummy variable, so if the committee consists of non-executive members in full, it is given the number (1), otherwise the committee is given the number (0).

➤ **Financial or accounting experience of members of the audit committee:**

It is the second independent variable, which was measured by determining the qualifications of the committee members and their possession of financial experience by knowing their educational attainment. The sample was divided into two groups. The group in which one of the members (at least) has financial and accounting experience was given the number (1) and (0) otherwise. .

➤ **Percentage of audit committee members ownership:**

The percentage of ownership of the members of the audit committee was measured by dividing the number of shares owned by the members of the audit committee by the total shares of the company. If the percentage of ownership was high, the number (1) and (0) were given otherwise.

➤ **Audit Committee Size:**

It is the fourth independent variable, the natural logarithm of the audit committee, and it is the fourth independent variable that is measured by giving the number (1) if the committee consists of three members and (0) if the audit committee consists of more or less than three members.

➤ **Frequency of Audit Committee Meetings:**

The number of times the audit committee meets annually, which is the fifth independent variable. The activity of the audit committee is measured by the number of its meetings during the fiscal year. The audit committee that met more than five times in one year was given the number (1), otherwise it is given the number (0) and as a result To apply these measures to the research sample, they are presented in the tables below:

**Table No. (1)  
Characteristics of the audit committee in Iraqi banks for the year 2019**

<b>Financial experience</b>	<b>Commission independence</b>	<b>Commis sion size</b>	<b>Percentage of ownership of committee members</b>	<b>number of meetings</b>	<b>the year</b>	<b>bank</b>
<b>1</b>	<b>1</b>	<b>3</b>	<b>0.00001</b>	<b>6</b>	<b>2019</b>	Sumer
<b>1</b>	<b>1</b>	<b>2</b>	<b>0.00007</b>	<b>6</b>	<b>2019</b>	Middle east
<b>0</b>	<b>0</b>	<b>1</b>	<b>0.17000</b>	<b>12</b>	<b>2019</b>	Kurdistan

Source: Preparing researchers

**The number of audit committee meetings :** The above table indicates that the activity characteristic of the audit committee is high in the study sample companies, which is 75%, indicating that the companies are aware of the role played by the number of audit committee meetings.

**Percentage of ownership of audit committee members :** The table above indicates that the percentage of members’ ownership of the company’s shares is low, as in the rest of the previous years, which amounted to each bank for the year 2019 (0.00007---0.00001----0.17000), and this supports the independence of the committee and thus its effectiveness.

**The size of the audit committee :** As in previous years, there is an optimal size for the audit committee, as it consists of 3 members in the largest part of the study sample companies. The largest size of the audit committee during the year 2019 was three members, and the least number is one member.

**The independence of the audit committee :** Table No. (1) indicates a decrease in the independence of audit committee members in the study sample companies, as they did not meet the audit committee independence standard. The size of the audit committee As in previous years, there is an optimal size for the audit committee, as it consists of 3 members in the largest part of the study sample companies. The largest size of the audit committee during the year 2019 was 3 members, and the least number is one member.

**Financial experience :** The percentage of members of the audit committee in the research sample companies that have financial and accounting experience reached 75%, and it was noted that there is a slight difference from year to year.

**Schedule( 2)  
Characteristics of the audit committee in Iraqi banks for the year 2020**

<b>Financial experience</b>	<b>Commission independence</b>	<b>Commis sion size</b>	<b>Percentage of ownership of committee members</b>	<b>number of meetings</b>	<b>the year</b>	<b>bank</b>
<b>1</b>	<b>0</b>	<b>4</b>	<b>0.00002</b>	<b>5</b>	<b>2020</b>	Sumer
<b>1</b>	<b>1</b>	<b>2</b>	<b>0.00004</b>	<b>6</b>	<b>2020</b>	Middle east
<b>0</b>	<b>0</b>	<b>1</b>	<b>0.17000</b>	<b>12</b>	<b>2020</b>	Kurdistan

Source: Prepared by researchers

**Second: Measuring the dependent variable: efficiency of investment decisions:**

The (Richardson, 2006) model was used to measure the efficiency of the investment decisions of the Iraqi companies under study. This model is based on a comparison between the actual investment of the company in a specific year and the expected investment volume of the company for the same year. The investment decision is considered an inefficient decision in two cases: the first: an increase in The actual investment volume is less than the optimal size of the expected investment. This case is known as over-investment or (over-investment). The second case is a decrease in actual investments than the optimal size of the expected investment. It is known as under-investment. The size of the expected investment of the company is estimated in light of its growth opportunities, which may be determined as a function of revenue growth. The (Piecewise Cinear Regression) model, the segmented regression model, is the appropriate model for formulating this relationship and takes the following form.

$$Investment_{it} = B_0 + B_1 Neg_{it-1} + B_2 \%RevGrowth_{it-1} + B_3 Neg * \%RevGrowth_{it-1} + \epsilon_{it}$$

Whereas (Investment) represents actual investments, which is the sum of new investments in fixed assets, long-term financial investments, and research and development expenditures minus sales of fixed assets and long-term investments, with a weighting of output by total assets in the previous year, Rev Growth<sub>it-1</sub>): represents the rate The annual growth in the revenues of the previous year is measured as follows: - Growth rate in revenues = revenues of the current year - revenues of the previous year / revenues of the previous year (Neg<sub>it-1</sub>): It is a dummy variable that takes the number (1) if the growth of revenues is positive and takes the number zero Otherwise, based on the above regression equation, the efficiency of investment decisions is calculated by dividing the companies into two groups depending on the value of the statistical residuals. My agencies: - Companies with negative statistical residuals are characterized by low investment. Companies with a positive statistical residual are characterized by high investment. First, how to calculate the actual investment of the study sample companies will be shown, and then how to calculate the efficiency of investment decisions for those companies through the following tables:

**Table No. (3)**  
**Actual investment for the year 2019**

actual investment	Long term financial investment sales	Asset sales are fixed	An increase in research and development expenditures	An increase in long-term financial investments	Increase in projects under implementation	Purchase of fixed assets	year	bank
11997445000	0		0	0	0	11997445000	2019	Sumer
270767400-0	0	5561330000	0	0	0	2853656000	2019	Middle east
4559146000	0	0	0	0	0	4559146000	2019	Kurdistan

Source: Prepared by researchers

**Table No. (4)**  
**Actual investment for the year 2020**

actual investment	Long term financial investment sales	Asset sales are fixed	An increase in research and development expenditures	An increase in long-term financial investments	Increase in projects under implementation	Purchase of fixed assets	year	bank
8447946000	0	0	0	0	0	8447946000	2020	Sumer
458319000	0	9477904000	0	0	0	9936223000	2020	Middle east
110469100-0	0	1209691000	0	0	0	105000000	2020	Kurdistan

Source: Prepared by researchers

The results of the above table showed, and as it was observed on all years of the study from 2012 to 2018, there is a discrepancy between the actual investment volume from year to year and from one bank to another. The lowest value of the actual investment volume was in the Bank of Baghdad, by 3%, while the Mosul Bank achieved the highest actual investment during the year, by 6%. The highest actual investment during the study period was in the year 2012, which amounted to (165404066461), followed by the year 2015, which amounted to 119438586661) and then the year 2017, with an amount of (110242590170). At the level of banks, Khaleej Commercial Bank achieved the highest actual investment (73419470201515), followed by Mosul Bank (49261096828), then Mansour Bank (44239638254).

**Third: Measuring the efficiency of investment decisions:**

**Table No. (5)**  
**Investment efficiency for the year 2019**

The type of difference high or low investment	Investment efficiency is the difference between actual and expected	The optimal expected investment	year	bank
lower investment	-0.008121804	-0.04222746	2019	Sumer
lower investment	-0.048147705	0.041433425	2019	Middle east
lower investment	-0.132374487	0.137126936	2019	Kurdistan

Source: Prepared by researchers

It is clear to us from the previous results of the table above and the current results that, in general, investment in Iraqi banks is characterized by a decline, which amounted to 79%, and a small percentage of banks with an increase in investment, by 21%.

**Table No. (6)**  
**Investment efficiency for the year 2020**

The type of difference high or low investment	Investment efficiency is the difference between actual and expected	The optimal expected investment	year	bank
lower investment	-0.108853177	0.130504796	2020	Sumer
lower investment	-0.134257331	0.135479774	2020	Middle east
lower investment	-0.048727964	0.047693233	2020	Kurdistan

Source: Prepared by researchers

It became clear from the previous results for the entire study period from 2019-2020 that there are a few Iraqi banks that exaggerate their investment, and it ranged between 10%-21% for all years of the study, which indicates that there is a large difference between companies that have an increase or decrease in investment. The number of banks with a lack of investment reached (105) watching, at a rate of 82%, while the number of banks with a high investment reached (23) watching, at a rate of 18%. The reasons for the low level of investment in all Iraqi banks are attributed to the prevailing political and economic conditions in Iraq and the state of severe recession Which prevailed in the Iraqi economic activity and most of the investment and service projects stopped, so the current situation of the country with its various political and security facilities is reflected in the activities and work of banks and their expansionary policy, which led to a decrease in the level of investment in the banking sector in general.

## CONCLUSION

The commitment to the application of audit committees in joint-stock companies is one of the basic things that investors place in their priorities when initiating investment decisions, especially in light of the development of the economic system and the intensification of competition between companies for investment. Therefore, companies that have effective audit committees have a competitive advantage in attracting money. more than those that do not have audit committees through the confidence of investors in them. The research has reached a set of conclusions, the most important of which is the presence of audit committees in companies that attract various funding sources, which makes them able to create new job opportunities, which leads to achieving efficiency and economic development. It works to control the company's performance by contributing to preventing fraud and limiting the commission of violations and illegal practices through the extent to which companies adhere to the laws, legislation and standards regulating the company's business, which increases the degree of reliability of the financial statements, which helps to make efficient investment decisions. The research also found a group Recommendations, the most important of which is the need for Iraqi joint stock companies to activate the role of audit committees in those companies and to define the framework and doubts The legal framework of the audit committee is in the form of a written charter in which the powers, responsibilities and characteristics that should be enjoyed by members of the audit committee and everything related to the effectiveness of these committees are clarified and the professional and legislative associations, the Iraq Stock Exchange, the Registrar of Companies and all relevant authorities are invited to find a responsible supervisory authority that follows up the work of the committees Auditing banks and following up on the extent of banks' compliance in applying them, while giving them powers and powers to impose fines and penalties in case of breach of the working conditions of those committees.

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