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Original Research

The Effect of Internal Audit and Audit Committee Formation History on the Company's Performance: Moderating Role of Firm Age

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Abstract

Conflict of interests between shareholders and managers and other problems have led to the creation of corporate governance mechanisms. But, firms' performances and the effect of corporate governance mechanisms on firm performance are still of interest to researchers. The objective of this study is to investigate the effect of internal audit formation history and audit committee formation history on the company's performance and also to investigate the moderating effect of firm age on these relationships. The population in this research includes all the companies listed on the Tehran Stock Exchange during 2018 to 2022, and the sample includes 120 companies. Research data were analyzed through multivariate regression model and by Stata software. The results show that the internal audit formation history has a positive and significant effect on the company's performance and also the audit committee formation history has a positive and significant effect on company's performance. The results also show that firm age is a positive and significant effect on company's performance. Moreover, the results show that firm age has no significant effect on the relationship between the internal audit formation history and the company's performance, but firm age has a positive effect on the relationship between the audit committee formation history and the company's performance.

Keywords: Audit Committee, Company's Performance, Firm Age, Formation History, Internal Audit.

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Introduction

Increasing the wealth of the company's shareholders in the long term is the most important goal of the company, which will be the only result of the company's optimal performance. In general, the importance of evaluating the financial performance of companies makes the way of financial reporting important, because the users of financial information demand complete and correct information about the performance of companies. In order to increase their wealth, the shareholders seek to improve the performance of company, and for this reason, evaluating the company performance is very important (AbuZraiq and Hanim, 2018). After the emergence of agency problems, companies seek to provide clear information and align the interests of company owners and managers. Therefore, companies use various mechanisms such as creating a theoretical framework and compiling accounting standards, the structure of internal controls, internal audit, audit committee, and the presence of independent managers in the board of directors. However, there are still problems in the performance of companies. Corporate governance can lead to the improvement of the company's performance. In fact, corporate governance creates a structure by which the objectives of the business unit can be adjusted and the achievement of the company's goals and the monitoring of the company's performance are facilitated. These mechanisms create the necessary motivation to realize the company's goals in management and provide effective supervision and as a result, companies use resources more effectively (Farooque et al. 2020). Van den Berghe believes that the company's performance is the result of many interconnected criteria and factors, among which the corporate governance mechanisms are an important and influential factor on the company's performance (Zhou et al. 2018). According to the studies, if the companies seek to strengthen the corporate governance mechanisms, this will lead to improved performance and even an increase in the value of the company. Optimal corporate governance mechanisms will create sustainable economic development, because it is expected that corporate governance mechanisms can improve the performance of companies and increase attention to financial performance, and thus cause the growth and development of investments and increase productivity and economic growth. Therefore, companies that use corporate governance mechanisms in a more efficient and effective way are expected to have better financial performance (Al-matari, 2022). The internal audit function as well as the audit committee are among the most important regulatory mechanisms and important part of corporate governance. Internal audit as the internal advisor of managers and also the audit committee as a supervisory mechanism on the internal control system are factors in optimizing the internal processes of companies and are effective in assessing the company's risk. Therefore, the performance of internal audit and the audit committee can be one of the most important tools to improve the performance of companies. Monitoring the company's performance is one of the important tasks of the company's management, for which the help of units such as the internal audit and the audit committee can reflect a clear picture of the organization's operations (Davidson et al. 2004). If these units perform their duties with sufficient accuracy and effective supervision, they will promote corporate governance and improve the performance and value of the company.

At the same time as the growth and age of a company, many of its features and characteristics have changed and these factors will affect the behavioral aspects of the company. With regard to corporate governance mechanisms, there are many studies that

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claim that companies with a longer history and a longer lifespan apply corporate governance mechanisms more effectively (Dina et al. 2017). According to the substitution theory, firm age is considered as a factor of market power, and the longer-lived firms evaluate and control the firm's operations more effectively by incurring less debt. Therefore, as companies grow and their lives and reputations increase, they usually become more profitable and diversify their operations. Firms with more growth opportunities will have greater relative cost advantages in external growth funding (Chijoke-mgbame et al. 2020). Therefore, firm age is expected to affect the financial performance of the companies. Also, the results of previous researches show that various corporate governance mechanisms are more effective in the case of companies with a longer history and a longer lifespan. For example, Johnson et al. (2016) state that the benefits of acquiring power as well as performance change with the age of the firm. They emphasize that the impact of control and monitoring mechanisms on the performance of companies can undergo evolution and change with the growth of the company and the increase of the life of the companies.

Past researches have investigated the effect of various factors on the performance of the company. Many studies consider the weak performance of companies as a result of weak corporate governance and regulatory mechanisms in the company. Corporate governance mechanisms represent the set of relationships between managers, shareholders, auditors and other people inside and outside the organization, which causes the establishment of a control system to respect the rights of shareholders and owners and prevent fraud. The review of previous researches showed that factors such as the size of the board of directors, independence of the board of directors, institutional ownership, managerial ownership and in fact most of the ownership and management characteristics have been investigated. However, the impact of internal audit formation history and audit committee formation history as advisors to managers and important supervisory factors on financial reporting in the field of companies' performance has not been given enough attention, or little research has been done regarding their necessity.

Based on above arguments, the objective of this study is to investigate the effect of internal audit formation history and audit committee formation history on the company's performance and also to investigate the moderating effect of firm age on these relationships. Therefore, this research seeks to answer these questions: Is there a significant relationship between internal audit formation history and the audit committee formation history with the company's performance? Does the firm age affect these relationships? In next sections, the relevant literature and conceptual framework to develop research hypotheses are discussed. Then, the research methodology including population, sample selection and research models are explained. The research results are analyzed in next section and finally the conclusions of study and suggestions for future researches are discussed in final section.

Theoretical Framework

The concept of financial performance is defined by efficiency and effectiveness, because effectiveness indicates the extent to which goals are achieved, and efficiency refers to how the resources are used economically to achieve goals, and they can be considered as two important dimensions of financial performance. Companies should use

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internal and external indicators to achieve better financial performance (Paolone et al. 2022). Corporate governance mechanisms are some controlling factors which might have effect on firm performance. Among the corporate governance mechanisms, the audit committee has a special and effective position in the company and has the task of monitoring the activities and affairs of the organization, which has caused it to be emphasized and investigated among researchers and experts. Due to the broad responsibilities, especially in large companies with more reputation and longevity, it is important to closely and directly monitor all aspects. In fact, by forming sub-committees such as the audit committee, the board of directors tries to manage effectively and improve the performance of the company (Zhou et al, 2018). The audit committee is one of the important supervisory mechanisms to improve the quality of the company's internal control system, which leads to the reduction of agency costs and the improvement of the company's performance. Many previous studies have investigated the role and impact of the audit committee in improving the quality of reporting, economic performance and dimensions of independent auditing. Their results indicate the positive impact of the audit committee on improving the quality of financial reporting and improving economic performance (Rezazadeh et al., 2016).

Tangsiri et al. (2018) investigated the impact of audit committee characteristics on the performance of companies listed on Tehran Stock Exchange. In this research, characteristics such as accounting expertise, independence and the size of the audit committee were examined. The data of 90 companies during 2011 to 2013 were collected. The results of research showed that the accounting expertise of the audit committee members and the size of the audit committee did not affect the performance, but the independence of the audit committee members had a positive effect on the company's performance. Abu Zaraq and Hanim (2018) also examined the relationship between the audit committee and the performance of Jordanian companies. Their sample included 228 industrial and service companies and concluded that the relationship between audit committee size and company performance is positive, while the relationship between audit committee size and earnings per share is also positive. Also, the results showed that the number of audit committee meetings is positively affect company's performance. The age of the company is one of the determining factors of the capital structure, reputation and performance of the company. According to the hierarchical theory, the longer life of the company will increase its capacity to improve internal resources and will reduce its need for external financing. On the other hand, start-up companies, in order to preserve their internal resources, consider themselves obliged to use external financing in the first years of their life. This relationship has been confirmed in the researches of Jordan et al. (1998), Hall et al. (2004) and Barid and Laki (2010). Majumdar (2014) concluded that the age of the company has an effect on the performance level of the company in such a way that companies with shorter life have more profitability. The results of Sarsarshahi and Oladi's (2016) indicate that there is a relationship between the age of the company and the research and development costs and the financial performance of the insurance and banking companies listed on Tehran Stock Exchange. On the other hand, corporate governance mechanisms such as the audit committee are very effective for the continuation of activity and success and growth of companies and cause the survival of companies in today's competitive world. Therefore, it is expected that older companies have a stronger regulatory and governance structure due to greater reputation, which leads to improved performance in such organizations.

Internal audit is a subset of the audit committee, whose members are non-commissioned or independent managers and have no executive responsibility. This committee is organized in order to increase the interests of shareholders and with the aim of reducing information asymmetry between managers and shareholders (Azad and Bakhtiari, 2019). Internal audit plays a significant role in the organization's value-adding ability in the design, establishment and monitoring of the implementation of internal controls, prevention of errors and frauds, and providing necessary advice to the management through the audit committee. If the independent auditor evaluates the control risk at a low level during the planning and gaining knowledge of the accounting and internal control systems, through a favorable evaluation of the internal audit unit's performance, it means that he can gain reasonable confidence in the operation and monitoring of the organization's internal controls (Babajani and Tahriri, 2012). Another indicator that determines the performance of a company is firm age. This criterion is directly related to the size of the company. That is, the greater the age or the number of years that have passed since the establishment of the company, it indicates that the company is bigger. It can be expected that companies with a longer lifespan have stronger governance mechanisms, and as a result, the internal audit unit will be older and more efficient and effective, and the company's performance will improve (Arslan et al., 2006). Abbasian (2018) examined the impact of the audit committee and internal audit performance on the earning management of companies listed on the Tehran Stock Exchange. The research samples included 99 companies and the research period was from 2008 to 2017. The results of the research showed that the presence of an audit committee has a negative relationship with earning management, and the presence of an internal auditor in the implementation of internal audits has a negative relationship with earning management. Also, the results showed that the meetings between the audit committee and the internal auditor have no negative relationship with earning management. Azadi et al. (2018) examined the relationship between the characteristics of the board of directors, the audit committee and the formation of the audit committee with the performance of companies. The statistical population of this research was all the companies listed on Tehran Stock Exchange in the period from 2013 to 2017. The results of this research showed that there is a positive and significant relationship between the formation of the audit committee and the complexity of the company's operations with the company's performance. However, there is no significant relationship between the size of the board of directors and the performance of the company, and the size of the audit committee and its formation do not moderate the relationship between the size of the board of directors and the performance of the company.

Chejuk-Magbam et al. (2020) investigated the impact of the presence and number of female directors on the board of directors and the audit committee on company performance among African companies. The samples included 77 companies and the research period was from 2008 to 2016. The results of this research showed that the presence of expert women on the board of directors has a positive and significant effect on the financial performance of companies, and the results also showed that the number of women on the board of directors has a positive effect on performance, so that the more women on the board of directors, the better the performance of the companies. Al-Mataari (2022) investigated the impact of corporate governance characteristics such as the expertise and tenure of the head of the audit committee on the company's performance. The research samples included 195 companies listed on Saudi Stock Exchange in the

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period from 2015 to 2019. The results of this research showed that the characteristics of corporate governance, such as the tenure and expertise of the head of the audit committee, have a positive and significant effect on the financial performance of companies. But the multiple management of the head of the audit committee has no relationship with the company's financial performance. Paolone et al. (2022) analyzed the effect of board of directors' tenure and audit committee tenure on environmental performance. The sample was European Union listed companies and research period was from 2018 to 2020. They found that longer board tenure and longer audit committee tenure enhance environmental performance, showing that firms could view the tenure rate as a proxy of the quality of the board monitoring. On the contrary, the interaction between board tenure and audit committee tenure is negatively related to environmental performance, showing that when two boards have a low rotation, companies may achieve lower environmental performance. These findings help understand the dynamic and complex nature of tenure in corporate governance mechanisms.

Firm age is another factor which has effect on firm reputation, capital structure and also firm performance. This factor is directly associated with firm size. Based on hierarchical theory, longer firm life will increase firm's capacity to upgrade domestic resources and reduce the need for external financing. Older firms usually may have better performance due to more experience that they have in managing the firm's affairs and having more knowledge about business situation (Kallunki et al., 2015). Majumdar (2014) mentioned that firm age has effect on the level of firm performance and older firms are more profitable. Also, Sarsarshahi and Oladi (2017) indicated that there is a significant relationship between firm age with research and development costs and financial performance. Moreover, corporate governance mechanisms such as internal audit and audit committee are very effective for the continuity of activity and success and growth of firms and led to survival of firms in today's competitive world. Therefore, older companies are expected to have a stronger regulatory and governance structure due to their greater reputation, which will lead to improved performance in such organizations. Based on above discussion and theoretical framework, the research hypotheses are as follows:

$\mathbf{H_1}$: Internal audit formation history has a positive and significant effect on the company's performance.

$\mathbf{H_2}$: Audit committee formation history has a positive and significant effect on the company's performance.

$\mathbf{H_3}$: Firm age has a positive and significant effect on the relationship between internal audit formation history and company's performance.

$\mathbf{H_4}$: Firm age has a positive and significant effect on the relationship between audit committee formation history and company's performance.

Methodology

This study is applied research in terms of purpose and based on research data, it is quantitative and post-event type and based on analyzes, it is a descriptive-correlation type.

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The statistical population of this research includes all the companies listed on Tehran Stock Exchange in the period from 2018 to 2022. According to the considered limitations in total, 120 companies were selected as samples and analyzed. The research model is

$$FP_{it} = \beta_0 + \beta_1 IAFH_{it} + \beta_2 ACFH_{it} + \beta_3 FA_{it} + \beta_4 IAFH * FA_{it} + \beta_5 ACFH * FA_{it} + \beta_6 Size_{it} + \beta_7 LEV_{it} + \beta_8 Loss_{it} + \varepsilon$$

FP: firm performance (ROA): return on assets

IAFH: internal audit formation history

ACFH: audit committee formation history

FA: firm age

Size: the size of company

LEV: leverage ratio

Loss: the loss of company

The dependent variable is the performance of the company, which is measured through the two criteria of return on assets and return on equity. Return on assets, which is the ratio of net profit to total assets. Return on equity, which is the ratio of net profit to total book value of equity. Independent variables include internal audit formation history and audit committee formation history, which are measured by the age of the internal audit and age of the audit committee. In this research, the moderating variable is the firm age, which is obtained through the natural logarithm of the number of years of company's activity. Control variables include firm size, financial leverage, and company losses. The size of the company was measured through the natural logarithm of the assets and the financial leverage was measured through the division of the sum of liabilities by the sum of the assets and losses of the company was a dummy variable of zero and one in such a way that if the company had accumulated losses in the given year it takes 1 and otherwise zero.

Results

Table 1. shows the descriptive statistics of research variables.

Table 1. Descriptive Statistics of Research Variables

Variables	Mean	Median	Max	Min	SD
ROA	0/17	0/14	0/71	-0/42	0/18
IAFH	0/53	1	1	0	0/50
ACFH	0/62	1	1	0	0/49
FA	3/76	1/85	4/25	2/91	0/34
SIZE	15/01	1/64	20/77	1/37	1/72
LEV	0/56	0/55	1/28	0/04	0/23
LOSS	0/09	0	1	0	0/28

In the descriptive statistics, the mean is the main indicator which represents the balance point and the distribution center, and is a good indicator of the centrality of the data. For example, the average value for a variable ROA is 0/17, which indicates that most data is centered on this point. One of the most important dispersion parameters is the standard deviation, the value of this parameter for the return on assets is 0.18. Also, it can be said that the highest and lowest values for the variables of this research are as follows: for the return on assets variable, the highest value is 0.71 and the lowest value is -0.42. For the audit committee and internal audit variable and the company's loss, which are dummy variables, the highest value is 1 and the lowest value is 0.

For analyzing data, assumptions of multivariable regression model are examined through normality test, multicollinirity test and variance homogeneity test which confirm the assumptions of the classical model. First, for the purpose of testing the normality of the data, the Jarque-Bera test is used. According to the results of this test, the Jarque statistic with a probability of 0.00 indicates that data is normal. Also, Brosh-GadFerry test is used to detect heterogeneity of variance. The results of this test show that the variances are heterogeneous. The Brosh-GadFerry test is also used to test the multicollinirity between variables. If the probability value is more than 5%, then the assumption zero of the test for multicollinirity is rejected and, conversely, if the probability of the statistics is less than 5%, multicollinirity is not rejected. Due to the result which is greater than 5% and is 0.159, there is no multicollinirity.

For testing research model, first the data type is determined using f-limer and hausman tests. The f-limer test results show that the research data are panel data and the hausman test results showed that fixed effect is exist. The adjusted R^2 is used to test the relationship between dependent and independent variables. The results of testing hypotheses (multiple regression analyses) are presented in Table 2.

Table 2. The results of data analysis for testing research hypothesis

Variables	Coefficient	Std. Error	Z-Statistic	P-Value
C	0/1006	0/0263	1/91	0/00
Iafh	0/0596	0/0294	0/01	0/02
Acfh	0/2699	0/0235	0/57	0/01
Fa	0/0026	0/005	0/26	0/00
Fa*Iafh	-0/1083	0/007	-0/695	0/08
Fa*Acfh	0/0552	0/001	2/505	0/00
Size	0/0019	0/006	0/16	0/37
Lev	-0/2331	0/007	-17/41	0/00
Loss	-0/0779	0/003	-10/82	0/00
R^2: 0/55 Prob: 0.00				

Discussion and Conclusion

The conflict of interests between managers and owners has caused the creation of control mechanisms in companies. However, the state of performance and efficiency of companies and the factors affecting them are still of interest to researchers. In this

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research, the effects of internal audit formation history and audit committee formation history on the company's performance are examined. Also, the effect of firm age on the relationship between internal audit formation history and company’s performance and also the effect of firm age on the relationship between audit committee formation history and company’s performance are investigated. The statistical population of the research included all the companies listed on Tehran Stock Exchange in the period from 2018 to 2022, and the number of samples was 120 companies according to the systematic elimination method. To collect data, library and document mining methods were used, and data and information needed for the research were extracted from the Codal website. Multiple regression method and Stata software were used to analyze the data. Based on research results, internal audit formation history has a positive and significant effect on the company's performance. Internal audit as a control mechanism and complementary to the internal control structure can play an important role in preventing fraud and mistakes in financial statements, informations and reports. In fact, an experienced internal audit improves the internal control structure, helps in risk management and ensures transparency in the organization's internal and external reports and leads to an increase in the company's performance. Therefore, according to the results, the longer the history of the internal audit formation in a company, the better and more efficient the company's performance. The results of this hypothesis are consistent with the research results of Abbasian (2018), Raghib Talab et al. (2018) and are against the results of Muslih (2021).

According to the research results, the audit committee formation history has a positive effect on company’s performance. The audit committee is actually responsible for monitoring the activities of independent and internal auditors, as well as monitoring the financial reporting process. Since the audit committee oversees the financial reporting process and providing information to users, investors will have more confidence in the information provided by companies with stronger and more experienced audit committees, which will lead to improved investment status. in these companies and improve their performance. In fact, the existence of a powerful and long-standing audit committee is a strong support for the accuracy of financial reports and is one of the company's powerful governance tools, which improves the company's internal controls and financial performance and increases the company's value. The results of this hypothesis is consistent with the research results of Oradi et al. (2016), Azadi et al. (2018), Aldamen et al. (2012). Moreover, based on the results, firm age has a positive effect on the relationship between audit committee formation history and company’s performance. The life of the company means the period of time that the company has been operating since its establishment. In general, the longer the company's life, the greater the company's ability to achieve desired performance and efficiency. In fact, increasing the life of the company increases the expertise of the company in the field of business, increases the relations with the stakeholders, increases the capital of the company and increases the human power. These factors are very important for the company to achieve its business goals and improve its performance. Since company life can improve company performance, it can also strengthen the impact of audit committee on company’s performance. The longer the company's life, the older the audit committee, which is a sign of the experience and history of the audit committee, aligns with the experience of the managers and employees of the company and leads to the improvement of the company's performance. The results of this hypothesis is consistent with the results of Muslih (2021).

There are some limitations in this research such as, the time period is limited to 2018 to 2022 and it was conducted among manufacturing companies, so the generalization of the results to other time periods and companies removed from the sample should be done with caution. Information and financial statements are not adjusted for inflation and this issue can affect the results of the research. The practical suggestions are as follows: 1. it is suggested to the senior executive managers of the organizations to establish and give importance to the internal audit and employ experienced and effective people in the internal audit unit, because the experience and background working and continuing cooperation with these members will lead to the improvement of the company's performance, try to strengthen this unit and take these matters into consideration. 2. it is suggested to the managers of the companies to try to strengthen the audit committee unit. Also, investors are suggested to consider the seniority of the company's audit committee when investing. For future studies, it is suggested that in order to use the results of the research as much as possible and to help clarify the factors affecting the company's performance and efficiency, more attention should be paid to the following issues: 1. Examining the impact of individual characteristics of managers and environmental factors in the company such as organizational culture on the performance and efficiency of the company. 2. Examining the impact of audit quality as an external variable on the relationship between the internal audit formation history and the audit committee formation history with the performance and efficiency of the company.

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