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Voluntary formation of corporate audit committees among NASDAQ firms

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Abstract

One of the major recommendations of the National Commission on Fraudulent Financial Reporting (NCFFR) was that all public companies be required by Securities and Exchange Commission rules to form audit committees composed exclusively of independent directors. This study investigates why some companies voluntarily form audit committees, while others do not. An agency theory framework is used to analyze the incentives to form audit committees. Based on 1986 data from a random sample of NASDAQ over-the-counter companies, six characteristics are found to be associated with voluntary audit committee formation: 1) lower percentage managerial ownership of the company's stock; 2) higher leverage; 3) larger firm size; 4) a greater proportion of outside directors to total directors; 5) Big Eight auditors; and 6) participation in the National Market System. The results are discussed in relation to the NCFFR's recommendation for mandatory audit committees.

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