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شئون البحث العلمي والدراسات العليا

Corporate Governance as an Internal Control System and Its Impact on Financial Performance
Empirical Study: Companies Listed at Palestine Exchange

حوكمة الشركات كنظام رقابة داخلي وتأثيرها على الأداء المالي
دراسة عملية :الشركات المدرجة في بورصة فلسطين

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أنا الموقع أدناه مقدم الرسالة التي تحمل العنوان:

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حوكمة الشركات كنظام رقابة داخلي وتأثيرها على الأداء المالي دراسة عملية :الشركات المدرجة في بورصة فلسطين

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نتيجة الحكم على أطروحة ماجستير

بناءً على موافقة شئون البحث العلمي والدراسات العليا بالجامعة الإسلامية بغزة على تشكيل لجنة الحكم على أطروحة الباحثة/ **غيداء يوسف فتحي عبدالنبي** لنيل درجة الماجستير في **كلية *التجارة*/ قسم المحاسبة والتمويل** وموضوعها:

حوكمة الشركات كنظام رقابة داخلي وتأثيرها على الأداء المالي

دراسة عملية :الشركات المدرجة في بورصة فلسطين

Corporate Governance as an Internal Control System and Its Impact on Financial Performance Empirical Study: Companies Listed at Palestine Exchange

وبعد المناقشة العلنية التي تمت اليوم الاثنين 06 ربيع الأول 1438هـ، الموافق2016/12/05م الساعة الواحدة ظهراً بمبنى اللحيدان، اجتمعت لجنة الحكم على الأطروحة والمكونة من:

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وبعد المداولة أوصت اللجنة بمنح الباحثة درجة الماجستير في كلية *التجارة*/قسم المحاسبة والتمويل.

واللجنة إذ تمنحها هذه الدرجة فإنها توصيها بتقوى الله ولزوم طاعته وأن تسخر علمها في خدمة دينها ووطنها.

والله ولي التوفيق،،،

نائب الرئيس لشئون البحث العلمي والدراسات العليا

أ.د. عبدالرؤوف على المناعمة

Abstract

This study investigates the effect of corporate governance as an internal control system on financial performance of some selected companies listed in the Palestine Exchange in 2015.The Study primarily employs the agency theory and the resource dependence theory to investigate the relationship between corporate governance as an internal control system and financial performance (boards of directors characteristics and audit committees characteristics).

The empirical part of the study is based on a sample of 29 firms out of 47 firms listed in the Palestine Exchange; data was gathered through their annual reports; and multiple regression and descriptive statistics are the main tools of analysis. Findings reveal that there is a statistically significant correlation between audit committee financial expertise and return on assets. Otherwise, there is no correlation between any independent variables and either return on assets or return on equity controlling for any permutations for firm size, leverage and big 4. The researcher refers these results, though go along with other similar studies in some of its parts, to the reality that these firms are family owned, where such board of directors and audit committees are, to great extent, not really validated, and if exist, they won't perform the required functions as per the related theories. The study recommends the Capital Market Authority to promote high standards of the principles and ethics of transparency of corporate governance, enlightening their positive role on value maximization. Also, it recommends the Capital Market Authority to issue a stricter enforcement of legislations of corporate governance, with special measurements on those evading them; and to periodically review related practices to ensure their continuous reflection of local and international developments. The study encourages other researchers to conduct similar studies on other samples and sectors.

الملخص

تبحث هذه الدراسة في تأثير حوكمة الشركات كنظام رقابة داخلي على الأداء المالي لبعض الشركات المدرجة في بورصة فلسطين لعام ٢٠١٥ . تقوم هذه الدراسة بشكل أساسي بتوظيف نظرية الوكالة ونظرية التبعية للموارد من أجل فحص العلاقة بين حوكمة الشركات كنظام رقابة داخلي و الأداء المالي (خصائص مجلس الإدارة وخصائص لجنة التدقيق) . الانحدار المتعدد والإحصاء الوصفي هي الأدوات الإحصائية التي استخدمت للتحليل في هذه الدراسة. بنيت هذه الدراسة على عينة مكونة من ٢٩ شركة من أصل ٤٧ شركة مدرجة في بورصة فلسطين، وجُمعت المعلومات من التقارير السنوية لهذه للشركات.

النتائج العملية لهذه الدراسة تشير إلى وجود علاقة ذات دلالة احصائية بين الخبرة المالية للجنة التدقيق والعائد على الأصول. غير ذلك، لا يوجد أي علاقة ذات دلالة احصائية بين المتغيرات المستقلة والعائد على الأصول أو حقوق الملكية . هذه النتائج، وإن توافقت مع دراسات مشابهة أخرى في بعض جزئياتها، إلا أن الباحثة تعزوها إلى أن الشركات الفلسطينية في بورصة فلسطين ذات ملكية عائلية، حيث يغيب – بشكل كبير – تشكيل مجالس للإدارة، ولجان التدقيق. وحتى إن وجدت هذه المجالس واللجان، لن تقوم بالمهام المنوطة بها بشكل يتناسب مع النظريات ذات العلاقة. أوصت الدراسة هيئة سوق رأس المال بالترويج لمبادئ الشفافية في ممارسات الحوكمة للشركات المدرجة، وبيان إيجابياتها على تعظيم القيمة. كما أوصت هيئة سوق رأس المال بتنفيذ تشريعات أكثر صرامة بما يجبر الشركات المدرجة على الالتزام بمعايير الحوكمة وكذلك مراجعة الممارسات بصورة دورية للتأكد من تفعيلها، ومن أنها تواكب التطورات المحلية والعالمية. كما أوصت الدراسة باحثين آخرين إلى تطبيق دراسات مشابهة على عينات وقطاعات أخرى.

Dedication

To those whose kindness, patience and support were the candles that enlightened my way towards success; **my Father and my Mother.**

Without their love, support and encouragement, this research would not have been made possible.

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I would like to start my acknowledgments in gratitude to **ALLAH** for having bestowed the blessing and his mercy on me to complete this thesis successfully, ALHAMDU LILLAH RABB ALALAMEEN.

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List of Abbreviations

CEO	Chief Executive Officer
COSO	Committee of Sponsoring Organization of the Treadway Commission
GAAP	Generally Accepted Accounting Principles
OECD	Organization of Economic Cooperation and Developments
ROA	Return on Assets
ROE	Return on Equity
SEC	Securities and Exchange Commission
SOX	Sarbanes –Oxley Act

Chapter 1
Overview of Research

Chapter 1

Overview of Research

1.1 Background and Context

Corporate governance' importance has grown tremendously in the past decades. Good corporate governance is perceived to increase firms' value as it may help to reduce agency problems (problems arising from misbehaving of company executives) and build investor's confidence (Uihoi, 2007). Moreover, it is perceived that good corporate governance not only reduces the risk of fraud and corporate collapse, but also creates wealth by improving the financial performance (Azizah &Islam, 2014). Its significance may be referred to the poor financial state of many companies, thus their willingness to improve and increase their profits.

The Organization of Economic Cooperation and Developments (OECD) define corporate governance as the system by which corporations are directed and controlled. It further states that the corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation such as, the board of directors, managers, shareholders and other stakeholders; and thus spells out the rules and procedures for making decisions on corporate affairs. It also provides the structure through which the company's objectives are set and the means of attaining those objectives and monitoring performance (OECD, 2008).

Effective corporate governance structures encourage companies to create value, through entrepreneurialism, innovation, development and exploration, and provide accountability and internal control systems commensurate with the risks involved (Australian Corporate Governance Council, 2010).

Hence, internal control system is considered to be an integral part of the corporate governance structures in both the public and the private sectors. An effective organization is one that has a good and valuable internal control system that could check problem areas in the organization so remedial action could be taken (Ijbara &Khoury, 2009).

There is no one universal definition of internal control as each author has his/her own insight as to what is internal control. In 1992, The Committee of Sponsoring Organizations of the Treadway Commission (COSO) defines internal control as a process, by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of business objectives. Based on this definition, one of the most significant parties in internal control framework is the board of directors who are responsible for the activities of the organization. The efficiency of the boards depends on the composition of the board, structure, procedures and also all the functions related to the boards. To perform its functions, board of directors comprise of several sub-committees such as audit committee. Today, Audit committee is one of the key fulcrums of any company (Internal Control Framework, 2009). The responsibility of audit committee is to provide assurance that the corporation is in rational compliance with relevant laws and regulations, is conducting its affairs fairly and is maintaining effective controls against employee conflict of interest and fraud (Siddiqui, 2012).

In a very unstable, uncertain economic and volatile financial environment, such as Palestine, firms become more prone to agency problems, which are expected to have negative consequences on the performance of the stock market and to result in the loss of domestic and foreign investor confidence. The difference in firm ownership and firm control is one of the primary differences between various countries' corporate governance systems. Within the context of Palestine Exchange, there are two types of controlling shareholders of listed firms, namely foreign and institutional shareholders. By the end of 2012, 41% and 36% of the total shares in the Palestine Exchange were owned by foreign and institutional investors, respectively. These indicators reflect that the Palestine Exchange has managed to attract, absorb and retain considerable amounts of foreign and institutional investments despite extreme economic and political instability. As such, these classes of investors are expected to become increasingly involved in corporate governance (including board of directors and audit committee's formation) through their ability to influence decision making (Hassan & Hijazi, 2015).

In addition, in developing countries, such as Palestine, more attention is needed on the acknowledgement and implementation of corporate governance; as there is a high potential for the agency problem to prevail in Palestine, since most companies are family-owned with family members holding key positions. The presence of large family-member shareholders is not a problem by itself, as long as proper corporate governance mechanisms are taken in order for other shareholders to detect any misbehaviour by controlling owners (Abedelkarim & Amer, 2010).

Thus far, this study provides a general overview by showing the need for corporate governance mechanisms to regain investors' confidence. The global financial scandals of very large corporations in the United States, which has been considered as the best regulated, most liquid and most efficient market, call into question the effectiveness of appropriate corporate governance mechanisms to improve the financial performance of Palestinian companies. The scandals have drawn attention to the corporate governance reforms in Palestine to improve and strengthen current corporate governance systems (Naveen & Singh, 2012).

The role of the board of directors and its related committees as the peak of corporate governance systems is seen as crucial to the effectiveness of corporate governance systems as well as to the success and survival of the company. Though corporate governance reforms in Palestine have been started from strong ones, critics believe that the reform measures are cosmetic because of the concentrated ownership structure and the embedded institutional and socio-cultural norms in Palestine that limit the effectiveness of these reforms. To address this issue, this study attempts to provide empirical evidence of the joint effect of board of directors' characteristics and audit committees characteristics on the financial performance of some selected companies listed at the Palestine Exchange, which has differences in the business and institutional environments as well as the ownership structure of firms compared to those of United Nations and United Kingdom firms (Duchin, Mastsusak &Ozbas, 2010).

1.2 Research Problem and Questions to be answered

Despite the campaign of awareness of the importance of corporate governance within the Palestinian context, there are still records of corporate failures that highlighted the role of corporate governance mechanisms especially boards of directors and audit committees in corporations. However, no prior studies have addressed the corporate governance as an internal control system and its impact on financial performance within the Palestinian context. This study sought to investigate the effects of corporate governance as an internal control system on the financial performance of listed firms in Palestine Exchange, in 2015, in an attempt to provide more empirical analysis in the local area.

Therefore, the main research question is: Does corporate governance (board of director's characteristics and audit committees characteristics), as an internal control system, influence financial performance of listed companies in Palestine Exchange? In addition, this study addresses the following minor questions:

1- Is there any relationship between board independence and financial performance of listed companies in Palestine Exchange?
2- Is there any relationship between board size and financial performance of listed companies in Palestine Exchange?
3- Is there any relationship between audit committee independence and financial performance of listed companies in Palestine Exchange?
4- Is there any relationship between audit committee financial expertise and financial performance of listed companies in Palestine Exchange?
5- Is there any relationship between audit committee meetings and financial performance of listed companies in Palestine Exchange?
6- Is there any relationship between audit committee size and financial performance of listed companies in Palestine Exchange?

1.3 Research Objectives

Therefore, based on previous discussion, the main objective of this study will be as follows:

To examine the impact of corporate governance as an internal control system on financial performance in Palestine (some selected companies listed at the Palestine Exchange in Gaza Strip and West Bank). This main objective will be divided into two minor ones:

1- To examine the impact of boards of directors characteristics on financial performance;
2- To examine the impact of audit committees characteristics on financial performance.

1.4 Significance of Study

A few prior studies have been conducted in Palestine addressing corporate governance practices and its impact on performance (Abdelkarim & Ijbara, 2010; Abdelkarim &Alawneh, 2009). Based on the above-mentioned arguments, the current study provides an opportunity to investigate the role of boards of directors and audit committees establishment in a context in which political instability and agency conflicts are very high and ownership structure is different from that in other developed and emerging economies. To the best of the researcher knowledge, no research to date has specifically addressed the boards of directors and audit committees role in a Palestinian context. This study will benefit policy makers and the Palestinian Capital Market Authority by clarifying the status and the limitations of the current corporate governance code. In addition, the researcher is motivated to help expand the very limited existing research on an environment characterized by severe political and economic circumstances and a lack of control over major economic and fiscal policy instruments (Hassan & Hijazi, 2015).

Moreover, the current research is expected to advance understanding and add more explanations on the effect of board of directors and audit committee's characteristics on financial performance. This study will contribute to the knowledge

of how the importance of mechanisms of good corporate governance could help to create firms' value. Furthermore, this study also will improve the understanding of the process of firm value creation. Considering the fact that the enhancement of financial performance is the ultimate goal of any firm, investigations into some new factors contributing to value creation will improve the literature in the area of corporate governance and corporate finance (Azizah &Islam, 2014).

1.5 Limitations of Study

The empirical results are however subject to a few limitations. The main limitations of the study are listed below:

- The study focused only at quantitative side; however, there is a soft side to corporate governance. Interviewing directors, managers and shareholders in order to know about their perceptions of good governance mechanisms would make it more reliable.
- The study period was limited to only year 2015. The researcher selected year 2015 for analysis because of the consistency of the variables. For example, with respect to the members of the boards of directors, the same people were present in companies over the three years or the five years, as well as the majority of those people were present themselves in other companies.
- The study was based on some selected companies listed at the Palestine Exchange which may limit the generalization of results to other jurisdictions such as to developed countries or to the non-listed companies. The population from which the sample is drawn was the listed companies therefore; results of this study may not be generalized to smaller and non- listed companies.
- The study only integrated six important variables of corporate governance: board independence, board size, audit committee independence, audit committee financial expertise, audit committee meetings and audit committee size. However, there is a variety of other important governance variables that have important effects on financial performance and are not included in this framework. In addition, this study only investigated some of the board of directors' characteristics; however, other characteristics (such as age, education, gender and

so on) might also strongly influence the relationship between corporate governance and firm performance.

– The companies that were included in the sample were not selected on a random sampling. Rather, the companies were selected based upon the availability of audit committee and the degree of disclosed information related to the audit committee and the board in the annual reports of the companies. Sampled firms in this study tend to be smaller. The entire population comprises only 29 firms.

Despite the above limitations, the quality of the study was not compromised. The study has made an immense contribution to the existing body of knowledge, especially in the area of corporate governance which has not been fully exploited.

1.6 Research Organization

The remainder of the thesis is organized as follows. The next chapter, Chapter 2 discusses the literature review and empirical studies. Chapter 3 explains the theoretical framework, hypotheses and research methodology used in the study. Chapter 4 presents and discusses the empirical results. Chapter 5 concludes the overall results, presents implications of the study and identifies additional potential issues for future research.

Chapter 2
Literature Review and Empirical Studies

Chapter 2
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2.1 Introduction

Corporate governance has developed as an important mechanism over the last decades. The recent global financial crisis has reinforced the importance of good corporate governance practices and structures. It is now well recognized that corporate governance structures play an important role in enhancing firm performance and sustainability in long term (Kumar &Singh, 2013).

Good corporate governance is a vital to companies across many business sectors as it enhances company image, boosts shareholders' confidence and reduce the risk of fraudulent practices (OECD, 2008). It is built on a number of interrelated components; internal control system, a key component, helps in the detection of irregularities at an early stage. All components (board of directors, audit committees, management, internal audit, external audit and internal controls) must function effectively as a whole to bring about good corporate governance (Internal Control Framework, 2008).

Although, corporate governance differs from firm to another and country to another, its ultimate objective is the same: to achieve high performance, profitability and to prevent the management from pursuing their own objectives at the cost of the shareholders (Luo, 2007). It must be remembered that a weak corporate governance or lack of adherence to its principles can lead to corporate abuses, frauds and poor performance of the companies (Mans-Kemp, 2014 & Solomon, 2010).

2.2 Corporate Governance

Corporate Governance was long ignored as a matter of potential importance for the development policy issue at the beginning of nineteenth century. After the Wall Street Crash in 1929, legal and economic scholars, such as Adolf Berle, Eugene Fama and Kathleen Eisenhardt began their endeavours to study corporate governance concepts. But it wasn't until the wave of chief executive officer (CEO) dismissals in the United States and increased shareholder activism in the first half of the 1990s, followed by the East Asian financial crisis in 1997-1998, and those that erupted in Russia and Brazil, and its perceived relationship to poor local corporate governance practices in several emerging markets (Abdeen, 2015).

Corporate governance includes both the private and the public institutions. In broad terms, corporate governance refers to the way in which a corporation is directed, administered and controlled. Corporate governance includes the laws and customs affecting that direction, as well as the goals for which the corporation is governed (Sobel, 2007).

Corporate governance also involves the governance processes designed to help a corporation achieve its goals. Of prime importance, are those mechanisms and controls that are designed to reduce or eliminate the principal- agent problem. The principal participants in corporate governance are the shareholders, management and the board of directors. Other participants include regulators, employees, suppliers, partners, customers, constituents (for elected bodies) and the general community (Ramdani & Witteloostuijn, 2010).

Corporate governance is actually the process carried out by the board of directors and its related committees (specifically audit committees), on behalf of and for the benefit of the company's stakeholders, to provide direction, authority and oversights to management (Anderson & Baker, 2010).

Additionally, according to OECD principles, corporate governance governs the relationships between the people who manage corporations and all others who

invest resources in corporations. Corporate governance also concerns the relationships among the various internal and external stakeholders (OECD, 1999).

The basic purpose of corporate governance is to enhance the performance of corporations by forming and maintaining incentives that motivate corporate insiders to maximize firms' operational efficiency, return on assets and long-term productivity growth; limit insiders' abuse of power over corporate resources, whether such abuse takes the form of insiders' asset stripping or allocating corporate resources for their private use; and provide the measures to monitor managers' behaviour to ensure corporate accountability and provide for a reasonable cost-effective protection of investors' and society's interest (Buiter, Fries &Omen,2003).

In today's globalized economies, companies and countries with weak corporate governance systems are likely to suffer serious consequences above and beyond financial scandals and crises. The main result will be the inability to expand internationally and attract new capital. Such failure to attract adequate capital could jeopardize the very existence of individual firms thus affecting entire economies, where operating firms would lose their competitiveness (Coombes & Wong, 2004).

Thus, within the context of the entire recent financial crisis, it is becoming more challenging to attract sufficient levels of capital. Investors nowadays are demanding evidence that companies are run according to sound businesses practices that minimize the possibility of corruption and mismanagement. Corporate governance helps companies and economies attract investments and strengthen the foundation for long-term economic performance and competitiveness in several ways:

1. Corporate governance attacks the supply side of the corruption relationship by demanding transparency in corporate transactions, accounting and auditing procedures, purchasing, and all individual transactions;
2. Corporate governance procedures improve the management of the firm by helping firm managers and boards to develop a sound company strategy;
3. A strong system of corporate governance, through adopting standards of transparency in dealings with investors and creditors, helps to prevent systematic

banking crises even in countries where most firms are not actively traded on stock markets;

4. Countries with strong corporate governance protection for minority shareholders have much larger and more liquid capital markets.

Therefore, the major role of corporate governance is to help increasing the flow and lowering the cost of the financial capital that firms need to finance their investment in real assets, and to strengthen the long- term performance of companies. McKinsey and his company research on investors' perception regarding corporate governance indicates that governance is of at least equal importance to reported financial performance and that investors would be willing to pay a premium for companies that exhibit strong governance procedures (Centre for International Private Enterprise, 2002).

Moreover, President of World Bank, J. Wolfenzon argues that "Corporate governance is about promoting corporate fairness, transparency and accountability" (Quoted in Financial Times, June 21, 1999) and companies that have good corporate governance systems are associated with:

- **Having better access to external finance**. Good corporate governance systems encourage global investors to invest, which subsequently leads to greater efficiencies in the financial and banking sectors.
- **Lower costs of capital**. Investors that are provided with high levels of disclosure by well-governed companies are likely to provide capital to those well-governed companies at a lower rate, reflecting the investors' improved knowledge of the company's strategy and performance.
- **Improved company performance**. Sustainable wealth creation within the private and the public sector can only be brought about through good management, entrepreneurship, innovation, and better allocation of resources. Better corporate governance adds value by improving the performance of companies through more efficient management, better asset allocation and improvements in productivity.
- **Higher firm valuation and share performance.** Many researchers have identified the existence of a "corporate governance premium" (e.g., an additional

price those investors will pay for shares in well-governed companies). In addition, some researchers have identified superior share performance by well-governed companies.

- **Reduced risk of corporate crises and scandals**. Companies with good corporate governance practices will, by definition, have a better risk-management system, which is more likely to cope with corporate crises and scandals, than those without.
- **Public Acceptance.** In terms of business, a company with corporate governance is widely accepted by the public. This is mostly due to the idea of disclosure and transparency that comes with corporate governance. With full disclosure and the ability for people who work in the business to get information, as well as the general public, there is a higher level of trust. There's also the fact that due to the way that corporate governance is setup, there is a lower chance of fraud and company-wide criminal activity, which helps gain the trust of the public as well.
- **Public Image.** Today many corporations hold a high level of corporate governance. This is because a corporation has a public image to maintain. With corporate governance, the corporation takes more responsibility for its actions, and also allows it to keep tabs on what is going on as well as helps those in charge remain more aware of the public image of the corporation. With the way that businesses are run today, it can be difficult for a corporation to become successful just by having a high level of profit. Due to the fact that a corporation is also evaluated based on its image, corporate governance is established to help ensure that image remains clean. Making sure there is a high level of awareness, ethical behavior, and understanding of what the public wants is all encompassed in corporate governance (Sun, 2012).

As corporate governance focuses on the independence of board of directors from shareholders, therefore the importance is highly connected with the good performance of any organization (Bob, 2009). Moreover, boards of directors are considered to be the representatives of the shareholders; the main purpose of their existence in the company is to oversee the functions of the company and monitoring whether the operations are being performed in the best interests of the company and are according the identified rules and regulations fulfilling the general objectives.

Their importance is associated with the effective responsibilities that they deliver to the organization and also its related committees (especially audit committees) (Awais & Hussain, 2015).

The next sections will provide thorough discussions on the issues of corporate governance as an internal control system (board of director's characteristics and audit committees characteristics) and its effect on financial performance.

2.3 Corporate Governance in Palestine

The governance structure for financial regulation and supervision in Palestine falls under the jurisdiction of two authorities: the Palestine Monetary Authority and the Palestine Capital Market Authority. Palestine Monetary Authority was established in 1995 as an independent public institution to assist in maintaining the stability and effectiveness of the Palestinian financial system through prudential regulation and supervision in line with international best practices. The Palestine Capital Market Authority was established in 2005 as the regulator for the non-banking financial sectors. The Palestine Capital Market Authority oversees and regulates the securities market, insurance companies and real-estate institutions, while the Palestine Monetary Authority is responsible for banks, money exchangers and microfinance institutions. In 2009, each authority issued its own code of good corporate governance. While the Palestine Capital Market Authority's "Code of Corporate Governance in Palestine" applies to all firms with securities listed on the Palestine Exchange, the Palestine Monetary Authority's "Corporate Governance Code for Banks" applies to the banking sector. The two codes are largely based on international standards. Both codes contain mandatory requirements that firms must adhere to along with additional guidelines representing good practices that are encouraged but not required. The Palestine Capital Market Authority code only encourages listed companies to form audit committees to ensure transparency of the company accounts and to inform stakeholders of the degree of risk facing the company. However, the Palestine Monetary Authority has adopted stricter standards for audit committees. The Palestine Monetary Authority code requires all banks to establish audit committees comprising at least three independent board members with appropriate banking and financial expertise (Hassan and Hijazi, 2015).

The Palestine Capital Market Authority's code addresses five fundamental aspects of the audit committee: general committee meetings, shareholders' compatible rights, corporate management, auditing, disclosure and transparency. The relevant elements in the Palestine Capital Market Authority code include the following:

1. The code requires the board of directors in public shareholding firms to have between five and eleven members;
2. The code recommends having two board directors as independent members;
3. The code recommends that the board director not be involved in the firm's executive functions to maintain the distribution of authority and responsibility as well as to ensure better accountability;
4. The code requires shareholders to select the external auditors during their annual meeting based on the recommendation from the board of directors and the audit committee and to approve their fees. The external auditors should be licensed, independent of their clients and possessed of adequate professional competence for the tasks required.

The reason for the existence of such barriers was due to Palestine's enforceable codes of corporate governance. There was a need for a greater level of regulation to be placed in Palestinian private firms with particular interests, namely, those listed on the country's stock exchange. There was a need for a stricter Capital Market Authority in order to enforce compliance on those firms which were seen to be evading it. In Palestine, the administrative and financial oversight bureau still lacks the authority to monitor private sector companies. This is an activity which needs to be taken into account when, for a better performing business sector, it comes to compliance with corporate governance (Kutum, 2015).

Empirically, there have been little researches undertaken about corporate governance in Palestine. Researchers, such as Abdelkarim & Ijbara (2010), studied the correlation between corporate governance and performance in Palestine, showed that concentration of ownership existed in the country and that, in turn, hindered the development of corporate governance. According to Abdelkarim & Alawneh (2009) whose results were carried out about corporate governance in Palestine, revealed that

there was a negative correlation between concentration of ownership and the company's value.

2.4 Agency Theory

Much of the research into corporate governance derives from agency theory. Agency theory has its roots in economic theory expanded by Alchian and Demsetz (1972), and further developed by Jensen and Meckling (1976). The agency relationship is seen as a contractual link between the shareholders (the principals) that provide capital to the company and the management (agent) who runs the company. The principals engage the agent to perform some services on their behalf and would normally delegate some decision-making authority. However, as the number of shareholders and the complexity of operations grew, management, who had the expertise and essential knowledge to operate the company, increasingly gained effective control and put them in a position where they were prone to pursue their own interests (Nasieku, Olubunmi & Togun, 2014).

The literature on agency theory addresses three types of problems that could transpire from the separation of ownership and management, which might consequently affect firm value. They are the effort problem, the assets' use problem and differential risk problem. The effort problem concerns whether or not managers apply proper effort in managing corporations so as to maximize shareholders' wealth. Problems arise because principals are not able to determine if the managers are performing their work appropriately. Managers may not exert the same high effort levels required for firm value maximization as they would if they owned the firm (Alhaji &Yusoff, 2012).

The problem of assets' use concerned the insiders who control corporate assets. They might abuse these assets for purposes that are harmful to the interests of shareholders such as diverting corporate assets, claiming excessive salaries and manipulating transfer prices of assets with other entities they control. The differential risk problem arises because the principal and managers have different views on risk taking. Managers may not act in the best interest of shareholders and may have different interests and risks preferences. For example, managers have a wider range

of economic and psychological needs (such as to maximize compensation, security, status and to boost their own reputation) which may be adversely affected by a project that increases a firm's total risk or has rewards in the longer-term. This may result in managers being too cautious in making investments and thus failing to maximize shareholders' wealth (Nympha, Patrick & Paulinus, 2015).

Hence, agency theorists recommended that corporate governance mechanisms are needed to reduce these agency conflicts and to align the interests of the agent with those of the principal. These mechanisms include incentive schemes for managers which reward them financially for maximizing shareholder interests. Such schemes typically include strategies whereby senior executives acquire shares, conceivably at a bargain price, thus aligning financial interests of executives with those of shareholders. Other mechanisms include fixing executive compensation and levels of benefits to shareholders returns and having part of executive compensation deferred to the future to reward long-run value maximization of the corporation. Besides that, appointing more independent directors on the boards to check on managers' behaviour could also reduce agency costs (Fulop, 2012).

From the agency theory perspective, corporate governance is seen as a mechanism where a board of directors is a crucial monitoring device to minimize the problems referred the principal-agent relationship and to ensure the maximization of shareholder's value (Mallin, 2004). The agency role of the directors refers to the governance function of the board of directors in serving the shareholders by ratifying the decisions made by the managers and monitoring the implementation of those decisions. This role has been examined in a large body of literature (Daily & Dalton, 1994; Fama &Jensen, 1983). Much of the researches had examined board composition due to the importance of the monitoring and governance function of the board (Kiel & Nicholson, 2003; Bhagat & Black, 1998; Daily & Dalton, 1994; Pearce & Zahra, 1992).

Advocates of the agency theory believe that boards comprising of a majority of independent directors reduces agency conflicts as they provide an effective monitoring tool for the board (Fama & Jensen, 1983). They argue that the inclusion

of independent directors increases the boards' ability to be more efficient in monitoring top management and ensures there is no collusion with top managers to expropriate stockholder wealth as they have an incentive to develop their reputation as experts in decision control. Agency theory suggests that the presence of independent directors is required as the guardians of stockholders' wealth (Peasnell, Pope& Young, 2003).

Early work by Fama & Jensen (1983) argued that independent directors offer a means to supervise management operations and activities through an improved focus on company's financial performance. Pearce &Zahra (1992) support this view and proved that there is a positive link between the amount of independent directors and company financial performance. Similarly, Lee, Rangan & Rosenstein (1998) support this view, providing evidence indicating that boards majorly subjected by independent directors are associated with improved returns than those subjugated by internal (executive) directors. Baysinger & Butler (1985) also describes that adjustments in board structure over a ten year period from 1970-80's suggests that there is a causal link with accounting performance. Furthermore, MacAvoy & Millstein (2007) found that there is a significant positive relationship amongst active, independent boards and higher company performance.

The agency theory perspective according to the formation of audit committee is considered to be a reaction to information asymmetry between a company's owners and its management (Koehler, 2005). Agency theory is the prevailing theoretical framework used to investigate the determinants of audit committee establishment; it has been extensively used in the literature (Menon & Williams, 1994). The separation of ownership and control in modern business creates conflicts of interest between managers and stakeholders. Following this conflict was between the principal and the agent, companies are obliged to use control mechanisms to reduce agency costs and information asymmetry like the audit committees (Kalbers, 1998). Similarly Pincus (1989) argues that audit committees are used primarily in situations where agency costs are high to improve the quality of information flows from the agent to the principal. According to the agency theory, to ensure the

effectiveness of an audit committee, managers are encouraged to prepare financial statements adequately to specify the return generated by the companies.

Felo, Krishnamurthy &Solieri (2003) and Beasley (1996), based on the agency theory, provide for the existence of a positive and significant relationship between the presence of an audit committee and the quality of financial statements. Similarly Mullen (1996), based on the agency theory, found a positive relationship between the existence of an audit committee and the reliability of financial statements. The agency theory states that the presence of an audit committee within the board of directors is sufficient to ensure the reliability of financial statements. However, Treadway (1987) concluded that the mere presence of an audit committee does not necessarily mean that this committee is effective in performing its oversight role.

Agency theory argues that the audit committee comprising of a majority of independent directors provide an effective monitoring role that improves the quality of information and enhances the disclosures quality (Akhtaruddin &Haron, 2010). It further argues that the inclusion of independent directors increases the audit committees' ability to monitor and control the opportunistic behaviour of corporate management (Hussin, 2009). Independent directors on audit committee are appointed to reduce managerial consumption of perquisites, act as a positive influence over directors' deliberations and decisions (Fama & Jensen, 1983), and to exercise independent judgment in situations where there are conflicts of interests between internal managers and shareholders such as reviewing financial reporting statements (Beasley, Carcello & Hermanson , 2009).

2.5 Resource Dependence Theory

Another theory that supports the research into corporate governance is the resource dependence theory. It was developed by Pfeffer (1973) and Pfeffer & Salancik (1978), emphasizes the important role played by board of directors in providing access to resources that would enhance the firm's performance. Independent boards enhance organizational functions through accessibility to resources (Certo, Daily, Dalton &Roengpitya, 2003); through linkages with the

external environment to appropriate resources and create buffer against adverse external changes (Canella, Hillman & Paetzold, 2000).

The basic suggestion of resource dependence theory is the need for environmental linkages between the firm and outside resources that are needed to survive. This means that boards of directors are an important mechanism for absorbing critical elements of environmental uncertainty into the firm. Environmental linkages could reduce transaction costs associated with environmental interdependency. The organization's need to require resources leads to the development of exchange relationships between organizations. Further, the uneven distribution of needed resources results in inter-dependent organizational relationships. Several factors would appear to intensify the character of this dependence, e.g. the importance of the resource(s), the relative shortage of the resource(s) and the extent to which the resource(s) is concentrated in the environment (Ahmed, Saleem, Sehrish, Shehzad & Yasir, 2012).

Independent directors play a positive role in monitoring and control functions of the board, because a firm's value increases with the number of independent directors (Abdullah & Valentine, 2009; Coles, Daniel &Naveen, 2006). Resource dependence theory is highly relevant to firms' as diverse background of directors enhance the quality of their advice (Pearce & Zahra, 1989). For example, larger board size may increase the number of external linkages and thus increase the potential for securing needed resources. Moreover, greater diversity within a board may provide for wider ranges of expertise which in turn could result in better decision making. Board diversity may exist in age, tenure, gender, functional backgrounds, professional experiences and education (Coffey & Wang, 1998).

Through the resource dependence role, independent directors may also bring resources such as specialized skills and expertise. This concept has important implications for the role of the board and its structure, which in turn affects performance. In this context, many of the resources are directly and indirectly controlled by the government. Hence, appointing independent directors that have influence and access to key policymakers and government is seen as an important

strategy for survival because of their knowledge and prestige in their professions and communities and then firms are able to extract useful resources. This could enhance the firm's legitimacy in society and to help it achieve its goals and improve performance. In summary, resource dependence theory provides a convincing justification for the creation of linkages between the firm and its external environment through independent boards as firms that create linkages could improve their survival and performance (Alhaji & Yusoff, 2012).

Whilst, under the resource dependence theory, the audit committee becomes more resourceful and the audit quality will be improved because of the different skills, knowledge and expertise exchanged among the members (Dalziel & Hillman, 2003). Therefore, appointing more audit committee members with expertise is considered an important strategy for good financial reporting and audit quality whereby firms are able to extract useful resources. Therefore, it is expected that a more resourceful audit committee is likely to engage in a greater level of internal control system to ensure the good corporate governance of the firm. It is expected that firms that have an audit committee will provide highly reliable financial reporting and audit quality, and accordingly better protect the benefits and interests of the shareholders and improving firms' value of companies (Nelson & Yasin, 2012).

2.6 Internal Control System

Drawing from Statements of Standard Auditing Practices No. 6 (SAS. 6) that defines internal control as "the plan of organization and all the methods and procedures adopted by the management of an entity to assist in achieving management objectives of ensuring as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, prevention and detection of fraud and error, the accuracy and completeness of accounting records and the timely preparation of reliable financial information" (Kiel & Nicholson,2007).

Internal control is also a system consisting of specific policies and procedures designed to provide management with reasonable assurance that the goals and

objectives it believes important to the entity will be met. It is also referred to the standards and rules used by companies to ensure that they achieve their stated goals in the marketplace. Moreover, internal control is a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting and compliance with laws, regulations and policies. A broad concept of internal control involves everything that controls risks to an organization. It is a mean by which an organization's resources are directed, monitored and measured. It plays an important role in detecting and preventing fraud and protecting the organization's resources (Kargin & Ozten, 2012).

As the researcher can see, there are many definitions of internal control, as it affects the various constituencies (stakeholders) of an organization in various ways and at different levels of aggregation, but the most widely used definition is under COSO. In 1992, COSO developed a model for evaluating internal controls, which had been adopted as the generally accepted framework for internal control and is widely recognized as the definitive standard against which organizations measure the effectiveness of their systems of internal control (COSO, 2012). This model defines internal control as "a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance of the achievement of objectives in the following categories: Effectiveness and efficiency of operations, Reliability of financial reporting and Compliance with applicable laws and regulations.

In an "effective" internal control system, the following five components work to support the achievement of an entity's mission, strategies and related business objectives: control environment, the entities risk assessment process, the information system, control activities and the monitoring of controls.

However, for the purposes of this study, the researcher narrowed down to only one component of the internal control system, which is the control environment; the other components of the internal control systems were held constant. The control environment is considered to be the most important aspect of internal control, or "tone at the top". It is the foundation for all other components of internal control. The

attitudes and behaviour of senior executive management and the board of directors are essential to a healthy system of internal control. According to the control environment elements, it consists of integrity and ethical values, commitment to competence, board of directors and audit committees participation, management's philosophy and operating style, organizational structure, assignment of authority and responsibility and human resource policies and procedures (COSO, 2009). However, the research will focus, as part of the corporate governance, on the board of directors and audit committee's participation.

According to the board of director's role in internal control system, it provides governance, guidance and oversight. Effective board members are objective, capable and inquisitive. They also have knowledge of the entity's activities and environment, and commit the time necessary to fulfil their board responsibilities. Management may be in a position to override controls and ignore or stifle communications from subordinates, enabling a dishonest management which intentionally misrepresents results to cover its tracks. A strong, active board, particularly when coupled with effective upward communications channels and capable financial, legal and internal audit functions, is often best able to identify and correct such a problem (Naveen & Singh, 2012).

While the audit committee role, in general terms, are to: (a) Discuss with management, internal and external auditors and major stakeholders the quality and adequacy of the organization's internal controls system and risk management process, and their effectiveness and outcomes, and meet regularly and privately with the director of internal audit; (b) Receive regular reports from the chief executive officer, chief financial officer and the company's other control committees regarding deficiencies in the design or operation of internal controls and any fraud that involves management or other employees with a significant role in internal controls; and (c) Support management in resolving conflicts of interest, monitor the adequacy of the organization's internal controls and ensure that all fraud cases are acted upon (Duchin et al.,2010).

2.7 Financial Performance

The word ‘Performance is derived from the word ‘parfourmen’, which means ‘to do’, ‘to carry out’ or ‘to render’. It refers the act of performing, execution, accomplishment, fulfilment, etc. In border sense, performance refers to the accomplishment of a given task measured against present standards of accuracy, completeness, cost and speed. In other words, it refers to the degree to which an achievement is being or has been accomplished. In the words of Frich Kohlar “The performance is a general term applied to a part or to all the conducts of activities of an organization over a period of time often with reference to past or projected cost efficiency, management responsibility or accountability or the like. Thus, not just the presentation, but the quality of results achieved refers to the performance. Performance is used to indicate firm’s success, conditions, and compliance (Metcalf & Titard, 2010).

Financial performance can be defined as the level of performance of a business over a specified period of time, expressed in terms of overall profits and losses during that time. Evaluating the financial performance of a business allows decision makers to judge the results of business strategies and activities in objective monetary terms. It is also measuring the results of a firm's policies and operations in monetary terms; these results are reflected in the firm's return on investment, return on assets, value added and other related measures. Financial performance is used to measure firm's overall financial health over a given period of time and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation, thus help managers in decision making i.e. provide an overall picture of how a firm is performing over time as well as relative to others (Barber &Lyon, 2010).

According to the importance of financial performance, interest of various related groups is affected by the financial performance of a firm. Therefore, these groups analyse the financial performance of the firm. The type of analysis varies according to the specific interest of the party involved. For creditors: interested in the liquidity of the firm (appraisal of firm’s liquidity), but for bond holders: interested in the cash flow ability of the firm (appraisal of firm’s capital structure, the major

sources and uses of funds, profitability over time, and projection of future profitability).; while, investors: interested in present and expected future earnings as well as stability of these earnings (appraisal of firm's profitability and financial condition) and finally, management: interested in internal control, better financial condition and better performance (appraisal of firm's present financial condition, evaluation of opportunities in relation to this current position, return on investment provided by various assets of the company) (Marashdeh,2014).

This study will use two financial measures of firm performance, the return on asset and the return on equity which also fits into accounting-based measures. Return on assets (ROA) measures how effectively the firm's assets are used to generate profits net of expenses. An ROA of 7 per cent would mean that for each dollar in assets, the firm generated seven cents in profits. This is an extremely useful measure of comparison among firms' competitive performance, for it is the job of managers to utilize the assets of the firm to produce profits. Return on equity (ROE) measures the net return per dollar invested in the firm by the owners, the common shareholders. An ROE of 11 per cent means the firm is generating 11cents return per dollar of net worth (Wang, 2010).

2.8 Internal Corporate Governance Controls

Internal corporate governance controls (corporate governance as an internal control system) monitor activities and then take corrective action to accomplish organizational goals. Examples include:

Monitoring by the board of directors: Board of directors is considered a corporate governance monitoring instrument, in both the private and the public companies. The board of directors is believed to be of significance in improving the enterprise performance as it provides expert advice, acts as a safeguard, brings skills, knowledge and experience. The board of directors should set the direction of the company and monitor management so that the company will achieve its objectives. The corporate governance framework should underpin the board's accountability to the company and its members. The main purpose of a board of directors is to provide

effective leadership, direction, support and guidance to the organization and to ensure that the policies and priorities are implemented (Muller, 2014).

Monitoring by the audit committees: Audit committees are identified as effective means for corporate governance that reduce the potential for fraudulent financial reporting. Audit committees oversee the organization's management, internal and external auditors to protect and preserve the shareholders' equity and interests. To ensure effective corporate governance, the audit committee report should be included annually in the organization's proxy statement, stating whether the audit committee has reviewed and discussed the financial statements with the management and the internal auditors (AL-Baidhan, Basuany & Mohamed, 2014). As a corporate governance monitor, the audit committee should provide the public with correct, accurate, complete, and reliable information, and it should not leave a gap for predictions or uninformed expectations. Most, if not all, of the audit committee activities and responsibilities are related directly or indirectly to the audit committee roles in corporate governance. The audit committee's composition, competence, independence, and expertise are strongly correlated with the organization's corporate governance (Internal Control Framework, 2012).

Taking into account that the board of directors and management are responsible for establishing and maintaining an appropriate system of internal control, which will be affected by the way the undertaking is managed, and therefore by corporate governance. There is a link between internal control and the way an entity is managed, whether in a positive or a negative way, thus internal control system should be seen as a core part of corporate governance (Lawal, 2012). Internal control system is considered a key element of corporate governance (Collier, 2007). Corporate governance is the umbrella concept that drives internal control system and reporting frameworks, which in turn depends on an efficient system of internal control (Kyereboah, 2009).

Internal control is considered important for corporate governance, to ensure the proper running of a corporation and to improve efficiency (Lawrence, Minutti-Meza & Vyas, 2010).The Sarbanes-Oxley Act (SOX, 2002) suggests that internal

control is a part of corporate governance (Choong 2009). Freeman and Herath suggest in corporate governance analysis that one of the causes of corporate collapse is a lack of internal controls (Freeman & Herath, 2012). The concept of the relationship between internal control and corporate governance can be defined as the process and structure used to direct and manage business affairs of the company towards enhancing prosperity and corporate accounting with the ultimate objective of realizing shareholders' long-term value while taking into account the interest of other stakeholders (COSO, 2012).

2.9 Boards of Directors Characteristics

A board of directors is a group of persons elected by the shareholders of a corporation to govern and manage the affairs of the company. It is the governing body of a corporation that establishes and carries out corporate policy, select the corporation's officers, make certain major decisions concerning the corporation's business and finances, and oversee the corporation's operations. It's important for public, private and non-profit companies to have a board of directors (Internal Control Framework, 2009).

The board of directors' role as a monitoring tool is viewed as the most crucial element for effective corporate governance mechanisms to enhance the quality and integrity of accounting information (Malaysian Code on Corporate Governance, 2000; Cadbury Committee Report, 1992). Fama & Jensen (1983) theorized that the board of directors is the most important internal control mechanism that is responsible to monitor the actions of top management. The separation of ownership and control in today's modern corporations makes the board of directors an important mechanism to protect the shareholders' interests. Although the shareholders are the owners of the firms, the extensive power of control is vested in the hands of the board of directors to manage the firms (Abd Manaf, Ahmad & Ishak, 2003).

Corporate Governance is actually conducted by the board of directors and the concerned committees, especially the audit committees, for the company's stakeholder's benefit. Typical role of boards of directors in corporate governance

include governing the organization by establishing broad policies and strategic objectives with the availability of sufficient resources to meet those objectives; selecting, appointing, supporting and reviewing the performance of the chief executive; ensuring the availability of adequate financial resources; approving annual budgets; accounting to the stakeholders for the organization's performance; setting the salaries and compensation of company management; understanding and meeting its obligations to the company's stakeholders; leading the company within a framework of prudent and effective controls which enable risk to be assessed and managed (Ramdani & Witteloostuijn,2010).

However, creating a board that is effective in monitoring management actions is dependent on the composition of individuals who serve on the board of directors (Fama & Jensen, 1983). Lately, many countries have reformed their code on corporate governance of boards monitoring responsibilities and have focused mainly on independence, expertise and diligence of corporate directors for the purpose of protecting shareholders' interests. Two characteristics i.e. board independence and board size, are among important attributes of the board (Albert, 2013).

2.9.1 Board Independence

Board independence is described as the number of independent directors having a seat on the board relative to the total number of directors. An independent director refers to a director having no affiliation with the firm other than directorship (Al-Matari et.al, 2014). First and most important, is the independence of directors. The 'Principles of Good Corporate Governance and Best Practice Recommendations' recommends that a majority of directors must be independent (Cadbury Committee Report, 1992). The purpose of introducing an independent director is to present objective and independent judgment on management's performance, whilst not being influenced by the company's management or major shareholders (Centre for Financial Market Integrity Institute, 2005).

Securities and Exchange Commission (SEC, 2006) spelt out conditions form appointment of an independent director as follows:

- Should be free from any relation with the company that may affect his ability to make independent judgments;
- Not a partner or an executive of the company's statutory audit firm, equal or consulting firms that associate with the company for three years preceding his appointment;
- Should have no business dealings that could impair his capacity to act in an independent manner;
- Should not be a vendor, supplier or customer of the company;
- One who is not being a member of the immediate family of an individual who is or has been in the employment of the company for the past three years;
- Has not served the company in any capacity or been employed by the company for the preceding three financial years;
- Not a representatives of a shareholders that has ability to control management and;
- Should not be one whose shareholding both direct and indirect does not exceed 1% of the company's paid up capital (Akpan & Amran, 2014).

In essence, directors must be independent from management, as well as from the controlling shareholder. They are not truly and fairly independent if they have any close relationships with either party, both agent and principal. As a result, independent judgment and fair view is not likely to be conveyed, and the interests of minority shareholders are unlikely to be rightly protected. The actions of an independent director will adhere closely to Generally Accepted Accounting Principles (GAAP) provided that he or she is acting impartially. Therefore, independence is the requirement to ensure an unbiased and impartial position which in turn creates effective corporate governance practice (Lodh &Rashid, 2011).

The role of any director is to scrutinize the actions and performance of senior decision makers within the firm to ensure that management decisions are consistent with enhancing shareholder value. Some of the main arguments for having independent directors are the following: a) Selected to provide specialist skills; b) Add diversity to the board, thereby modifying the culture of a unitary Board; c) Provide independent appraisal and vision; d) Corporate experience and leadership

qualities; e) Explicitly to support the CEO; and f) Status and credibility of the governance model – to represent the public face of the business (Ronald, 2012).

2.9.2 Board Size and Financial Performance

The board size represents the total head counts of directors seating on the corporate board. Size of the board is recognized as one of the unique features of board dynamics with considerable but strategic impact on the board independence as well as the overall quality of corporate governance (Jensen 1993). The size of board is vital in achieving the board effectiveness and improved firm performance especially from resource dependence perspective which place more emphasis on the board ability to co-opt limited and scarce resources from various external links (Kiel & Nicholson, 2003).

Board size affects the quality of deliberation among members and ability of board to arrive at optimal corporate decisions. However, determining an ideal size of the board has being an ongoing and controversial debate in corporate governance literature. Connelly & Limpaphayom (2004) argued that optimal board size is a function of many variables such as firm age, size, industrial classification as well as the degree of monitoring and value addition required amongst others.

Lipton & Lorsch (1992) and Jensen (1993) argued that firms should not appoint too many directors to the board and suggested a maximum of seven or eight directors. According to Lipton &Lorsch (1992), directors on a large board are less likely to criticize the policies of top managers, hence are subject to CEO control. Further, large board tends to involve less meaningful discussion since too many directors are involved in the discussion, making it both time consuming and difficult to achieve cohesiveness. In addition, a large board is less effective due to slowness in decision making, is more risk averse and creates a free rider problem i.e. one member is depending on other members to monitor management. Supporting Lipton & Lorsch (1992) and Jensen (1993), Judge & Zeithamal (1992) found that a large board was less involved in strategic decision making and Forbes & Milliken (1999) reported that a large board led to a problem of coordination.

In opposing arguments, Dalton & Dalton (2005) suggested that a large board offers a broader pool of knowledge and expertise. Also, Dalton & Dalton (2005) argued that fewer members on the board occupied themselves with decision making, and hence become less effective in monitoring the management. Coles, Daniel & Naveen (2008) reported that a large board was beneficial to complex firms because they have greater advisory needs, a larger degree of diversification and higher financial leverage. In summary, a large board provides a better exchange of skill and knowledge but there is more risk that many members will be unable to coordinate well, and will create free rider problems. Nevertheless, evidence on board size is indeed mixed.

2.10 Audit Committees Characteristics

The audit committee is a committee of the board of directors responsible for oversight of the financial reporting process, selection of the independent auditor, and receipt of audit results both internal and external. The committee assists the board of directors fulfil its corporate governance and overseeing responsibilities in relation to an entity's financial reporting, internal control system, risk management system and internal and external audit functions. Its role is to provide advice and recommendations to the board within the scope of its charter (Lodh & Rashid, 2011).

Moreover, it is responsible for reviewing the company's business activities to identify inefficiencies, reduce costs and achieve organizational objectives. Audit committee may investigate potential theft or fraud and ensure compliance with applicable regulations and policies, and assists in risk management. An audit committee is composed of subgroups from the corporation's board of directors. Members of the audit committee must be independent, which means they have no ties to the company's management team (Todorovic, 2013).

By effectively carrying out its functions and responsibilities, the audit committee helps to ensure that management properly develops and adheres to a sound system of internal control, that procedures are in place to objectively assess management's practices and internal control, and that the external auditors, through their own review, objectively assess the company's financial reporting practices that

leads to improving the financial performance of companies and boost investors' confidence. In addition, the effectiveness of the audit committee could be an indicator of the seriousness attached to issues of transparency and sends the right signal to the public who then develops confidence in the organization (Phan & VO, 2013).

However, creating an audit committee that is effective in its monitoring and oversight role is dependent on the composition of individuals who serve on the committee. Four characteristics i.e. audit committee independence, audit committee financial expertise, audit committee meetings and audit committee size, are among important attributes of the committee (Duchin et al., 2010).

2.10.1 Audit Committees in Palestine

The General aim of the committee is enhancing transparency of all financial processes and informing the board of directors of any possible risks that the company may encounter. Stimulating appropriate policies commensurate with the nature of the work and economic developments in the region to achieve clarity and integrity in decision-making based on scientific examination. According to the formation of the committee, the board shall issue a decision forming the committee in accordance with the following conditions:

1. Membership is for two years, renewable according to a recommendation of the board. The committee is composed of three to five independent members from the board of directors, those who do not perform any task that is paid monthly or annually by the company. No member, nor any of their first degree relatives, should occupy any key position (such as executive chairman, general manager, or any similar job that follows according to the organizational structure) during the previous two years. And, they should not have any kind of relation that would result in financial deals with the company, the mother company, or any related or affiliate company;

2. At least one of the members should have financial and auditing experience.

For committee meetings and minutes

1. The committee shall hold its meetings as it deems appropriate, provided that the majority of the members are present;
2. The meeting agenda shall be specified in advance. All issues shall be discussed according to the committee. Minutes of the meeting shall be prepared and they shall include all results and recommendations;
3. A signed copy of the minutes by all members shall be sent to all committee members;
4. The committee has the right to get any data from the executive management. It also has the right to invite any executive employee or board member to attend its meetings.

For duties and responsibilities of the committee

1. Reviewing all financial data before submitting it to the board of directors and meeting with the external auditors;
2. Reviewing and approving the annual internal audit plan, reviewing the internal audit reports and following up on actions taken;
3. Recommending to the board of directors about any accounting policies and revising any accounting issues that have significant impact on the financial data;
4. Monitoring internal control regulations and verifying their adequacy based on the internal and external audit reports;
5. Presenting recommendations to the board concerning recruiting, terminating and rewarding the internal auditor. In addition, evaluating the objectivity of the external auditor taking into consideration any tasks he had conducted outside of the audit;
6. Verifying the safety of internal controls and procedures.

The independence of the committee member

Given the importance of the role that the audit committee performs in supervision, following up, directing and giving recommendations, it is important that its members have enough independence to make sure that its work is clear and

authentic and does not conflict with the public interest of the company. It is therefore necessary to clarify some factors that may affect committee members' independence. These factors are as follows:

1. Being an employee of the company in or one of its subsidiary companies during the current year;
2. Accepting a compensation exceeding 20 thousand American dollars from the company or from its subsidiary during the previous year except for the compensation he is paid as a board member;
3. If one of his family direct members occupies the position of a director, or an executive employee in the company or in a subsidiary;
4. If he or one of his direct family members was a partner or a controlling shareholder, or an executive employee of a "for profit business foundation", and that this received or paid amounts that exceed 5% of the gross income for that year (Audit Committee – Palestine Securities Exchange Co. plc., 2009).

2.10.2 Audit Committee Independence

SOX Section 301clarifies the definition of audit committee independence. It prohibits audit committee members from accepting any consulting or advisory fee from the issuer or any subsidiary, as well as from being otherwise affiliated with the issuer or subsidiary. Prohibited compensation can include indirect compensation to spouses, minority children or adult children who live with the committee member. Independence should be reviewed at least annually, but preferably more frequently, to identify changing relationships or circumstances that may affect independence as soon as possible. To ensure the audit committee independence, it is a leading practice for the majority of its members to be independent from the organization. An independent audit committee member is a person who is employed by, or providing any services to, the organization beyond his or her duties as a committee member (Ernst & Young LLP., 2014).

Existence of the independent members of the audit committee is the true and fair picture of the firm's commitment for better corporate governance practices. An

essential feature of an effective audit committee is its independence from management. By providing an independent source of advice to the board, audit committees play a key role in an organization's governance structure (The Institute of Internal Auditors, 2014).

2.10.3 Audit Committee Financial Expertise

SEC rules define an "audit committee financial expert" as an individual who possesses the following attributes, which may have been obtained through education and experience, supervisory experience, analyst experience or through other experience; An understanding of GAAP and financial statements; the ability to assess the applicability of GAAP in connection with the issuer's financial statements; Experience in preparing, auditing, analysing or evaluating, or actively supervising, financial statements comparable to the issuer's; Understanding of internal controls and procedures for financial reporting; and Understanding audit committee functions (International Bar Association, 2003).

The effectiveness of an audit committee is further enhanced if its members possess accounting and financial expertise. Audit committee member's financial expertise allows better understanding of auditing issues, hazards and the audit procedures proposed to address and observe these issues and risks (DeZoort & Salterio, 2001). Bull & Sharp (1989) stressed the importance of financial knowledge of the audit committee. Knowledgeable audit committee members are in a better place to understand auditor judgments and discern the substance of disagreements between management and external auditors. Furthermore, it will improve audit committee role in identifying and demanding questions that 'make management think harder and auditors dig deeper (Levitt, 2000). Additionally, Knapp (1987) argued that if the audit committee does not have the knowledge necessary to understand technical auditing and financial reporting matters, its oversight role is likely to be ignored by the auditor and management. This would undermine the purpose of the audit committee in the financial reporting process. Hence, an audit committee that has knowledge and accomplishments in fiscal coverage is more likely to raise the audit committee roles.

2.10.4 Audit Committee Meetings

The number of audit committee meetings is considered to be an important attribute for their monitoring effectiveness. The number of audit committee meetings is considered as a proxy for audit committee activity. Thus, for the audit committee effectiveness, its members must be willing to invest a substantial amount of time and energy in the functioning of the audit committee (Xie, Davidson & DaDalt, 2003).

Audit committee meeting frequency plays an essential role in audit committee effectiveness with respect to audit and control quality. This finding suggests that audit committee works to increase audit quality and to use better the system of monitoring process. Hence, the meeting frequency reduces any perceived audit and controls risk (Klapper &Love, 2010). Findings also suggest that frequent meetings of audit committee provide a better monitoring of financial environment and reduce financial reporting problems. By meeting regularly, audit committee enhances its effectiveness and ensures the integrity of financial reporting process (McMullen & Raghunandan, 1996). Moreover, Inactive audit committees with fewer numbers of meetings are unlikely to supervise management effectively, while an active audit committee with more meetings, has more time to oversee the financial reporting process, identify management risk and monitor internal controls. As a result, firm performance increases with audit committee activities (Menon & Williams, 1994).

2.10.5 Audit Committee Size

Audit committee size represents the total head counts of members seating on the corporate audit committee. Size of the committee is recognized as one of the unique features of audit committee dynamics with considerable impact on the overall effectiveness of audit committee. The size of committee is vital to achieve the committee effectiveness and improved firm performance especially from resource dependence perspective which place more emphasis on the committee ability to co-opt limited and scarce resources from various external links (Kiel & Nicholson, 2003).

(Al- Najjar, 2013), indicated that large audit committees provide more monitoring resources for top management and quality of the financial reports. It may enhance the internal governance practice and improve the resources of internal

monitoring. They are more efficient in monitoring the financial reporting process. Additionally, a research has been done by Anderson, Deli & Gillan, 2013found that large audit committee improves financial reporting quality, as its effectiveness increases with the existence of experienced and knowledgeable members. This supports that the right-sized committees can use their experience to help the committee in monitoring .On the other hand, it found that the large audit committee loses concentration and becomes less participative than the smaller one. The audit committee with small number of members tends to be more participative comparing to those of a larger size (Ghosh, Marra & Moon, 2010).

2.11 Empirical Studies

2.11.1 Financial Performance

Empirically, there are several studies that examined the relationship between corporate governance and financial performance. It was evident that there were different findings that suggest there may be positive, negative or no relationship between corporate governance and financial performance. Aduda, Okiro & Omoro, 2015, findings of the study revealed that there was a significant positive relationship between corporate governance and firm performance. Ahmed & Yameen (2015) examined the impact of corporate governance practices on the shareholders wealth and financial performance of the organizations. They found that the corporate governance practices have a positive impact on shareholder's wealth as well as the financial performance of the organizations. Akbar (2015), the result of this study suggested that corporate governance positively and significantly contributes towards firm performance. Similarly, the study by Olweny & Wanyama (2013) analyses the effects of corporate governance on the financial performance of listed insurance companies in Kenya; the study found that a strong positive relationship exists between the corporate governance practices and the firms' financial performance. Evidence, from Jordan, by Haddad, Sufy &Zurqan (2011) showed that there is a direct positive relationship between profitability and corporate governance.

Contrasting to above, it was concluded that there is a negative relationship between corporate governance and financial performance (Rad, 2014). Similarly, a

study conducted by Guo & Kumara (2012) found a negative relationship between corporate governance with firms' value. On the other hand, Ebelechukwu, Paul & Yakubu (2015) presented evidence that there is no significant relationship between corporate governance and banks financial performance. Another one conducted by Gillani, Latief & Raza in 2014, concluded that there is no significant impact between corporate governance and firm performance. Moreover, it was found that corporate governance practices do not improve financial performance consistently (Lodhi &Makki, 2013).

Additionally, many studies have highlighted the relationship between different corporate governance variables but the relation between them varies. AL-Sahafi, Barnes & Rodrigs (2015) conducted another study of all listed banks in Saudi Arabia that shows board independence and board size have a significant positive relationship with banks' financial performance, whereas ownership concentration and leverage ratio have a significant negative association with banks' financial performance. However, CEO status, audit committee size and audit committee independence are not related to banks' financial performance. EL-Chaarani (2014) showed a positive impact of independent boards on the performance of Lebanese banks; also, there is a significant and negative relationship between CEO duality and bank performance. Kumar & Nihalani (2014) investigated the effect of corporate governance on the performance of Indian Banks and found that board of the directors has played significant role in firm performance but the board meetings negatively impacted on the financial performance. Marashdeh (2014) also could not find any significant impact for the board size on firm performance; however, CEO duality tends to have a positive effect on the Jordanian firms' performance; it was also found that existence of independent directors have a negative impact on firm performance. Danoshana & Ravivathani (2013) found that board size and audit committee size exert positive influence on the firm performance while board meetings frequency has negative impact on the firm performance. Gillani et al., (2014) found that board size and CEO duality had significant positive impact on firm performance while independent directors had insignificant impact on performance. Khan, Sheikh & Wang (2013) studied the impact of internal attributes of corporate governance on firm performance, the study found that board size, CEO duality, and ownership

concentration were positively related to the firm performance but independent directors and managerial ownership are negatively related to the return on assets and earning per share. Nyamonogo & Temesgen (2013) analysed the impact of corporate governance on firm performance and found that board size negatively impacts firm performance while independent board directors tend to enhance the firm performance. Phan & VO (2013) examined elements of corporate governance such as CEO duality, presence of female board members, the working experience of the board members and compensation of board members and found that all the elements had positive impact on the firm performance but board size had negative impact on the firm performance. Todorovic (2013) found that if the company rigidly follows principles of corporate governance then it results in higher net profit margins and earnings per share. Moreover, within the Palestinian context, a study by Ahmed (2010) showed a positive impact of board size on the performance of banks and a negative relationship with family ownership.

2.11.2 Internal Control System

Empirically, a number of studies examined the relationship between internal control system and financial performance. Basodan, Rehaily & Thuneibat (2015) found that the effect of internal control and its components on return on assets and return on equity of Saudi Shareholding Companies is significant and positive, while the effect on earnings per share and profit margin is positive but statistically insignificant. Malekmahmoudi, Saeidi & Shokoohi (2015) showed that there was a significant and positive relation between internal control system and financial performance of the Telecommunication Company of Nigeria and an internal control system seems to be necessary for effective performance. Additionally, Wnjeri (2014), study's findings revealed that most manufacturing firms in Kenya had a control environment as one of the functionality of internal control of the organization that greatly impacts on the financial performance of the firms. Results showed that there was a positive relationship between internal control and financial performance of manufacturing firms in Kenya. It was concluded that manufacturing firms that had invested on effective internal control system had more improved financial performance as compared to those manufacturing firms that had a weak internal

control system. The study further recommends that the governing body, possibly supported by the audit committee, should ensure that the internal control system is periodically monitored and evaluated. Samuriwo (2014) sorted out the establishment of relationship between internal control systems and financial performance in Zimbabwe; the study proved this relationship and that it is a significant positive relationship.

According to the findings of Dineshkumar & Kogulacumar (2013), there is a strong positive relationship between internal control system and financial performance of the Sri Lanka Telecommunication companies. (Chukwu, 2012), investigated the impact of internal control system on the financial performance of organizations in Kenya. The study found that fraud perpetration and losses of revenue in the organization are a result of weak internal control system. Muraleetharan (2010), in his study of internal control and its impact on financial performance of universities of Jaffna, concluded that there was a positive relationship between internal control and financial performance. Mawanda (2008) conducted a research on effects of internal control systems on financial performance in institution of higher learning in Uganda; it established a significant positive relationship between internal control system and financial performance.

2.11.3 Internal Corporate Governance Controls and Financial Performance

Empirically, several studies stated that an effective internal control system is essential to achieve sound corporate governance practices. Fadilah (2013) indicated that the implementation of internal control provides a greater contribution to the implementation of good governance. Iulian & Mihaela (2012) asserted that corporate governance and internal control should be considered. An organization without an efficient long-term view of leadership and effective internal control mechanisms cannot be sustainable. So, corporate governance is not entirely effective without a good internal control. Vlad (2012) argued that the key elements of solid corporative governance include adequate internal control systems and transparency. Danescu & Prozan (2011) emphasized that the elaboration and the implementation of adequate internal control activities will lead to good corporate governance. Gombarume,

Mutengezanwa & Njanike (2011) discovered that failure to effectively implement internal controls contributed significantly to poor corporate governance.

Additionally, it has been attempted in other studies to establish association between corporate governance, internal control system and financial performance. According to AL-Zwyalif (2015), which examined the role of internal control in enhancing corporate governance in the context of Jordanian insurance companies; the results indicated that the commitment to all elements of internal control contributes to strengthening corporate governance; these results show that internal control has a significant role in enhancing corporate governance in Jordanian insurance companies, and the success of corporate governance requires compliance with all elements of internal control which in turn enhancing the financial performance. Hariyanto & Suyono (2012) showed that internal control has a positive significant relationship with corporate governance. It means that when Indonesian local governments implement internal control effectively, it makes good governance practices increase which leads to high financial performance of Indonesian companies. Olumbe (2012) sought to establish the relationship between internal control and corporate governance in commercial banks in Kenya; the study concluded that there is a positive relationship between internal control and corporate governance which leads to improving firm performance and maximizing shareholder value.

2.11.4 Boards of Directors Characteristics

Empirically, many studies have attempted to answer the question if there is a relationship between board of directors and financial performance. There is no unanimity among the researchers regarding the relationship. Amer, Ragab & Ragheb (2014) provided evidence of the positive relationship between board of directors and financial performance. The findings showed that there is a positive relationship between the proportion of independent directors, board meetings, CEO duality and board size of companies listed in the Egyptian Stock Market. This means there is a positive relation between board of director's characteristics and financial performance. Awais & Hussain (2015) found that the company performance is

positively related to the board independence and corporate governance should be considered as a system that controls the organizations so that it can provide better and favourable results for organizations.

Contrasting to above, it was concluded that there is a negative impact of board of director's characteristics (the independent director's proportion and board size) and firm performance of Spanish companies (Arosa, Iturralde and Maseda, 2013). On the other side, Kutum (2015) presented evidence within the Palestinian context that there is no relationship between board characteristics (board independence, board meetings, and board size and board expertise) and return on assets.

Moreover, many studies have highlighted the relationship between different board characteristics but the relation between them varies. AL-Matari, AL-Swidi and Bt Fadzil (2014) indicated a significant positive relationship between board size, board meetings and return on equity. Furthermore, board independence is significantly and negatively related to return on equity of Omani listed companies. Similarly, Ghabayen (2012), concluded empirical evidence that board size has no effect on firm performance while board independence has a significant negative relationship with firm performance of Saudi Arabian companies. Also, there is a positive and significant relationship between ROE with board independence and board size (Entebang, Mansor & Yasser, 2011).

2.11.4.1 Board Independence and Financial Performance

Empirically, there are different findings that suggest there may be positive, negative and no relationship between board independence and financial performance. AL-Sahafi et. al. (2015) provided evidence of a significant positive relationship between board independence with banks' financial performance in Saudi Arabia. It was evident that board independence as a characteristic of board of directors has a significant strong positive impact on firm performance as measured by ROA of Romanian listed companies (Muller, 2014). Butt, Saeed & Shah (2011) examined the relationship that exists between ownership structure and performance of the listed companies in an emerging South Asian market and found that a more independent

and effective board of director's boosts a firm's performance. Their results reflect the linkage between board independence and firm performance and evidence that independent board members are important to companies' improved performance. Another one by Lodh, Rashid, Rudkin & Zoysa (2010) examined the relationship between independent board composition and firm performance and found that independent board directors added value to the firm performance of Bangladeshi firms.

In contrast, Arosa et al. (2014) concluded that there is a negative impact of the independent director's proportion on firm performance. The presence of independent directors can be said not to have resulted in improved firm performance. It was concluded that proportion of independent directors shows a marginal negative relationship with firm value of listed firms on Colombo Stock Exchange in Sri Lanka (Kumara & Zhaoyang, 2012). Agrawal & Knoeber (1996) found a negative relationship between board independence and firm performance.

Similarly, there is another influential empirical research by Bhagat & Black (1996), who conducted the first large sample, long-horizon study of whether the proportion of independent directors affects firm performance. Using a wide variety of market and accounting measures, they found that there is a strikingly significant negative correlation between the proportion of independent directors and firm performance measured by a large variety of accounting measures. Similar results concluded by Yermack (1996), whose empirical work on the association between the fraction of independent directors and firm performance.

On the other hand, Costa (2015) presented evidence that board independence has no significant association with Romanian firms' financial performance. According to Wang (2014), this article also found that board independence has no significant impact on firm performance of Chinese listed companies. This may suggest that independent directors may primarily play an advisory role but not a monitoring role in Chinese listed companies. Many authors found that there is no relationship between effective monitoring of independent directors and firm performance (Bhagat & Black 2002; Dalton, Daily, Ellstrand & Johnson, 1998; Klein

1998). Baysinger & Butler (1985) found also that there is no relationship between the proportion of independent directors on the board and the firm's profitability in the same period in 1970s.

2.11.4.2 Board Size and Financial Performance

Empirically, there are different findings that suggest there may be positive, negative and no relationship between board size and financial performance. AL-Sahafi et al. (2015) provide evidence that board size has a significant positive relationship with banks' financial performance in Saudi Arabia. It was evident that there is a strong positive association between large board size and corporate financial performance of companies listed at Nairobi Securities Exchange (Bebji, Mohammed & Tanko, 2015). Weterings & Swagerman (2011) conducted a study to trace out the impact of board size on firm value using a sample of 155 property firms and real estate firms listed in the exchanges of Singapore, Hong Kong and Malaysia, and found a positive relationship between board size and firm value of the property firms. Haniffa & Hudaib (2006) found a positive relationship between the board size and the firm performance as measured by ROA, which is in contrast with their prior finding of a negative relationship between board size and the firm performance measured by Tobin's Q. Garba, Mikailu & Sanda (2005) studying a sample of 93 Nigerian listed firms during the period 1996 to 1999, found a positive correlation between the board size and the firm profitability as measured by ROE. Their results support that large boards have better access than smaller ones to the external environment by offering better chances to have wide resources for finance and raw materials.

Contrasting to above, Dogan & Yildiz (2013) showed that there was a negative and statistically significant results between such accounting- based performance indicators as ROA along with ROE and the banks' board of directors in Turkey. It was concluded that there is a negative impact of board size on Spanish firm performance (Arosa et. al., 2014). The negative effect of board size could indicate the disadvantages of worse coordination, flexibility and communication inside large boards seem to be more important than the benefits of better manager

control by the board of directors. In addition, Pathan (2011) revealed the existence of a negative relationship between them. Garg (2007) investigated the influence of board size on firm performance on a sample of Indian firms. Firm performance was measured by Tobin's Q, return on assets and total assets turnover, the research results recommend that there is an inverse relationship between board size and firm performance. On the other hand, Farkhanda (2015) concluded that financial performance of banks in Pakistan is not affected by board size. According to Gillani et.al, (2014), the results of the study concluded that board size did not show significant relationship with Pakistani firm performance. In addition, the researches of Bino & Tomar (2012), there is no effect of the size of the board of directors on the bank's performance has been identified. Moreover, Topak (2011) reported that there is no relationship between the board size and firm performance.

2.11.5 Audit Committees Characteristics

Empirically, a number of studies have looked at the relationship between audit committees and financial performance. Ali & Nasir (2014) showed empirical evidence that audit committee has a significant positive impact on the performance of firm. Evidence by Wakaba (2014) showed that audit committees characteristics have a significant positive impact on financial performance. Research findings showed that audit committee financial expertise, audit committee size and number of independent members of audit committee has a significant positive effect on financial performance. The presence of audit committee members with financial expertise will also reduce financial misreporting and enhance quality monitoring. Also increasing of audit committee members with financial expertise and proportion of independent members reduces the chances of financial misreporting and leads to positive perception by investors. Another one from Jordan by Hamdan, Reyad & Sarea (2013) concluded that there was a positive statistical significant relation between audit committee characteristics and financial performance in the financial sector listed in the Amman Stock Exchange Market and a positive relation between audit committee characteristics and stock performance, but there was no relation between audit committee characteristics and operational performance.

Moreover, Al-Sartawi, Hamdan & Mushtaha (2013) showed empirical evidence that the size of the audit committee is inversely connected with earnings quality measured by its ability to survive in the future. They realized that it is not suitable to increase the size of the audit committee to a great extent in order to perform perfectly; the size should be within the convenient range which makes it more effective. Afterward, they studied the role of independence of members of the audit committee, but they did not find any relationship between this variable and earnings quality. As for the financial experience of members of the audit committee, and despite meeting that condition by the Jordanian Industrial Companies, they did not find any role to be played by it in improving earnings quality. Regarding the role of the number of meetings of audit committees, they found that the increase in the number of meetings helps improve earnings quality.

2.11.5.1 Audit Committee Independence and Financial Performance

Studies investigating the audit committee characteristics generally revealed that audit committee independence is a key factor for its effectiveness, as well as an essential element of achieving financial reporting quality (Bedard & Gendrom, 2010). It has been evidenced that independent directors on audit committee improve earnings quality (Dhaliwal, Naiker & Navissi, 2010; Iskandar, Saleh and Rahmat, 2007), and decrease the likelihood of financial reporting fraud (Jackson, Robinson & Shelton, 2009).

Similar results indicated in Bronson & Sharma (2009) that the likelihood that firms receive a going concern opinion is influenced by the proportion of independent directors on audit committee. Concerning corporate disclosure, Akhtaruddin & Haron (2010) found that firms with more independent directors on audit committee are more probably to release more additional information. Indeed, audit committee independence provides an effective monitoring means of overseeing financial reporting process. Several previous researches showed that audit committees that are independent, are more likely to reduce frauds and misleading financial reporting process (Menon & Williams, 1994; Beasley, 1996).

The empirical studies of the relationship between audit committee independence and firm performance showed different results. AL-Matari et al. (2014) indicated that a significant positive relationship was existed between audit committee independence and the Tobin's Q of the Omani listed companies. Similarly, AL-Matari et al. (2012) concluded that a positive relationship was existed between the independence of the audit committee members and the performance of Saudi Arabian firms. Another one by Islam & Nuryanah (2011) which studied the 46 of 315 listed companies, from financial sectors over 2002-2004; the study concluded that the relationship between audit committee independence and financial performance is positive. Yasser et al. (2011) examined 30 Pakistani listed firms through 2008-2009; the results indicated that there is a positive relationship between audit committee independence and financial performance. In addition, Chan & Li (2008) explained that independent directors on the audit committee have a significant positive role in enhancing the firm value. In addition, Dey (2008) the study used 371 American firms through year 2000 to 2001and concluded that there is a positive relationship between audit committee independence and financial performance. Also, Khanchel (2007) used 624 American listed and non-financial firms for the period of 1994-2003and found that the impact is positive.

Contrasting to above, Ormin, Shadrach & Tuta (2015) concluded that audit committee independence has a negative and significant influence on financial reporting quality of listed deposit money banks in Nigeria. Dar, Naseem, Niazi & Rehman (2011), which studied 11oil and gas firms listed on the Karachi stock exchange over 2004-2010, revealed that there was a negative relationship between audit committee independence and financial performance. On the other hand, (AL-Sahafi et. al. 2015) concluded that audit committee independence is not related to banks' financial performance in Saudi Arabia. Al-Matari et al. (2012) and Dar et al. (2012) studies concluded that there is no relationship between audit committee independence and financial performance. Moreover, Ghabayen (2012) revealed that audit committee independence have no effect on firm performance of listed companies in the Saudi Arabian Market.

2.11.5.2 Audit Committee Financial Expertise and Financial Performance

Empirically, there are several studies that examine the relationship between audit committee financial expertise and financial performance. Aanu, Odianosen & Taiwo (2015) found that audit committee financial expertise has a positive significant impact on financial reporting quality in Nigeria. The study, therefore, recommends that more attention should be given to the financial expertise of members being recommended to the audit committee effectiveness. Ismail &Kamarudin (2014) showed that the expertise of members of the audit committee is negatively associated with corporate fraud. This suggests that when audit committee members are financially literate, they are more competent to curb fraudulent financial reporting. The presence of audit members with financial expertise will also reduce financial misreporting and enhance the monitoring quality (Wakaba, 2014). According to Iyoha, Obigbemi & Ojeka (2013), the results of the study showed a positive significant relationship between financial expertise of the audit committee and ROA and ROE of manufacturing firms in Italy. Similarly, Bouaziz (2012) showed empirical evidence that financial expertise of the members of the audit committee of the Tunisian companies, listed in the stock exchange, has a significant positive effect on financial performance.

Contrasting to above, Badolato, Donelson & Ege (2014), audit committees with financial expertise are associated with lower levels of earnings management, as measured by accounting irregularities and abnormal accruals. It was evident that audit committee financial expertise has a significant negative effect on firm performance. On the other hand, it was found that financial experience of audit committee members do not affect in reducing earnings management of Jordanian manufacturing companies (AL-Sartawi et.al, 2013).

2.11.5.3 Audit Committee Meetings and Financial Performance

Empirically, there are several studies that examined the relationship between audit committee meetings and financial performance. Haider, Iqbal & Khan (2015) concluded that a positive relationship was existed between audit committee meetings and financial performance. Kang & Kim (2011) used 1104 nonfinancial firms listing

on the Korea stock exchange over the period 2005 to 2007. The study found that the relation is positive. The same findings were found in the study by Kyereboah-Coleman (2007). Also, Hsu (2007) found that there is a positive relationship between audit committee meetings and firm performance. It could be due primarily to the fact that audit committees are generally perceived to serve the interests of shareholders and the public at large. Thus, when they meet frequently, it further reaffirms the position of the organization in dealing with transparency and working to promote shareholder value.

Contrary to above, Danoshana & Ravivathani (2013) found that meeting frequency has negatively impact on firm's performance. Hsu and Petchsakulwong (2010), studied Public non-life insurance companies in Thailand over the period 2000-2007, and concluded that there was a negative relationship between audit committee meetings and financial performance. In a subsequent research, Anderson, Mansi & Reeb (2004) found that there is a negative relationship between costs of debt and audit committee meeting frequency. In addition, the frequency of audit committee meetings has a significant negative effect on ROA in the Ghanaian sample (Menon & Williams, 1994). On the other side, Mohd (2011) from Malaysia employed 162 non-financial firms through 2006-2008 and found that there is no significant relation between audit committee meetings and financial performance. Huang (2008) found no relationship between audit committee diligence and a firm's performance. Another research by Rebeiz & Salameh (2006) concluded that the quality of meetings is also important and increasing the number of meetings doesn't necessarily enhance a firm's performance.

2.11.5.4 Audit Committee Size and Financial Performance

Empirically, prior studies arrived at mixed results in the relationship between audit committee size and company financial performance. Danoshana & Ravivathani (2013) concluded that audit committee size has a positive impact on firm's performance of financial institutions in Sri Lanka. Lenee & Obiyo (2011) from Nigeria employed 10 firms of 51 firms of Banks, food, construction and oil firms over 2004-2008 and Swamy (2011) from India for 83 unlisted family firms over

2008-2010, showed that there is a positive relationship between audit committee size and financial performance.

In contrast, Moilah & Talukdar (2007) from Bangladesh used 55 firms, which were listed on Dhaka Stock Exchange, between 2002 to 2004. The results concluded that there is a negative relationship between audit committee size and financial performance. On the other hand, Al-Sahafi et al., 2015, showed that audit committee size is not related to banks' financial performance in Saudi Arabia. Islam & Nuryanah (2011) from Indonesia used 315 listed companies; only 46 companies were selected from financial sectors during 2002-2004. The study concluded that there is no relationship between audit committee size and financial performance.

Chapter 3
Research Methodology

Chapter 3
Research Methodology

3.1 Introduction

There are two main objectives of this chapter. The first objective is to explain the theoretical framework of the study and develop hypotheses in relation to financial performance, based on issues identified in the preceding chapter. The second objective is to explain the process of how the sample is gathered and measured in the study to test the hypotheses developed. To meet the research objectives, the study used the descriptive statistics and the multiple regressions using secondary data available from corporate annual reports and the financial statements.

Based on the review of prior literature in the preceding chapter, Section 3.2 presents and discusses the theoretical framework of the study. Following the theoretical framework, the relevant hypotheses are developed in section 3.2. Section 3.3 provides an explanation of the measurement used for the dependent variables followed by an explanation of the measurement used for independent variables and control variables. Section 3.4 presents how samples are selected in the study. Finally, section 3.5 presents data analysis tools.

3.2 Hypotheses Development

Figure 3.1 presents the diagrammatic representation of the theoretical framework examined in the study, including the variables to be investigated in the study. Based on the agency and resource dependence theoretical framework, this study includes the board of directors' characteristics and audit committees characteristics to provide evidence of their monitoring role as a main agent of corporate governance systems to reduce agency costs and thus enhance the financial performance.

Referring to the framework, the study examines the relationship between the board of directors' characteristics (board independence and board size), and audit committees characteristics (audit committee independence, audit committee financial expertise, audit committee meetings and audit committee size), which are the

independent variables. The financial performance, measured in terms of return on assets (ROA) and return on equity (ROE), as the dependent variable.

Control variables, i.e. firm size, leverage and big 4 are also included in the analysis. Based on prior studies, these variables are included as they have been shown to have an impact on financial performance (Wang, 2006; Abdullah, 2006).

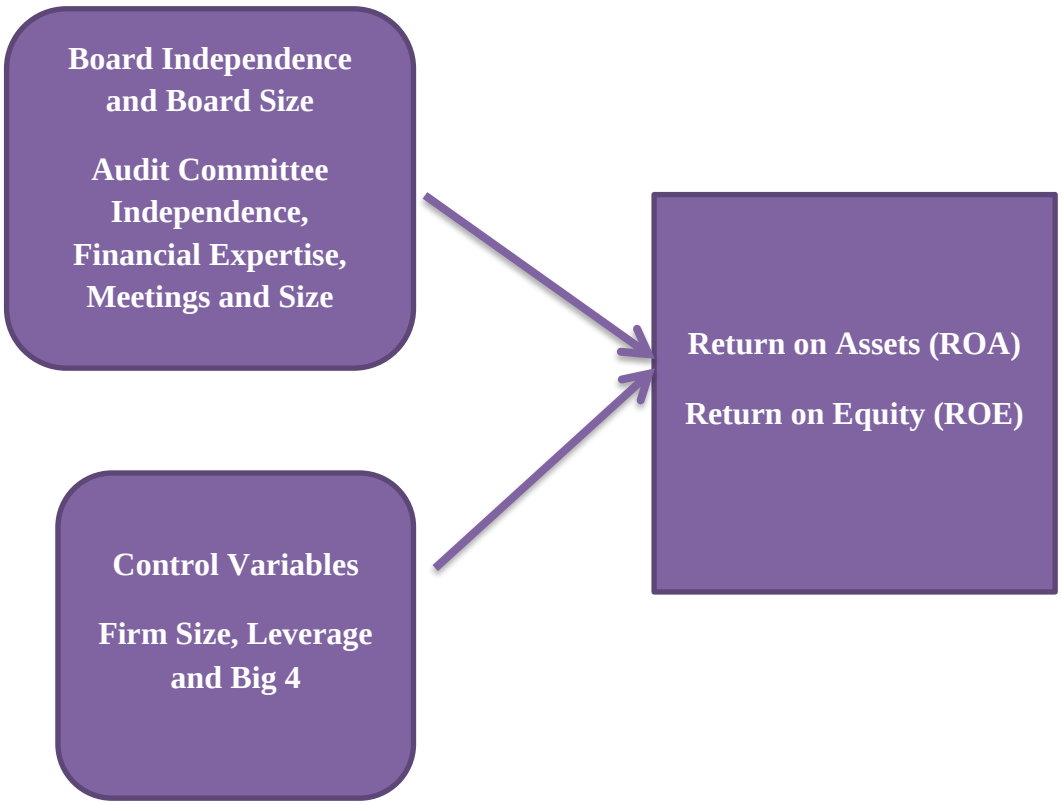

Figure (3.1): Theoretical Framework

3.2.1 Board Independence

From the agency theory perspective, independent directors contribute to effective governance by exercising control over top managers' decision-making, because they are seen as the check and balance mechanism to enhance board's effectiveness. Board independence is considered crucial as it enables directors to truly monitor and discipline the management and improve its performance (Duchin et al., 2010).

They should be financially independent of management, free from potentially conflicting situations, are able to alleviate agency problems and curb managerial self-interest (Rechner, Rhoades &Sundaramurthy, 2000). They can protect the shareholder interest, perform monitoring and control function in a better way to align firm resources for better performance (Naveen &Singh, 2012).

Previous empirical studies on the relationship between effectiveness of independent directors and organization performance had mixed results. Some researchers (Naveen & Singh, 2012 and Xie et al., 2003) found a positive effect on the firm performance as a result of having independent directors on the company board. While some researchers (Kajola, 2012) discovered that there is no any relationship between independent directors and firm performance. On the other hand, Coles, McWilliams & Sen (2001) demonstrated that there is a negative impact of independent directors on firm performance. Erickson, Park, Reising & Shin (2005) also found a negative relationship between greater board independence and firm value.

Based on above discussion, the following hypothesis is set, and will be empirically tested:

H1: There is a significant positive relationship between the proportion of independent directors and financial performance.

3.2.2 Board Size

Jensen (1993) and Lipton & Lorsch (1992) revealed that large boards are not as effective as smaller ones and there is a possibility that the members' discussions are not as meaningful as expected. Increase in board size corresponds to difficulties arising in coordination and processing of issues. Shaver (2005) mirrored the same statement by saying that larger board primarily shows issues of responsibility diffusion leading to social loafing and urging the fractionalization of the group and the reduction of the members' commitment to strategic change. Moreover, larger boards are inefficient in terms of higher spending on the maintenance and report more difficulties in terms of planning, work coordination, decision making and having regular meetings because of the number of members.

On the other hand, smaller boards are ideally able to avoid free riding by directors and encourage efficient decision making process. Also, the bigger the board, the more possibility that the stakeholders' interests are considered and the less likely that decisions will be reached in favour of only a few members (Shao, 2010). According to Pfeffer & Salancik (1978), larger boards are more able to obtain valuable resources including budgeting, funding and leveraging the external environments which can lead to the improvement of the performance of the firm.

Despite the empirical evidences regarding the impact of board size on firm performance, the findings are still inconclusive. Prior studies conducted in the developed countries showed consistency of results with the agency theory and confirm a negative association between board size and firm performance. These studies include Nanka-Bruce (2011) and O`Connell and Cramer (2010). Similarly, in the developing countries many studies found the relationship between the board size and firm performance to be negative (Lin, 2011; Kota & Tomar, 2010; Noor, Afza & Ayoib, 2009; Garg, 2007).

According to the resource dependence theory, several studies in the context of the developed countries reported positive relationship between board size and firm performance (e.g. Larmou & Vafeas, 2010; Khanchel, 2007). In the same line of similar outcome but different countries, a positive relationship has been found between board size and firm performance in the developing countries; this is evidenced in studies conducted by EL- Najjar (2013), Kang & Kim (2011), Khan & Javid (2011), Obiyo & Lenee (2011), Swamy (2011), Yasser et al. (2011) and Kyereboah-Coleman (2007). Apart from agency and resource dependence theory, other evidence has revealed that no association exists between firm performance and board size in the developed nations (Wei, 2007) and the developing countries (Abdurrouf, 2011; Chiang & Lin, 2011; Kajola, 2008).

On the basis of the previous discussion and supporting arguments, the following hypothesis is developed:

H2: There is a significant negative relationship between board size and financial performance.

3.2.3 Audit Committee Independence

Audit committee must be independent from the management in order to fulfill the oversight role. Corporate governance mechanisms and regulations support the independence of audit committee. According to the agency theory and the resource dependence theory, the independent members in audit committee can help the owners to monitor the managements' activities and reduce benefits from withholding information. As a result, the independent audit committee members in the audit committee help to increase the level of disclosure by the listed companies and facilitate more effective monitoring on financial reporting (Beasley, 1996).

Previous studies also provided evidence of the importance of audit committee independence. Yang & Krishnan (2005) found that independent audit committees are significantly less likely to be associated with the incidence of internal control problems. Likewise, Abbott, Parker & Peters (2004) found that audit committees consisting of all independent members are negatively associated with financial restatements. Beasley, Carcello, Hermanson & Lapides (2000) found firms that commit fraud are likely to have less independent audit committees.

Moreover, Chen & Jaggi (2000) provided a positive relationship between the proportion of independent audit committee members serving in the board and the comprehensive of financial disclosure. Klein (2008) and Hsu (2008) concluded no significant association. MakandKusnadi (2005) failed to find any significant relationship between the proportion of independent directors on the audit committee and firm performance. Sunday (2008) studied the relationship between audit committee composition and firm performance by using a sample of 20 non-financial listed companies in Nigeria, and he could not provide a significant association between them.

Based on the above discussion, the following hypothesis is formulated:

H3: There is a significant positive relationship between audit committee independence and financial performance.

3.2.4 Audit Committee Financial Expertise

Audit committee members need to have sufficient understanding of accounting, finance, or financial literacy to act as effective monitors of the integrity of company's financial reporting process and its disclosure practices (Emmerich, Racz & Unger, 2005). Further, Dhaliwal, Naiker & Navissi (2010) have argued that having audit committee members who are lack of accounting knowledge and experiences actually threatens the firm's overall financial reporting due to the inability to deal with issues affecting the firm's financial reporting.

Jackson, Robinson & Shelton (2009) claimed that probability of financial fraud is lower when audit committee has accounting expertise. Dhaliwal et al., (2010) documented that accounting expertise of audit committee members mitigates the earnings management. Accounting expertise sitting on audit committee could ensure a good system of internal control and consequently contribute to reliable and relevant financial reporting and high quality financial statements (Naiker & Sharma, 2009). These studies indicated the importance of audit committee accounting expertise in performing effective monitoring roles.

Therefore, it is hypothesized that:

H4: There is a significant positive relationship between audit committee financial expertise and financial performance.

3.2.5 Audit Committee Meetings

The frequency of audit committee meeting is one of the most extensively examined, as previous studies made use of it as a proxy for audit committee activeness (e.g. Hsu & Petchsakulwong, 2010; Khanchel, 2007; Kyereboah-Coleman, 2007). Abbott, Peters & Raghunandan (2003) stated that frequent meetings

of audit committee may lead to the improvement of the financial accounting processes, which in turn leads to superior performance. Sharing the same perspective is the resource dependence theory that stated that the committee meetings help the committee to evaluate the company from time to time and to solve any problem encountered by employees (Pearce & Zahra, 1992; Pfeffer, 1987). From the agency theory's perspective, Jensen (1993) stated that boards have to be relatively relaxed as evidence of higher audit committee activity is a sign of poor performance. Some authors like Jackling & Johl (2009) and Lipton & Lorsch (1992) contended that frequent meetings are likely to lead to higher performance while Rebeiz & Salame (2006) highlighted that the quality of the meeting and not just the quantity is significant for firm performance.

A review of literature revealed no evident relationship between audit committee meeting and firm performance. While some authors revealed a positive relationship between the two variables in developed countries (Khanchel, 2007) and in developing countries (e.g. Kang & Kim, 2011; Kyereboah-Coleman, 2007), others found a negative relationship (e.g. Hsu & Petchsakulwong, 2010). Some other authors found no relationship between audit committee meeting and performance such as Al-Matari et al. (2014), Al-Matari et al. (2012), Mohd (2011), and Mohd et al. (2009). Due to this conflict, no conclusive evidence has been reached.

Therefore, this research proposes the following hypothesis:

H5: There is a significant positive relationship between audit committee meetings and financial performance.

3.2.6 Audit Committee Size

The size of the audit committee is widely explored as an audit committee effectiveness element. It is gauged through the number of audit committee members (Nuryana & Islam, 2011; Obiyo & Lenee, 2011; Hsu & Petchsakulwong, 2010).

Based on the premise of the resource dependence theory, the bigger the size of the audit committee, the better it will mean to the firm performance. A small audit

committee lacks the same diversity of skills and knowledge of its large counterpart and hence, is ineffective. An audit committee with an ideal size enables members to employ experience and expertise to satisfy the interests of shareholders (Pearce & Zahra, 1992; Pfeffer, 1987). Although literature provides an extensive discussion of the audit committee size-firm performance relationship, the results reported are still inconclusive. Agency theory advocates propose that if the committee size is too big, the performance is expected to be poor.

Several researchers investigated the relationship between audit committee size and firm performance in both developed countries (e.g. Bozec, 2005) and developing ones (Al-Matari et al., 2012; Hsua & Petchsakulwong, 2010). These studies reported the negative relationship between the two variables. However, some studies in developed countries reported a positive relationship (e.g. Reddy, Locke &Scrimgeour, 2010; Khanchel, 2007) as well as some of those conducted in the developing countries (e.g. Al-Matari et al., 2012; Obiyo & Lenee, 2011; Swamy, 2011; Black & Kim, 2007; Kyereboah-Coleman, 2007; Black, Jang & Kim, 2003). Besides the proponents of the agency theory and the resource dependence theory, some other studies reported no relationship between the audit committee size and the firm performance and these include, Ghabayen (2012), Abdurrouf (2011), Nuryana & Islam (2011) ,Mohd (2011), Mohd et al. (2009), Kajola (2008) and Wei (2007).

On the basis of these findings, the researcher formulates the following hypothesis:

H6: There is a significant negative relationship between audit committee size and financial performance.

3.3 Measurement of Dependent, Independent and Control Variables

3.3.1 Dependent Variables

In many studies, financial performance is measured by two methods based on accounting and market value (Abdul Rahman & Ali, 2006; Baber, Kang & Kumar, 1998). In this study, two accounting measurements have been used to estimate financial performance. Return on assets (ROA) and return on equity (ROE). ROA and ROE indicate the effectiveness in using total assets and equity of firms. It means

that these two ratios present the amount of net income being generated by one unit of total assets and equity respectively. All of the financial indicators relating to ROA and ROE estimation are taken from audited annual financial statements of firms.

a. **ROA**: it's calculated by the ratio between net income and total assets
b. **ROE**: it's calculated by the ratio between net income and total stockholder's equity.

The total assets and total stockholder's equity are estimated by average of beginning and ending figures in a financial year.

3.3.2 Independent Variables

For examining the corporate governance as an internal control system and its impact on financial performance, in this study, board of director's characteristics and audit committee's characteristics are used as proxies. The relevant information is extracted from the annual reports of the selected companies that listed in the Palestine Exchange.

3.3.2.1 Board of Directors Characteristics

For board characteristics: this study uses board independence and board size as the proxies. They are explained as follow:

a. The independence of board is measured by the ratio between a number of independent members and the total members in the board.
b. The size of board referred to the number of directors on the board.

3.3.2.2 Audit Committees Characteristics

For audit committee characteristics: this study uses audit committee independence, audit committee financial expertise, audit committee meetings and audit committee size as the proxies. They are explained as follow:

a. Audit committee independence is measured by the ratio between a number of independent members and the total members in the audit committee;
b. Audit committee financial expertise is measured by any professional experience and knowledge that the audit committee members possess, either accounting or non-accounting expertise;

c. Audit committee meetings are measured by the frequency of meetings;
d. Audit committee size, it is measured by the number of members on the committee.

3.3.3 Control Variables

As prior studies, this study includes firm size, leverage and big 4 as control variables in the regression model given the evidence of the association between these variables and financial performance.

The natural log of total assets is included in the regression to control for the firm size effect (Abdul Rahman & Mohamed Ali, 2006). Firm size denotes the size of the company in terms of total assets. Leverage is measured as the ratio of total liabilities to total assets and is used to control for the liquidity of the firm. The Big 4 audit firms are used to measure audit quality.

Table (3.1): A summary of all variables used in this study: Definitions and Measurements.

Variables codes	Definition	Measurement
Dependent Variables ROA	Return On Assets	Earnings after tax / Total assets
ROE	Return On Equity	Earnings after tax / Total equity
Independent Variables BOARD INDE	Board Independence	Proportion of independent members over total members
BOARD SIZE	Board Size	Total number of board of directors
AC INDE	Audit Committee Independence	Proportion of independent members over total members
AC FIN EXP	Audit Committee Financial Expertise	Any professional expertise accounting or non-accounting that audit committee members possess either through education or experience
AC MEET	Audit Committee Meetings	Frequency of meetings
AC SIZE	Audit Committee Size	Total number of audit committee members
Control Variables FIRM SIZE	Size of the Firm	Natural logarithm of total assets
LEVERAGE	Leverage of the Firm	Ratio of total debt to total assets
BIG 4	Audit firm	The four largest audit firms in the world

3.4 Sample Selection

The target population was 29 companies of 47 companies listed in the Palestine Exchange for the year 2015. The companies are selected based on the availability of audit committee and the availability of information related to the board of directors and audit committees. The required data has been gathered from the annual reports of these companies. To introduce the theoretical literature of the subject, the research used several sources. The following sources were used in this study:

- Books, published papers, articles and journals;
- Corporate governance frameworks and internal control frameworks
- Websites and electronic versions.

3.5 Data Analysis Tools

The researcher applies the descriptive statistics and the multiple regression analysis, using SPSS and Microsoft Excel programs, to test the hypotheses presented in the preceding section. Drawing on previous research on corporate governance, the research also includes three control variables to minimize specification bias in the hypothesis testing.

Chapter 4
Results and Discussions

Chapter 4
Results and Discussions

4.1 Introduction

The objective of this chapter is to report and discuss the findings of the study. The chapter is organized as follows, in addition to the introduction as a first section, the second section presents the descriptive statistics of the variables used in the regression tests, the third section reports the results of the multiple regression analysis of the model tested, and finally the fourth section discusses the overall findings of the study.

4.2 Descriptive Statistics

Table (4.1) presents the descriptive statistics of the variables used in the regression tests for year 2015.

Table (4.1): Descriptive Statistics of Dependent, Independent and Control Variables

Variables	N	Minimum	Maximum	Mean	Std. Deviation
ROA	29	-62.20	22.18	0.19	14.61
ROE	29	-120.90	121.00	3.82	34.88
BOD_INDE	29	0.00	54.55	9.46	15.62
BOD Size	29	6.00	15.00	9.28	2.14
AC_INDE	29	0.00	100.00	14.66	30.18
AC Financial Expertise	29	0.00	100.00	61.44	29.58
AC_MEET	29	0.00	7.00	4.52	1.84
AC Size	29	2.00	5.00	3.10	0.72
Firm Size	29	4.49	9.44	7.55	1.10
Leverage	29	4.5	90.43	47.93	29.12

- As reported in Table 4.1, ROA and ROE range from -62.20 to 22.18 and -120.90 to 121, respectively. The mean and standard deviations values are 0.19, 14.61 and 3.82, 34.88, respectively.
- In terms of board independence, the average, 9.46, of the proportion of independent directors indicates the domination of dependents in the board composition of the selected companies in Palestine Exchange. This suggests that the recommendation contained in the Palestinian corporate governance code for the board independence were compiled by 9 percent of Palestinian corporations.

The maximum, minimum values and standard deviations values are, 0, 54.55 and 15.62 respectively.

- As depicted in Table 4.1, the average board size of the selected companies in Palestine Exchange is nine directors. This suggests that the recommendation contained in the Palestinian corporate governance code for the board size were compiled by most Palestinian corporations. The size is within the range recommended by Jensen (1993) for board effectiveness.
- In terms of audit committee independence, 85.34% of the members in the committee are not independent. This suggests that the recommendation contained in the Palestinian corporate governance code for the audit committee independence were compiled by 15 percent of Palestinian corporations.
- With respect to audit committee financial expertise, the mean percentage of committee members with financial expertise is 61.44. This means that more than half of the committee members are financial experts. This suggests that the recommendation contained in the Palestinian corporate governance code for the audit committee financial expertise were compiled by Palestinian corporations
- In terms of audit committee meetings, the sample firms held a mean of 4.52 meetings in a year. According to audit committee size, the mean value is 3 members per committee.
- As reported in Table 4.1, firm size and leverage range from 4.49 to 9.44 and 4.5 to 90.43, respectively. The mean and standard deviations values are 7.55, 1.10 and 47.93, 29.12, respectively.

4.3 Multiple Regression Analysis

This section reports the results of the multiple regression analysis of the model tested of 29 selected companies in Palestine Exchange in year 2015, where it links board of directors' characteristics and audit committees' characteristics with financial performance measured by return on assets, ROA, and return on equity, ROE.

4.3.1 Dependent variable: ROA

4.3.1.1 Controlling for Firm Size and Leverage

Without controlling variables, the coefficient of determination and adjusted coefficient of determination equal 0.145 and 0.088, respectively. While, after controlling for firm size and leverage, the coefficient of determination and adjusted coefficient of determination equal 0.507 and 0.31, respectively. The difference between the two coefficients of determinations in pre and post controlling variables are large (0.362 and 0.222). This result indicates that the controlling variables firm size and leverage are important to the regression model and hence do significant changes in the analysis.

Table (4.2) shows the regression coefficients and their P-values (Sig.). Firm size and Leverage are statistically significant since the P-value (Sig.) is smaller than 0.05.

Table (4.2): The Regression Coefficients- ROA

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	-83.874	27.003		-3.106	0.006
BOD_INDE	-0.005	0.174	-0.005	-0.026	0.979
BOD_Size	1.740	1.297	0.254	1.341	0.195
AC_INDE	0.047	0.098	0.097	0.480	0.636
AC_Financial_Expertise	0.121	0.090	0.246	1.349	0.192
AC_MEET	0.294	1.605	0.037	0.183	0.856
AC_Size	-2.080	3.778	-0.103	-0.551	0.588
Firm Size	**11.529**	**3.229**	**0.869**	**3.571**	**0.002***
Leverage	**-0.460**	**0.137**	**-0.917**	**-3.362**	**0.003***

* The variable is statistically significant at 0.05 levels

4.3.1.2 Controlling for Firm Size, Leverage and Big 4

Without controlling variables, the coefficient of determination and adjusted coefficient of determination equal 0.145 and 0.088, respectively. While, after controlling for firm size, leverage, and big 4, the coefficient of determination and adjusted coefficient of determination equal 0.635 and 0.462, respectively. The difference between the two coefficients of determinations in pre and post controlling

variables are large (0.49 and 0.374). This result indicates that the controlling variables firm size, leverage, and big 4 are important to the regression model and hence do significant changes in the analysis.

Table (4.3) shows the regression coefficients and their P-values (Sig.). BOD_Size, C_Financial_Expertise, Big 4, Firm size and Leverage are statistically significant since the P-value (Sig.) is smaller than 0.05.

Table (4.3): The Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	-85.298	23.861		-3.575	0.002
BOD_INDE	0.016	0.154	0.017	0.103	0.919
BOD_Size	**2.142**	**1.157**	**0.313**	**1.852**	**0.040***
AC_INDE	0.131	0.092	0.271	1.418	0.172
AC_Financial_Expertise	**0.243**	**0.093**	**0.492**	**2.628**	**0.017***
AC_MEET	0.873	1.436	0.110	0.608	0.550
AC_Size	-1.932	3.338	-0.096	-0.579	0.570
Big 4	**-18.556**	**7.208**	**-0.446**	**-2.574**	**0.019***
Firm Size	**12.119**	**2.861**	**0.914**	**4.235**	**0.000***
Leverage	**-0.517**	**0.123**	**-1.031**	**-4.208**	**0.000***

* The variable is statistically significant at 0.05 levels

4.3.2 Dependent variable: ROE

4.3.2.1 Controlling for Firm Size and Big 4

Without controlling variables, the coefficient of determination and adjusted coefficient of determination equal 0.030 and -0.235, respectively. While, after controlling for firm size and big 4, the coefficient of determination and adjusted coefficient of determination equal 0.359 and 0.103, respectively. The difference between the two coefficients of determinations in pre and post controlling variables are large (0.329 and 0.338). This result indicates that the controlling variables firm size and big 4 are important to the regression model and hence do significant changes in the analysis.

Table (4.4) shows the regression coefficients and their P-values (Sig.). Big 4 is statistically significant since the P-value (Sig.) is smaller than 0.05.

Table (4.4): The Regression Coefficients - ROE

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	-79.529	65.064		-1.222	0.236
BOD_INDE	0.313	0.434	0.140	0.721	0.479
BOD_Size	0.107	3.300	0.007	0.032	0.974
AC_INDE	0.053	0.279	0.045	0.189	0.852
AC_Financial_Expertise	0.215	0.277	0.182	0.775	0.447
AC_MEET	1.947	4.027	0.103	0.484	0.634
AC_Size	6.569	9.648	0.136	0.681	0.504
Firm Size	11.387	6.729	0.360	1.692	0.106
Big 4	**-57.631**	**21.836**	**-0.580**	**-2.639**	**0.016***

* The variable is statistically significant at 0.05 levels

4.3.2.2 Controlling for Firm Size, Leverage and Big 4

Without controlling variables, the coefficient of determination and adjusted coefficient of determination equal 0.030 and -0.233, respectively. While, after controlling for firm size, leverage, and big 4, the coefficient of determination and adjusted coefficient of determination equal 0.410 and 0.130, respectively. The difference between the two coefficients of determinations in pre and post controlling variables are large (0.38 and 0.365). This result indicates that the controlling variables firm size, leverage and big 4 are important to the regression model and hence do significant changes in the analysis.

Table (4.5) shows the regression coefficients and their P-values (Sig.). Big 4 and Firm size are statistically significant since the P-value (Sig.) is smaller than 0.05.

Table (4.5): The Regression Coefficients-ROE

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	-122.518	72.363		-1.693	0.107
BOD_INDE	0.073	0.467	0.033	0.157	0.877
BOD_Size	1.798	3.508	0.110	0.513	0.614
AC_INDE	0.126	0.280	0.109	0.449	0.658
AC_Financial_Expertise	0.298	0.281	0.253	1.063	0.301
AC_MEET	4.247	4.354	0.225	0.975	0.342
AC_Size	2.101	10.122	0.044	0.208	0.838
Big 4	**-62.668**	**21.858**	**-0.631**	**-2.867**	**0.010***
Leverage	-0.476	0.373	-0.398	-1.277	0.217
Firm Size	**18.544**	**8.677**	**0.586**	**2.137**	**0.046***

* The variable is statistically significant at 0.05 levels

Table (4.6): Complete results for Multiple Regression with controlling variables

Control variables	ROA		ROE	
	R-squared	Adjusted R2	R-squared	Adjusted R2
Without	0.145	0.088	0.03	-0.235
Firm Size	0.229	0.029	0.136	-0.152
Leverage	0.193	0.076	0.041	-0.279
Big 4	0.218	0.043	0.268	0.023
Firm size & leverage	**0.507**	**0.310**	0.155	-0.183
Firm size & Big 4	0.294	0.012	**0.359**	**0.103**
Leverage & Big 4	0.29	0.006	0.268	-0.025
Firm size, leverage, and Big 4	**0.635**	**0.462**	0.41	**0.13**

Partial correlation

ONLY, when controlling for the variables “Firm Size, Leverage and Big 4", the correlation between AC_Financial_Expertise and ROA equals 0.335 with Sig. (P-value) equals 0.047. So there is statistically significant correlation between AC_Financial_Expertise and ROA. Otherwise, there is no correlation between any independent variables and either ROA or ROE controlling for any permutations for Firm Size, Leverage and Big 4.

Therefore, contradictory to the prediction of the hypothesis of the research, this study finds that an insignificant positive association between board independence and financial performance of the 29 selected Palestinian companies from Palestine Exchange in 2015. It suggests that there is no relation between board independence and financial performance as measured by ROA and ROE. The findings are, however, consistent with the recent findings by Costa, 2015; Wang, 2014; Wei, 2007; Bhagat and Black, 2002; Dalton et al., 1998 and Baysinger and Butler, 1985 in the developed countries and the same findings by AL-Matari et al., 2012; Chugh et al., 2011 revealed that there is no association between board independence and financial performance.

Moreover, contradictory to the prediction of the hypothesis of the research, this study finds that an insignificant positive association between board size and financial performance of the 29 selected Palestinian companies from Palestine Exchange in 2015. It suggests that there is no relation between board size and financial performance as measured by ROA and ROE. The findings are, however, consistent with the recent findings by Farkhanda (2015); Gillani et al., (2014); Bino and Tomer (2012) and Topak (2011) that showed there is no association exists between board size and financial performance.

In addition, contradictory to the prediction of the hypothesis of the research, this study reveals that an insignificant positive relationship between audit committee independence and financial performance of the 29 selected Palestinian companies from Palestine Exchange in 2015. It suggests that there is no relation between audit committee independence and financial performance as measured by ROA and ROE. The findings are, however, consistent with the recent findings by Barnes et al. (2015); Al-Matari et al. (2014); Al-Matari et al. (2012); Dar et al. (2012) and Ghabayen (2012) that reported there is no association exists between audit committee independence and financial performance.

Additionally, Contrary to the prediction of the agency theory and the resource dependence theory, this study finds a statistically significant positive association between audit committee financial expertise and financial performance as measured

by ROA and ROE. The findings of this study suggest that there is a relation between audit committee financial expertise and financial performance. The findings are, however, consistent with the recent findings by Ismail and Kamarudin (2014); Obigbemi and Ojeka (2013) and Zied Bouaziz (2012) that reported there is a positive association exists between audit committee financial expertise and financial performance.

Also, contradictory to the prediction of the hypothesis of the research, this study finds that an insignificant negative and positive association between audit committee meetings and financial performance (ROA and ROE respectively) in 2015. It proposes that there is no relation between audit committee meetings and financial performance as measured by ROA and ROE. The findings are, however, consistent with the recent findings by The findings are, however, consistent with the recent findings by Al-Matari et al. (2014); Al-Matari et al. (2012); Mohd (2011); Huang (2008) and Rebeiz and Salameh (206) that reported there is no association exists between audit committee meetings and financial performance.

Finally, contradictory to the prediction of the hypothesis of the research, this study finds that an insignificant positive association between audit committee size and financial performance of the sampled Palestinian companies listed in Palestine Exchange in 2015. It proposes that there is no relation between audit committee size and financial performance as measured by ROA and ROE. The findings are, however, consistent with the recent findings by AL-Sahafi et al., (2015); Ghabayen (2012); Mohd (2011) and Islam and Nuryanah (2011) that concluded there is no association exists between audit committee size and financial performance.

4.4 Discussions

4.4.1 Board of Directors' Characteristics and Financial Performance

4.4.1.1Board Independence

Contrary to the prediction of the agency theory and the resource dependence theory, this study finds a statistically insignificant positive association between board independence and financial performance as measured by ROA and ROE. The findings of this study suggest that there is no relation between board independence

and financial performance. These findings are, however, similar to the earlier papers by Costa,2015; Wang,2014; Wei,2007;Bhagat and Black,2002;Dalton et al.,1998 and Baysinger and Butler,1985 in the developed countries and the same findings by AL-Matari et al.,2012; Chugh et al., 2011 that reported there is no association between board independence and financial performance. This may be explained in reference to the study done by Bar-Yosef and Prencipe (2009), who argued even if formally independent, board members may have implicit ties to the controlling-family; therefore, these board members may not be effectively independent. This also may suggest that that the problem can be the criteria for choosing directors. Independent director's selection is important because they must give professionalism to the board. Therefore, they should be selected carefully in order to be adequately qualified to carry out the responsibilities, but in the study's sample, most companies are family-owned with family members holding key positions and large portions of shares

In addition to above discussions, the possible explanations for this result might be that the independent directors primarily play an advisory role not their monitoring role in the companies. They are commonly part-time workers; this will undermine their ability to monitor and advise the board because of the lack of the information that they have which will reduce the independent director's ability to apply their functions efficiently. In addition, because they are part- time workers they are less incentivized to fulfill their responsibilities. Also, they might have other commitments which might affect their devotion to undertake effective monitoring. Furthermore, they might be unfamiliar with all the operations and business in the company. Finally, there might be some private connections between the chief executive director and the independent directors which, therefore, might reduce the contributions of the latter. This is especially the case if they have been appointed for long periods in the company.

4.4.1.2 Board Size

Contrary to the prediction of the agency theory and the resource dependence theory, this study finds a statistically insignificant positive association between board size and financial performance as measured by ROA and ROE. The findings of this study suggest that there is no relation between board size and financial performance.

The findings are, however, consistent with the recent findings by Farkhanda (2015); Gillani et al., (2014); Bino and Tomer (2012) and Topak (2011) that reported there is no relationship between board size and financial performance.

In terms of board size, the research findings can't reveal any significant impacts of the board size on firm performance. Boards in Palestinian firms are generally heavily dominated by large block holders, typically members of a single family or a group of families (Ahmed, 2010). This might result in the appointment of management and members for the board on the basis of friendship and nepotism rather than experience and skills. Such group can use their power to influence management decisions and undermine the monitoring and coordination of the board.

4.4.2 Audit Committees' Characteristics and Financial Performance

4.4.2.1 Audit Committee Independence

Contrary to the prediction of the agency theory and the resource dependence theory, this study finds a statistically insignificant positive association between audit committee independence and financial performance as measured by ROA and ROE. The findings of this study suggest that there is no relation between audit committee independence and financial performance. The findings are, however, consistent with the recent findings by Barnes et al. (2015); Al-Matari et al. (2014); Al-Matari et al. (2012); Dar et al. (2012) and Ghabayen (2012) that showed there is no association between audit committee independence and financial performance.

4.4.2.2 Audit Committee Financial Expertise

Contrary to the prediction of the agency theory and the resource dependence theory, this study finds a statistically significant positive association between audit committee financial expertise and financial performance as measured by ROA and ROE. The findings of this study suggest that there is no relation between audit committee financial expertise and financial performance. The findings are, however, consistent with the recent findings by Ismail and Kamarudin (2014); Obigbemi and Ojeka (2013) and Zied Bouaziz (2012) that reported there is a positive association exists between audit committee financial expertise and financial performance.

4.4.4.3 Audit Committee Meetings

Contrary to the prediction of the agency theory and the resource dependence theory, this study finds a statistically insignificant positive association between audit committee meetings and financial performance as measured by ROA and ROE. The findings of this study suggest that there is no relation between audit committee meetings and financial performance. The findings are, however, consistent with the recent findings by Al-Matari et al. (2014); Al-Matari et al. (2012); Mohd (2011); Huang (2008) and Rebeiz and Salameh (206) that reported there is no association exists between audit committee meetings and financial performance.

4.4.2.4 Audit Committee Size

Contrary to the prediction of the agency theory and the resource dependence theory, this study finds a statistically insignificant positive association between audit committee size and financial performance as measured by ROA and ROE. The findings of this study suggest that there is no relation between audit committee size and financial performance. The findings are, however, consistent with the recent findings by AL-Sahafi et al., (2015); Ghabayen (2012); Mohd (2011) and Islam and Nuryanah (2011) that reported there is no association exists between audit committee size and financial performance.

According to the characteristics of audit committees, the study came to the following conclusions:

- The first conclusion the researcher reached is that not all the companies listed on Palestine Exchange have a separate audit committee, with clearly defined responsibilities. All the companies selected in the sample have a separate audit committee, with clearly defined responsibilities. It is obviously that the managers of Palestinian companies do not understand the necessity of an audit committee in corporate governance.
- Most companies listed on Palestine Exchange do not publish information about the role of audit committee. This hinders annual statements users of understanding the role of the audit committee within the company.

- It is also observed that some companies that listed on Palestine Exchange which have an audit committee do not publish its composition and the information related to the expertise of the audit committee members.
- The responsibilities of the audit committee are not met by some companies listed on Palestine Exchange because they lack the appropriate skills and experience and thus their role is not effective.
- The study reveals that there is a positive relationship between audit committee financial expertise and financial performance as measured by ROA. This result may be explained through the fact that the researcher in the measurement of audit committee financial expertise took only members who just read the financial statements and not the required financial expertise.
- Regarding the number of meetings of the audit committee, the sampled companies hold a mean of 3 meetings in a year and this number is not sufficient. Besides, in relation with committee meetings, we can analyze other aspects, such as how far in advance the members receive the agenda and the information needed to properly prepare the meetings. Therefore, the analysis of this aspect will give an idea of whether the members have sufficient time to analyze the material received and prepare the meetings. Otherwise, these meetings can turn into purely informative, as the chairman set out the points of the day and members can hardly take part or exposed his points of view if they have not had time to consider the information received. Most firms in the sample give the information needed to prepare the meeting with just less time than a week. With this information it seems that the sample's firm could have passive boards. As a general conclusion, it can be seen that the companies listed on Palestine Exchange are not aware of the significant role of the audit committee within corporate governance, especially for a company listed on a stock exchange.
- This study also does not document any significant relationship between audit committee size and financial performance of selected Palestinian companies in Palestine Exchange, in 2015. This result may be explained through the fact that audit committees in the sampled companies are not considered as important control bodies. The findings may be attributable to the ownership structure of Palestinian corporations, which are concentrated in the hands of family members

making greater representation of audit committee members, who it is argued lack financial expertise. Consequently, this raises concerns of the effectiveness of some requirements such as calls for a majority of independent members when there is a scarcity of qualified independent members and also given the fact that family controlled firms are dominant in Palestinian corporations.

Chapter 5
Summary and Conclusions

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5.1 Introduction

The purpose of this chapter is to reflect on the findings and the suggestions for future research. It is organized into four sections: in addition to this section, the second one summarizes the overall findings of this study, while the third section addresses the potential implications of the study, followed by the several possible avenues for further researches in section four. The last section concludes the chapter with brief conclusions.

5.2 Summary

Corporate governance has been a hot issue in financial literature since some major financial manipulation and corporate frauds were observed due to lack of disclosure , poor audit and governing structure in large firms like Enron and World Com. Till then, corporate governing bodies and board committees are putting more emphasis on designing and implementing a strong corporate governance mechanisms. Majority of the researchers are of the view that an effective governance as an internal control structure will force the managers to work in the best interest of the firm owners by providing full and accurate information on time. Moreover, a good corporate governance system will ensure that managers are accepting only those projects that maximize the wealth of the shareholders thus resolving the inherent agency issue to a greater extent (Gupta & Sharma, 2014).

Developed countries have taken the lead in designing and implementing corporate governance than developing ones. If we look into the literature review, we can easily find that a lot of work is done on how to design and implement an effective governance structure in a corporate setting. From the developed countries perspective work is also done to establish a corporate governance rating system to evaluate how well the firms are doing to ensure good corporate governance (Akbar, 2015).

This study examines the effects of corporate governance as an internal control system on the financial performance of some selected Palestinian companies listed in the Palestine Exchange, in 2015. To measure the effect of corporate governance as an internal control system, this study employs the board of directors' characteristics (board independence and board size) and the audit committees' characteristics (audit committee independence, audit committee financial expertise, audit committee meetings and audit committee size).

There are many proxies that are used to measure the financial performance of companies, but this study uses two financial measures of firm performance: return on asset and return on equity which also fits into accounting-based measures. Return on assets (ROA) measures how effectively the firm's assets are used to generate profits net of expenses. This is an extremely useful measure of comparison among firms' competitive performance; it is the job of managers to utilize the assets of the firm to produce profits. Return on equity (ROE) measures the net return per dollar invested in the firm by the owners, the common shareholders.

To see the impact of the board of director's characteristics and the audit committee's characteristics on the financial performance of companies, a total of 29 companies listed in the Palestine Exchange, over the year 2015, with complete data, were selected. A quantitative research that is based on descriptive statistics and multiple regressions has been adopted to answer the six specific hypotheses developed in this study.

From the analysis conducted, it reveals that there is a statistically significant correlation between audit committee financial expertise and return on assets. Otherwise, there is no correlation between any independent variables and either ROA or ROE controlling for any permutations for firm size, leverage and big 4. These results are consistent with previous studies like AL-Matari et al. (2014), AL-Matari et al. (2012), Ghabayen, 2012 and Dar et al., (2011).

5.3 Implications of Study

The adoption of corporate governance principles is a giant step towards creating safeguards against corruption and mismanagement, promoting transparency in economic life and attracting more domestic and foreign investment. In addition an effective program to combat corruption is also capable of protecting shareholder value is an important requirement for improvement of corporate governance practices in Palestine (Aduda, Okiro & Omoro, 2015). The Palestinian companies have to focus on improving their corporate governance practices, which will lead to enhance their firm's value. The study has empirically examined the relationship that exists between corporate governance as an internal control system and firm Performance using some selected firms listed on the Palestine Exchange. The study therefore recommends that:

1-Implications for Theory

The findings of this study generally show that (board independence, board size, audit committee independence, audit committee meetings and audit committee size) are not related to financial performance. Daily et al. (2003) argued that corporate governance literature stems from a wider range of theoretical perspectives such as the resource dependence theory, the legalistic perspective, the institutional theory as well as the stewardship theory and that these theoretical perspectives are intended to complement the agency theory. As suggested by Bevir & Rhoades (2001), it is important for the researcher to study the role of the board of directors and audit committees through multiple theoretical approaches. Although the agency theory predictions dominate corporate governance studies, describing other alternative theories will be an important step towards gaining further understanding of the relationship between board effectiveness and financial performance. Therefore, it is significant to re-visit corporate governance in the light of the conjunction of alternative theories with a fresh angle, which has a universal view and incorporating subjectivity from the perspective of social sciences.

2- Implications for Policymakers

- This study will benefit policy makers and the Palestinian Capital Market Authority by clarifying the status and the limitations of the current corporate governance code. In addition, the researcher is motivated to help expand the very limited existing research on an environment characterized by severe political and economic circumstances and a lack of control over major economic and fiscal policy instruments. It is important to periodically review corporate governance practices to ensure they continue to reflect local and international developments and promote high standards of transparency about the corporate governance practices of listed entities.
- Also, it recommends the Capital Market Authority to issue a stricter enforcement of legislations of corporate governance, with special measurements on those evading them. In Palestine, the administrative and financial oversight bureau still lacks the authority to monitor private sector companies. This is an activity which needs to be taken into account when, for a better performing business sector, it comes to compliance with corporate governance.
- Since Palestinian independent directors are argued to have a lack of expertise, skills and knowledge to understand financial reporting details, it is important for Palestine Exchange to ensure that all directors fully attend the continuing education program to enhance the competency and professionalism of the directors in performing and thereby enabling them to discharge their duties more effectively. The steps taken by the Palestine Exchange requiring listed companies to disclose whether their directors have attended such training in the annual reports for financial year-end of 31 December onwards may be seen as a step in the right direction.
- The study further recommends that the governing body, possibly supported by the audit committee, should ensure that the internal control system is periodically monitored and evaluated. Additionally, the necessity of activating the role of audit committees in Palestinian corporations through clearer legislative and regulatory instructions and by expanding the powers of audit committees. More explicit texts can be added on setting an upper limit to the proportion of the ownership of the members of the board and the committee of the shares of the company because

those things strengthen the independence of the board of directors and the audit committee, thereby increasing their monitoring and supervisory role in the company.

- Additionally, family controlled firms are dominant in Palestinian corporations, the findings of this study support the call to address the implementation of corporate governance mechanisms that are most appropriate for the institutional context of Palestine.

3-Implications for companies and shareholders

- Companies should ensure that majority of their board members are independent meaning that the directors are not employees of the company and do not depend on it for their livelihood so that they can fearlessly and honestly monitor the activities and provide their expertise in the best interest of the company.
- Companies should have adequate board size to the scale and complexity of the company's operations and be composed in such a way as to ensure diversity of experience without compromising independence, compatibility, integrity and availability of members to attend meetings. The board size should not be too large and must be made up of qualified professional who are conversant with oversight function.
- Corporations should establish evaluation procedures where contributions and results of the board of directors and its committees, as well as collaboration with the executive board are annually evaluated. Significant changes deriving from the evaluation should be included in the management commentary or on the company's website.
- With respect to meeting frequency, the minimum number of meetings to be held by the audit committee should be increase from three to at least four. This will promote audit committee activity level and ensure that the committee meets to consider financial reports quarterly. Finally, there should be regulatory provision that considers a member who is absent for more than one meeting in the year as inactive therefore requiring for the replacement of the member. This would likely ensure greater members attendance at meetings.

- Companies should provide shareholders with periodic reports on changes affecting shareholders in the company, and held regular meetings with members of the board of directors ensuring that their role done effectively.
- Companies should publish the manual rules of corporate governance and distributing them to the public in order to benefit from the application of rules by the management and employees and the various activities of the company.

The results presented in this study could be useful to management and shareholders who are concerned with improving financial reporting quality and corporate governance practices in their firms. It should create awareness for both management and shareholders of the importance of best corporate governance practices in enhancing the quality and credibility of their financial reporting quality.

4-Implications for Academics

- The findings of this study are useful in establishing a starting point for empirically exploring the importance of various boards of directors' characteristics and audit committees' characteristics in Palestine. The results presented in this study could be useful to academic researchers studying corporate governance and financial performance worldwide. It will be of great need to assess whether the findings of this study will hold for a period of time span or if the findings will vary with the period under study.

5.4 Suggestions for Future Research

Extension to the current study is possible in the following areas:

- The findings of this study encourage further investigation of the nature and the quality of the roles played by board of directors and audit committees, to establish a more complete picture between the board's and committee's characteristics and financial performance. Specifically, the financial expertise and the backgrounds of such players and its impact on financial performance should be further explored.

- Further studies could explore in more depth the effect of various board committees (e.g., audit, remuneration and nomination committees) on the firm performance.
- Future research could be carried out with a large number of governance variables and data pertaining at least to three years.
- Future research could also explore on board, audit committee characteristics and firm performance by using different research method. Semi structured interviews for example with members will provide further insights on the effects of board, audit committee characteristics and firm performance.
- Conduct further studies and taking into consideration other sectors in Palestine.
- Finally, future research should focus on assessing corporate governance mechanisms and firm performance from the perspective of different stakeholders' perspective such as employees, management, shareholders and depositors of commercial banks.

5.5 Conclusion

The present study was pursued as an attempt to investigate the roles of the board of directors, audit committee and financial performance for Palestinian companies listed in the Palestine Exchange. Generally, this study suggests that corporate governance characteristics as an internal control system are important for improving the financial performance of the Palestinian companies. Nevertheless, the study tries to provide a strong support for the role of board and audit committee characteristics in enhancing the firm performance in Palestine. Perhaps, this study is the first to examine the association between the characteristics of the board, the committee and the financial performance that explicates the distinctive institutional context of Palestine.

Results appear inconclusive and detection of trends among the studies in Palestine is almost contrasting. This may be due to the transition phase through which the Palestinian Companies are passing after the enactment of code of corporate governance in 2008 or it may be traced back to the fact that Palestine has

an incomplete legal infrastructure and the lack of an efficient stock market (El Jafary & Makhool, 2014).

In Palestine, it has been put into place various legislations regarding corporate governance practices and disclosure norms but is not able to fully implement it due to the power concentration in the hands of family run businesses. The application of corporate governance practices will surely help the Palestinian firms in establishing a positive impact on various firm level performance measures. The findings of the study serve as a wake-up call for setting in motion the reform process for improved financial performance and more independent boards and committees.

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Appendix

Control Variable - Firm Size		ROA	ROE
BOD_INDE	Correlation	0.258	0.068
	Significance	0.093	0.366
BOD_Size	Correlation	0.016	0.013
	Significance	0.468	0.473
AC_INDE	Correlation	-0.042	-0.078
	Significance	0.417	0.347
AC_Financial_Expertise	Correlation	0.093	-0.055
	Significance	0.319	0.391
AC_MEET	Correlation	-0.163	0.038
	Significance	0.204	0.425
AC_Size	Correlation	0.100	0.094
	Significance	0.307	0.317

Control Variable – Leverage		ROA	ROE
BOD_INDE	Correlation	0.274	0.132
	Significance	0.079	0.251
BOD_Size	Correlation	0.016	-0.040
	Significance	0.469	0.419
AC_INDE	Correlation	0.190	0.046
	Significance	0.166	0.408
AC_Financial_Expertise	Correlation	0.133	-0.054
	Significance	0.251	0.393
AC_MEET	Correlation	-0.002	0.059
	Significance	0.496	0.384
AC_Size	Correlation	0.004	0.057
	Significance	0.491	0.386

Control Variable- Big 4		ROA	ROE
BOD_INDE	Correlation	0.317	0.190
	Significance	0.050	0.166
BOD_Size	Correlation	-0.007	0.033
	Significance	0.485	0.434
AC_INDE	Correlation	0.128	0.160
	Significance	0.258	0.209
AC_Financial_Expertise	Correlation	0.152	0.120
	Significance	0.220	0.272
AC_MEET	Correlation	-0.069	0.218
	Significance	0.363	0.133
AC_Size	Correlation	0.067	0.125
	Significance	0.367	0.263

Control Variables - Firm Size and Leverage		ROA	ROE
BOD_INDE	Correlation	0.085	0.016
	Significance	0.337	0.468
BOD_Size	Correlation	0.264	0.069
	Significance	0.091	0.367
AC_INDE	Correlation	0.002	-0.067
	Significance	0.495	0.370
AC_Financial_Expertise	Correlation	0.225	-0.032
	Significance	0.130	0.437
AC_MEET	Correlation	0.110	0.116
	Significance	0.292	0.282
AC_Size	Correlation	0.039	0.077
	Significance	0.423	0.351

Control Variable - Firm Size and Big 4		ROA	ROE
BOD_INDE	Correlation	0.285	0.142
	Significance	0.075	0.240
BOD_Size	Correlation	0.044	0.099
	Significance	0.414	0.311
AC_INDE	Correlation	-0.017	-0.010
	Significance	0.466	0.479
AC_Financial_Expertise	Correlation	0.171	0.142
	Significance	0.197	0.240
AC_MEET	Correlation	-0.126	0.179
	Significance	0.265	0.186
AC_Size	Correlation	0.141	0.222
	Significance	0.241	0.132

Control Variables - Big 4 and Leverage		ROA	ROE
BOD_INDE	Correlation	0.294	0.215
	Significance	0.069	0.140
BOD_Size	Correlation	0.028	0.012
	Significance	0.445	0.476
AC_INDE	Correlation	0.210	0.126
	Significance	0.146	0.266
AC_Financial_Expertise	Correlation	0.180	0.107
	Significance	0.184	0.297
AC_MEET	Correlation	0.023	0.181
	Significance	0.456	0.183
AC_Size	Correlation	0.024	0.157
	Significance	0.452	0.217

Control Variables - Firm Size , Leverage and Big 4		ROA	ROE
BOD_INDE	Correlation	0.116	0.089
	Significance	0.287	0.333
BOD_Size	Correlation	0.310	0.168
	Significance	0.061	0.205
AC_INDE	Correlation	0.034	0.003
	Significance	0.434	0.494
AC_Financial_Expertise	Correlation	0.335	0.176
	Significance	**0.047***	0.195
AC_MEET	Correlation	0.179	0.288
	Significance	0.191	0.077
AC_Size	Correlation	0.088	0.206
	Significance	0.334	0.157