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Audit Committee Effectiveness
- from the Perspective of Audit Committee Members in New Zealand Listed Companies

A thesis
Submitted in partial fulfilment
Of the requirements for the degree of
Doctor of Philosophy

At Lincoln University
By
Julia Yonghua Wu

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Abstract of a thesis submitted in partial fulfilment of the requirements for the Degree of Ph.D

Audit Committee Effectiveness
- from the Perspective of Audit Committee Members
in New Zealand Listed Companies

by
Julia Yonghua Wu

This study examines audit committee effectiveness from the perspective of audit committee members of New Zealand listed companies. Using a responsive interviewing technique, data were obtained from 21 semi-structured, questionnaire-based interviews with current audit committee members. The data were analysed using a qualitative approach, namely, reflective analysis. The research results revealed that performing audit committee duties is an intended process, comprising at least two distinctive intentional orientations, in terms of which audit committee members tend to justify the effectiveness of their respective audit committees. Therefore, investigating audit committee members’ intentional sense-making processes behind their audit committee activities can be argued to be of value in understanding the effectiveness of an audit committee. The research reveals that the audit committee acts as an instrument for the board of directors and the findings challenge several public expectations of audit committees, most noticeably the notion of ‘independence’. The study illustrates the potential value for corporate governance stakeholders in considering the individuality of audit committee members, within the context of their specific organisations, in promoting corporate governance best practice.

Keywords: Audit committee effectiveness, listed companies, New Zealand, corporate governance, board of directors, accountability, compliance, auditing, financial reporting, interviews, qualitative research
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Chapter One: Introduction

1.1 Research background

1.1.1 Audit committees and global corporate governance reforms

Audit committee effectiveness has been a focus of international corporate governance reform for many years. Kalbers and Fogarty (1998) suggested that the genesis of audit committees as a part of corporate governance structure is rooted in the reactions to the abuse of power by corporate management which led to financial scandals, financial reporting defalcations, and unjustifiable manipulation of accounting policies.

Discussion of the impact of audit committees on listed companies dates back to 1938, following the United States (US) Supreme Court’s decision in the Securities and Exchange Commission (SEC) vs McKesson and Robbins Inc. case on fraudulent financial reporting (Markham, 2006). The company recognised assets and earnings of $19 million through fictitious inventories and sales. One of the recommended practices that emerged from the McKesson-Robbins scandal was the New York Stock Exchange’s (NYSE) and the SEC’s endorsement of establishing audit committees in listed companies to improve the integrity of corporate financial information in 1939 and 1940 respectively.

The interest in audit committee effectiveness came to the attention of the SEC again following a series of lawsuits involving companies’ directors in corporate financial frauds and misconduct in the late 1960s and 1970 (DeZoort, 1997). The scandals involved financial reporting misstatement on a massive scale, for example, the collapse of the Investors Overseas Services (Markham, 2006). In 1970, the SEC recommended that all listed companies must establish audit committees that include independent directors. Then, in 1972, the SEC further recommended that audit committees should meet annually (U.S. SEC, 1972). Listed companies in the United States were also required to disclose compliance with the above requirements in their proxies (U.S. SEC, 1974). According to Birkett (1986), the increased adoption of audit committees in the US corporations in 1970s was the result of joint promotion efforts by the Congress, the SEC and the accounting and legal professions. At the same time, the audit committee mechanism started to garner the attention of scholars. Studies show that the percentage of firms with audit committees in the USA went from nearly ten percent in 1958 to nearly forty percent in 1972, to over ninety percent in 1982 (Harrison, 1987).
Once again in the 1990s, as in the 1970s, earnings management and creative accounting practices were discovered in corporations and investigated as a threat to market integrity associated with corporate governance (Harrast & Mason-Olsen, 2007). A number of research projects sponsored by practitioners or government bodies were published, for example, the Blue Ribbon Committee (1999) in the United States; the Cadbury Committee (1992) in the United Kingdom (UK); and the Dey Committee (1994) in Canada. Simultaneously, several survey studies were published by international accounting firms, for example, PricewaterhouseCoopers (Dooley, 1993) and KPMG (1999), calling for more effective audit committees.

The Sarbanes-Oxley Act of 2002 required - for the first time at a statutory level - all listed companies in the United States to establish an audit committee as a subcommittee of the board of directors (Sarbanes-Oxley Act of 2002, SEC2 - Definitions). It established a mandatory requirement for the audit committee to have at least one financial expert and prescribed the audit committee’s role in ensuring the auditor’s independence (Sarbanes-Oxley Act of 2002, Title II - Auditor Independence) and in overseeing corporate financial reporting responsibilities (Sarbanes-Oxley Act of 2002, Title III - Corporate Responsibility).

One of the expectations of the implementation of the Sarbanes-Oxley Act of 2002 was to enhance the audit committee’s functioning and effectiveness in monitoring the corporate financial reporting process (Vera-Muñoz, 2005). However, some argued that the legislation was passed in anger and haste in responding to the confidence crisis caused by the financial scandals at Enron and WorldCom (Nordberg, 2008). Furthermore, McDonnell describes the Sarbanes-Oxley Act of 2002 as “an appealing reform” (McDonnell, 2008, p. 1) for financial reporting stakeholders, but it suffers from a lack of innovation and substance (Cunningham, 2002). Despite inconsistent comments about the impact of the Sarbanes-Oxley Act of 2002, the Act triggered a new round of corporate governance reforms on a global scale. Its key provisions have been reflected in recent regulatory reforms in other large capital markets in Asia, Europe and Latin America (Tafara, 2006).

Audit committee effectiveness is one of the key emphases of this international corporate governance reform. The requirements for audit committee composition and functioning on almost all stock exchanges have become more prescriptive and more
rigorous. Some commentators state that these requirements have been applied as a box-
ticking approach (Davis, 2002; Barma, 2007).

Have the audit committees indeed prevented or reduced the occurrence of
management abuse of power in corporate settings? In other words, has the effectiveness
of audit committees been proven? According to Kalbers and Fogarty (1998), an audit
committee, as a bureaucratically established corporate governance structure, did not
naturally result in effectiveness; therefore, the presumption that corporate governance
could be improved by adopting audit committees did not necessarily follow. The
inconsistent and inconclusive empirical evidence about the effectiveness of audit
committees will be discussed in detail in Chapter Two, Literature Review.

Given that the effectiveness of audit committees has not been proven, if listed
companies disclose all aspects of their audit committees in accordance with stock
exchange requirements, is this evidence of compliance with regulation, or is it evidence
of having effectively functioning audit committees? What substantially makes an
effective audit committee? These and other similar questions motivated this research.

1.1.2 Overview of the existing body of knowledge regarding audit committees

The audit committee, as one of the most important elements of corporate
governance, has been the subject of much discussion by practitioners and policy makers,
and researched by scholars.

The existing literature on audit committees can be characterized as: (1) theoretical
hypotheses adopted from its contextual areas, for example, agency theory is applied in
corporate governance research and stewardship theory is applied in studies of firms’
directors; (2) being dominated by empirical research drawing upon archival data
(DeZoort, Hermanson, Archambeault, & Reed, 2002); and (3) the research results
represent a considerable level of inconsistency and are thus inconclusive (Spira, 1998).
Little research, however, has examined the perceptions that audit committee members
have – particularly about their audit committees’ responsibilities and the factors that assist
them to carry out their audit committee functions effectively.

1.1.3 Audit committees in New Zealand listed companies

Although studies of audit committees in New Zealand date back to the 1990s, they
have been sparse (Bradbury, 1990; Porter & Gendall, 1998). The studies share the same characteristics as existing audit committee research in other countries, namely, they have a single paradigm and are dominated by empirical studies (Turley & Zaman, 2004; DeZoort et al, 2002).

Audit committee developments in New Zealand reflect the international impact of corporate governance reforms. While the adoption of these practices in New Zealand companies appears to be comparatively slow, the movement to improve overall organizational accountability in New Zealand is emerging as well as anywhere in the world (Bradbury, 1990).

After an extensive process of public consultation, the New Zealand Securities Commission released Corporate Governance in New Zealand Principles and Guidelines (the Principles) in February 2004. The Principles consulted the existing corporate governance research that was done in New Zealand and overseas, and recognised that New Zealand must heed policies and practices in other countries and ‘aspire to standards of behaviour consistent with rising expectations in international capital markets’ (The Securities Commission, New Zealand, 2004). The Principles do not impose any new legal obligations on New Zealand issuers. This is because the Principles recognise that ‘different types of entities can take different approaches to achieving good corporate governance. Good governance practices should reflect the nature of each entity, its ownership structure, and the range and interests of stakeholders’ (The Securities Commission, New Zealand, 2004). However, the Commission expects boards of directors of listed companies to observe and to report to their investors and other stakeholders about the application of the Principles.

The Principles have a separation section regarding board committees. Principle 3.4 provides that publicly owned companies should establish audit committees comprising only non-executive directors, a majority of whom are independent, with at least one director who is a chartered accountant. Meanwhile the audit committee chairperson should be an independent director, who is not the chairperson of the entire board. According to the New Zealand Securities Commission, the responsibilities of an audit committee include recommending the appointment of external and internal auditors; overseeing the entity-auditor relationship; and promoting the integrity of the entity's financial reporting (The Securities Commission, New Zealand, 2004).
Simultaneously, the New Zealand Exchange (NZX) released its new corporate governance regime on 15 August 2003. The regime is in the form of a Corporate Governance Best Practice Code (the Code) and a number of governance-focused amendments to the NZX Listing Rules. The framework for the regime adopted by the NZX is a mix of prescriptive and disclosure-based rules. The amendments to the Listing Rules require listed companies to compose their boards of directors in a certain way and impose certain rules around the composition and operation of a listed company’s audit committee. The Code is a model for best practice. Compliance with the Code is voluntary (NZX Ltd, 2003).

Both the Principles and the Code have the objective of bringing New Zealand markets into line with other developed countries’ security markets. Both the Principles and the Code emphasise the importance of establishing audit committees in publicly owned companies. It is noteworthy that the Principles, however, specify that the accountability of the board as a whole must be maintained, including in relation to work undertaken by committees. In other words, board committees, including audit committees, do not bear separate accountability. The Code also recognises that good corporate governance practices lie ultimately in the accountability of company directors, instead of with any particular regulatory requirement per se.

The assumptions underlying this research are in line with the tone of the NZX, namely that:

(1) An effective audit committee is crucial for good corporate governance; and

(2) Audit committee effectiveness lies ultimately in the conduct of the committee members (NZX Ltd, 2003).

1.1.4 Research objective

This is a positive research study which uses a qualitative method to expand the existing body of knowledge on audit committee effectiveness. The objective of the study is to enhance understanding of the qualitative factors that give rise to an effective audit committee and to enrich the discussion of how to evaluate the contribution of audit committees to listed companies. The study argues that the effectiveness of an audit committee ultimately lies in the attributes and conscious efforts of its committee
members. The study contributes to the general research problem ‘what gives rise to an effective audit committee?’ by providing several insights and explanations. It is hoped that this study will encourage further and broader investigation into the many aspects, including an effective audit committee, which contribute to improved corporate governance for companies.

1.2 Statement of research questions

In dismissing the New Zealand Registrar of Companies’ lawsuit against the directors of the iconic New Zealand company - Feltex, in August 2010, Judge Jan Doogue ruled that the board of directors, including the four members of its audit committee, had acted with sufficient care, but blamed the company’s accounting firm Ernst & Young (E&Y). Feltex had been placed in receivership and then liquidation in 2006, two years after listing on the NZX. Judge Doogue said, “Having engaged E&Y to act as the company’s international financial reporting standards (IFRS) advisers, the directors could legitimately expect that the review would pay particular attention to ensuring that the IFRS requirements were met. Questions asked by members of the Feltex board’s audit committee demonstrated this, as did the fact that the express purpose of the IFRS review sought by Feltex was ‘restoring Feltex’s credibility in the market as recommended by E&Y’” (Krause, 2010). If an effective audit committee is expected to enhance the integrity of financial reporting and the independent audit, it needs to be asked why a diligent audit committee - as ruled by the judge - could not prevent the company’s auditors from issuing an unreliable opinion.

As stated previously, the motivation for this research is to answer the general research problem: “What gives rise to an effective audit committee?” It is an exploratory study that aims to identify qualitative factors that contribute to an audit committee’s effectiveness in carrying out its function. The general research problem is investigated by answering four interrelated, specific research questions:

(1) What do audit committee members perceive the desired objectives of an audit committee to be?

(2) What do the members bring to an audit committee in order to achieve its desired objectives?
(3) How do members help attain the desired audit committee objectives?

(4) How do members assess the extent to which the audit committee objectives have been achieved?

The relationship between the four research questions is illustrated in Figure 1-1.

1.2.1 Research question 1: what do audit committee members perceive the desired objectives of an audit committee to be?

This question is designed to investigate audit committee members’ perceptions of the role of the audit committee within the context of their company. It is not only aimed at obtaining an account of the responsibility of the audit committee, but also at understanding what the important factors or events for individual members are in linking the role of the audit committee to a specific organisational setting and to the member’s role.

1.2.2 Research question 2: what do the members bring to an audit committee in order to achieve its desired objectives?

This question is designed to gain an insight into: (1) how audit committee members explain their own presence in their specific audit committee; and (2) how they justify this to match the committee’s role as identified in research question 1. This research question, unlike other audit committee quantitative research studies, does not assume that independence and financial expertise are the desirable attributes for being an audit committee member, but provides an opportunity for actual audit committee members to openly discuss what has helped them in performing their audit committee roles.
Research question 1: What do audit committee members perceive the desired objectives of an audit committee to be?

Research question 2: What do the members bring to an audit committee in order to achieve its desired objectives?

Research question 3: How do members help attain the desired audit committee objectives?

Research question 4: How do members assess the extent to which the audit committee objectives have been achieved?

1.2.3 Research question 3: how do members help attain the desired audit committee objectives?

Further to research question 2, research question 3 goes beyond the members’ personal attributes. It is designed to investigate members’ observations from their experiences on how they use the delegated audit committee authority and facilities to achieve the desired outcomes. The emphasis is not only on those authorities and facilities *per se*, but also on the members’ perceptions of the cause-and-effect relationships between those authorities and facilities and their audit committee responsibilities.

1.2.4 Research question 4: how do members assess the extent to which the audit committee objectives have been achieved?

The aim of research question 4 is not to document an assessment of the audit committees’ performance, but to understand how, i.e. from what perspective(s), members of the audit committee determine the extent to which they believe that their duties have been fulfilled and how they justify this belief, or degree of comfort. This research
question provides an area for in-depth discussion of the main reasons for the presence of audit committees in firms.

The rationale for the development and selection of these four specific research questions is discussed in Chapter Four, Research Design and Data Collection.

1.3 Organisation of the study

This thesis consists of seven chapters.

Chapter One is an introductory overview of the research. It explains the background that motivated this research. The research objective and the statement of the research questions in the chapter outline the general and the four interrelated, detailed research questions.

Chapter Two, titled “Literature Review”, serves two purposes. Firstly, the review of the empirical audit committee literature to date aims to identify gaps in the existing body of knowledge. Secondly, the review of research methodologies is intended to justify the choice of the research design.

Chapter Three describes and explains the theoretical framework on which the study is based. It discusses, inter alia, sociological and positive accounting theories that guide the gathering, analysis, and interpretation of the qualitative data, and the audit committee theories which underpin the interview questions.

Chapter Four describes and explains the research design, the data collection method, the interview questionnaire design, and the protocol of the interviews. The chapter also describes the interview and data collection processes.

Chapter Five explains the data analysis process.

Chapter Six documents the research results and discussions.

Chapter Seven, the final chapter, discusses the implications of the research from both a theoretical and a methodological perspective, specifies the limitations of the study, and identifies opportunities for future research.
Chapter Two: Literature Review

2.1 Introduction

There is a large body of previous research on audit committees. This literature needs to be reviewed to provide a foundation and a catalyst for this research. The purpose of this literature review is to examine the existing research studies on audit committees, with a view to identifying any gaps in the existing body of knowledge about audit committee effectiveness.

The literature review is divided into two sections:

1) Syntheses of audit committee literature

In this section, three syntheses of the audit committee literature by DeZoort, Hermanson, Archambeault and Reed (2002); Turley and Zaman (2004); and Bédard and Gendron (2010) are evaluated. Other corporate governance syntheses that are relevant to this research are also discussed.

2) Empirical research on audit committees subsequent to the Sarbanes-Oxley Act (2002)

In this section, empirical research studies published subsequent to the Sarbanes-Oxley Act (2002), hereafter SOX (2002), are examined and evaluated within a framework developed from the previous syntheses.

Although the existing research on audit committees has been dominated by empirical research, there is a growing trend for exploratory studies on audit committee operations and interactions with other parties within the corporate governance mechanism. The existing qualitative studies on audit committee effectiveness are discussed from the perspectives of background theory, research design, and their research results in Chapter Three, Theoretical Framework, in order to justify the originality of this research. Chapter Two focuses on the review of the empirical research on audit committees.
2.2 Syntheses of empirical audit committee literature

2.2.1. Overview

The large volume of corporate governance literature has produced several literature reviews on audit committees. A study by DeZoort, et al (2002) was the first systematic review of audit committee literature focusing on the factors contributing to audit committee effectiveness from an agency theory perspective. In contrast to DeZoort et al (2002), who focused on the factors contributing to audit committee effectiveness, Turley and Zaman (2004) synthesised the research on the impact of audit committee output on corporate governance. Bédard and Gendron (2010) have provided the most updated audit committee literature review, requesting future researchers to adopt different theoretical, methodological, and geographical points of view, rather than focusing solely on a positive accounting approach. In this section, the above three syntheses will be critically discussed in order to organise the existing audit committee research.

2.2.2. DeZoort et al (2002) – synthesis of the determinants of audit committee effectiveness

To organise the literature on the determinants of audit committee effectiveness, DeZoort et al (2002) developed a framework to classify the contributing factors of ‘an effective audit committee’ into four dimensions, namely composition, authority, resources, and diligence (p. 41). This framework is illustrated in Figure 2-1.

DeZoort et al (2002) asserted that an effective audit committee could protect stakeholders’ interests by ensuring reliable financial reporting, effective internal control, and high quality risk management (i.e. by way of the output of audit committees). DeZoort et al (2002) were the first to systematically summarise the audit committee characteristics that have been tested for establishing associations with audit committee effectiveness. Their framework demonstrated that an audit committees should be equipped with appropriate members, authorities, and resources (i.e. the process factor of audit committees) in order to achieve their effectiveness.
DeZoort et al (2002) identified several limitations of the empirical research. The measurement of the determinants of audit committee effectiveness suffered from a lack of meaningful substance, for example, the diligence of audit committees was only quantified by the frequency of meetings (p. 58). They believed that to enrich the measurements, observations should be the desirable data collection method rather than the use of archival records.

There are also limitations within the DeZoort et al (2002) synthesis per se. Firstly, the objective of an effective audit committee, defined as ‘to protect stakeholders’ interests’ (p. 39) reflects a public expectation. This objective is in line with the expectations of regulators and listing rules for the creation of audit committees, especially in public companies. Such assumptions are rooted in public perception, rather than being a matter of fact (Petra, 2005).

Secondly, a discussion of the meaning of ‘effectiveness’ in regard to an audit committee is missing from the DeZoort et al (2002) synthesis. Effectiveness literally means the ability to produce the expected outcome (Webster English Dictionary, 1987).
If effectiveness represents an ability to accomplish, then audit committee effectiveness should be explained as an ability, instead of a mere association between the characteristics and outputs of an audit committee.

As detailed in Chapter One, this research is aimed at obtaining an in-depth account of the beliefs and experiences pertaining to the effectiveness of audit committees in New Zealand listed companies. The research design addresses the above two limitations, firstly by investigating the perceptions of audit committee objectives held by audit committee members within the organisational context, instead of assuming public expectations. Secondly, the audit committee members provide an insight of the mechanism (including both the contributing factors and their ability to utilise these contributing factors) that they believe facilitates the attainment of their perceived audit committee objectives.

2.2.3. Turley and Zaman (2004) – synthesis of the audit committee effects on corporate governance

In contrast to DeZoort et al (2002), who focused on factors contributing to audit committee effectiveness, Turley and Zaman (2004) synthesised the impact on corporate governance as the output of the audit committee. They also developed a framework to organise the empirical research under review. The effects of audit committees were categorised in terms of: (a) the expectations that led to their establishment, and (b) the corporate governance effects represented by audit function, financial reporting quality, and firm performance. The Turley and Zaman (2004) framework may be represented as in Figure 2-2.

Without assuming that audit committees were adopted to fulfil a public expectation, Turley and Zaman (2004) pointed out that understanding the impact of audit committees could assist in formulating appropriate expectations about the audit committee function, based on which the effectiveness of audit committees could then be assessed.
Turley and Zaman (2004) criticised the empirical audit committee literature’s mixed results with respect to claims about the audit committee’s corporate governance effects. The unexpected testing results on audit committee impacts were not explained, for example, audit committees’ presence was not associated with the likelihood of fraud (Beasley, 1996). The theoretical framework underpinning the empirical research on audit committees was predominantly within agency theory. Agency theory was also deployed to support the formation of other corporate governance mechanisms, for example, boards
of directors and management incentive plans. It was unclear whether it was the audit committee, or several corporate governance mechanisms which contributed jointly to an outcome (Turley & Zaman 2004; 2007).

In addressing the limitations of existing evidence and the importance of researching audit committees, they indicated directions for future studies. Turley and Zaman (2004) argued that having an audit committee in place and/or presenting certain characteristics did not automatically generate effectiveness. Therefore, further research on investigating the organisational setting inside audit committees is needed. Firstly, it is possible to theoretically reconceptualise the audit committee underlying members’ behaviour, corporate culture, and other institutional and organisational contexts. Secondly, the extant research methods should include qualitative research design, especially field studies, to investigate both the intended and unintended consequences of audit committees (Turley & Zaman, 2004). The qualitative research design of this study addresses the need expressed by Turley and Zaman (2004), employing a qualitative approach to enrich the understanding of the audit committee effectiveness within organisational contexts. This research also argues that the effectiveness of an audit committee should only be evaluated within an overall corporate governance setting of the organisation.

2.2.4. Bédard and Gendron (2010) – synthesis of the relationship between audit committee characteristics and strengthening the financial reporting system

The authors reviewed the existing audit committee literature with the intention of evaluating the extent to which audit committees are effective in terms of contributing to a positive financial reporting environment. They surveyed 103 papers published from 1994 to 2008 in different accounting journals. Bédard and Gendron (2010) extended the aforementioned research frameworks and mapped out a comprehensive landscape of existing audit committee studies. This may be represented as in Figure 2-3.
The objective of Bédard and Gendron (2010) synthesis is to evaluate the extent to which audit committees contribute to the strengthening of financial reporting. In addition to the audit committee input-process-output continuum covered by the previous two syntheses, Bédard and Gendron (2010) extended their review to include the theoretical, methodological aspects of the existing audit committee studies, as well as the studies from different countries.

In terms of synthesising the existing research findings, they reported that a large proportion of the studies report a positive association between effectiveness and the presence, independence, and competencies of the audit committee. However, meeting frequencies and the size of the committee were not conclusively associated positively with audit committee effectiveness.

Bédard and Gendron (2010) also identified the gap of literature and the opportunities of future research by criticising that the majority of audit committee studies were relational and explanatory based on economics theories. Very few studies were exploratory. Psychological and sociological studies were scarce. Investigations on audit committees in jurisdictions which did not follow the Anglo-Saxon model of corporate governance were also scant. An important aspect of their literature review called for enriching the body of knowledge on audit committees from different theoretical, methodological, and geographical points of view. The current research largely answers this call of Bédard and Gendron (2010) by obtaining an insight into audit committees in New Zealand listed companies through a sociological theoretical framework and qualitative research design. Figure 2-3 presents the landscape of audit committee research framework integrating these three important reviews.

**Dimensions of audit committee input**
- **Composition** (measured as a proportion of membership):
  - Independence
    - employment relationship
    - personal relationship
    - business relationship
  - Competence
    - financial literacy
    - financial expertise
    - governance and other expertise
- **Authority** as specified by the charter:
  - oversight of external communications monitoring of the internal control system, and
  - oversight of the external auditor
- **Resources**
  - Size
  - Monetary resources
  - Information resources

**Dimensions of audit committee effectiveness**
- **Financial reporting**
  - earnings management
  - misstatement
  - voluntary disclosure
  - directors’ assessment on financial reporting quality
  - forecast reliability
- **External auditing**
  - auditor selection
  - audit scope
  - remuneration
  - auditors’ independence
  - audit opinion
  - process and communication
- **Internal control**
  - internal audit
  - disclosure on weakness
  - members’ judgement on internal control issues
- **Investors’ expectations**
  - cost of capital
  - market reactions
  - voting at the annual general meeting
  - perceptions of the audit quality and auditors’
2.2.5. Other relevant corporate governance syntheses

Gramling, Maletta, Schneider, and Church (2004) synthesised the existing internal audit literature to discuss the current and potential role of the corporate internal audit function. The interrelationship between audit committees and the firm’s internal audit function is regarded as influential to the quality of corporate governance as a whole. However, only a limited number of empirical research focuses on this area by surveying internal auditors and associating internal audit function with audit committee characteristics. Gramling et al (2004) encouraged future internal audit research to expand investigations to audit committee qualitative characteristics including inquisitiveness, willingness to pursue issues, and scepticism. They also suggested potential gaps between the audit committee’s expectation and current internal audit performance. This research posits that the interaction with internal auditors constitutes one of the significant aspects of audit committees’ operation. The research result confirms that audit committee members’ characteristics, such as inquisitiveness and willingness to pursue issues, assist their performance.

Cohen, Krishnamoorthy, and Wright (2004) suggested a corporate governance mosaic in relation to the existing research regarding financial reporting quality. Studies on the association between audit committees and financial reporting quality were evaluated in-depth and potential future research was identified (Cohen et al, 2004, p. 141). The three under-researched areas of audit committees are: a) the interactions between boards of directors and audit committees; b) a comparison of audit committee characteristics reflecting the influence of corporate governance reform, for example, pre- and post the passage of the Sarbanes-Oxley Act; and c) the influence of industrial context on audit committees, for example, less regulated industries. Addressing the areas identified by Cohen et al (2004), this research investigates and provides evidence that the interaction with the boards of directors constitutes one of the significant aspects of audit committees’ operation.

Jefferies (1999) argued that a literature review should incorporate statistical techniques, for example, meta-analyses and best-evidence syntheses. If not used, the conclusions of literature syntheses have to rely solely on the authors’ interpretation (McGaw, 1997; Sandelowski, 1997). Pomeroy and Thornton (2007) conducted a meta-analysis on 27
empirical research studies testing the associations of audit committee independence with financial reporting quality, and concluded that most of the inconsistency in the association was due to the variety of measurements adopted in measuring financial reporting quality. They criticised the fact that statistical technologies were scarcely applied in accounting literature reviews and also raised concerns about conceptual constructs. Such concerns reflect the problematic nature of the notion of measurement according to the physical sciences (Campbell, 1938) when applied to a social science, such as corporate governance.

2.2.6. Summary of review of audit committee literature syntheses

This study argues that conceptualisation of the factors involved in audit committee effectiveness is a vital addition to the existing body of knowledge. If inconsistent measurements are responsible for mixed empirical testing results, the loosely defined ‘effectiveness’ of an audit committee might be the reason. Furthermore, as shown in all of the preceding syntheses, the overall research on audit committees suffers from a lack of insight into the operation of the audit committees, which in turn has led to the existing weaknesses in the conceptualisation of audit committee effectiveness.

In the next section, the empirical audit committee literature since the SOX (2002) will be evaluated. This is not intended to repeat the efforts of Bédard and Gendron (2010), but rather to focus on the empirical findings and identify the gaps in knowledge of audit committee effectiveness, to which this research aims to contribute.

2.3 Empirical audit committee literature since the SOX (2002)

Since the passage of the Sarbanes-Oxley Act of 2002, research on audit committees has expanded geographically from the US and the UK to other share markets, for example, Carson (2002) in Australia, Chau and Leung (2006) in Hong Kong, Rainsbury, Bradbury, and Cahan (2008) in New Zealand. In the latter countries, the mandatory requirements for establishing audit committees are less rigid than those in the USA and the UK, and can be regarded as followers of countries at the front line of corporate governance reform.

There have also been studies on audit committees in European share markets, for example, Melis (2004) in Italy, Piot (2004) in France, Knechel and Willekens (2006) in
Belgium, and Osma and Noguer (2007) in Spain. These studies not only shed light on audit committees operating in the European jurisdictions in contrast to the Anglo-American system (Collier & Zaman, 2005), but also enriched the discussion of audit committees in different institutional backgrounds. The research on audit committees also spread to less developed countries, for example, Al–Twajry, Brierley, and Gwilliam (2002) in Saudi Arabia, Alleyn, Howard, and Greenidge (2006) in Barbados, Barako, Hancock, and Izan (2006) in Kenya, Okike (2007) in Nigeria, and Tengamnuay and Stapleton (2008) in Thailand. These research studies are of a descriptive nature and evaluate the presence and operation of audit committees in their ‘infancy’, which are ‘finding their feet’ (Spira, 1998, p. 42). There have been observations that the establishment of audit committees in these countries is largely driven by the US literature (Alleyn, Howard, & Greenidge, 2006) and regulatory recommendations, even prior to the establishment of such audit committees becoming mandatory. These studies expanded the discussion of audit committees in the context of more diversified political and cultural backgrounds. More importantly, these studies revealed the features and implications of audit committees driven largely by compliance (Haron, Jantan, & Pheng, 2005).

There has also been a development of research on audit committees of non-profit organisations within the context of corporate governance, for example, Vermeer, Raghunandan, and Forgione (2006), and Iyer and Watkins (2008). Non-profit organisations (bear) responsibility for maximising the efficiency of utilising the funds provided. There has been a strong demand for non-profit organisations to employ the same good corporate governance practices as in the private sector (Iyer & Watkins, 2008). However, the public expectation and board accountability for those non-profit organisations largely depend on their fund providers and the nature of their services, for example, public medical care and tertiary education. These studies are constructed on resource dependency theory instead of agency framework, which has been largely adopted by corporate governance research in the private sector, thus expanding the theoretical explanation for organisations establishing audit committees.
2.3.1. The framework for reviewing empirical audit committee literature

The audit committee empirical research since the syntheses of DeZoort et al (2002) and Turley and Zaman (2004) has expanded the discussion of audit committee inputs, functioning processes, and outputs. Previous associations have been retested with new data. Furthermore, new variables which proxy audit committee inputs, functioning processes, and outputs have been tested, but the results have been mixed. Innovative research designs incorporating social psychological theories to interpret the research findings are being used increasingly.

To organise this section of the literature review, a framework is developed by combining the frameworks of DeZoort et al (2002) and Turley and Zaman (2004). This framework involves pooling and analysing the empirical studies into the following categories: (a) determinants of audit committee formation and composition\(^1\); (b) audit committee composition characteristics\(^2\); (c) audit committee functions and activities\(^2\); and (d) audit committees’ corporate governance impacts. The framework is illustrated in Figure 2-4.

Figure 2-4: Framework for reviewing the recent empirical audit committee literature

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\(^1\) Adapted from the DeZoort et al (2002) synthesis.

\(^2\) Adapted from the Turley & Zaman (2004) synthesis.
Each of these dimensions of audit committee research is discussed by: (1) examining developments since the DeZoort et al. (2002) and Turley and Zaman (2004) syntheses; (2) summarising the research findings, (3) discussions, and (4) identifying gaps in the existing research.

2.3.2. Determinants of audit committee formation and composition

(1) Recent developments

Prior to the SOX (2002), the formation of audit committees was voluntary. According to Turley and Zaman (2004), the formation of audit committees was usually an attempt to reduce agency costs. The variables hypothesised to support such a proposition were therefore mainly agency cost proxies (Dey, 2008; Rainsbury, Bradbury & Cahan, 2008). Subsequent to the SOX (2002), research into the audit committee’s formation has been geographically spread to other share markets where the regulatory requirement on the audit committee formation is regarded as less rigid than those of the United States and the United Kingdom.

(2) Synthesis of the determinants of audit committee formation and composition

As a result of regulatory requirements, the establishment of audit committees in listed companies has been regarded as standard corporate governance practice for most of the world’s major stock exchanges. Despite some inconsistency in the research findings, it is generally established that the determinants of an audit committee: (i) formation, (ii) independence, and (iii) financial expertise, are associated with:

(1) Ownership structure
(2) Leverage
(3) Source of funding
(4) Board of directors’ characteristics; and
(5) Firm characteristics.
I. Determinants of audit committee formation

The discussion of the determinants of audit committee formation has been expanded and enriched. Using ownership structure as an example, Chau and Leung (2006) investigated the association between family ownership and the establishment of audit committees in Hong Kong listed companies, while Piot (2004) and Ruiz-Barbadillo, Biedma-López and Gómez-Aguilar (2007) examined the association between management ownership and the formation of audit committees in European companies. In addition, Vermeer, Raghunandan and Forgione (2006) and Iyer and Watkins (2008) studied the formation of audit committees in not-for-profit organisations, expanding the scope of the theoretical framework that can be applied to explain the formation of audit committees. See Table 2-1.
<table>
<thead>
<tr>
<th>Studies</th>
<th>Ownership structure</th>
<th>Leverage</th>
<th>Source of funding</th>
<th>BOD characteristics</th>
<th>Firm characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Piot (2004)</td>
<td>Negative association (+) with level of insider ownership</td>
<td>Positive association (±) with debt to equity structure</td>
<td>Positive association (+) with board size</td>
<td>Positive association (+) with the level of operational diversity</td>
<td></td>
</tr>
<tr>
<td>Chau and Leung (2006)</td>
<td>Negative association (+) with family dominated ownership</td>
<td>Positive association (+) with board independence</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vermeer, Raghunandan and Forgione (2006)</td>
<td>Positive association (+) in non-profit organisations with level of government funding</td>
<td>No association (-) in non-profit organisations with long-term debt or donations</td>
<td>Positive association (+) with the size of the non-profit organisations, but negative association (-) with universities and hospitals</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Iyer and Watkins (2008)</td>
<td>Positive association (+) with board size</td>
<td>Positive association (+) with board independence</td>
<td>Positive association (+) with the size of the budget</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rainsbury, Bradbury and Cahan (2008)</td>
<td>No association (-) with debt to equity structure</td>
<td>Positive association (+) with board size</td>
<td>No association (-) with firms’ growth opportunity measured by the market to book ratio</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3 (+) indicates that the test result confirmed the expectation of the audit committee impact, whereas (-) indicates that the test result did not support the expected impact of the audit committee.
I.  Determinants of audit committee financial expertise

Given that the nature of the audit committee function is to oversee the financial reporting process, having financial experts serving on the audit committee has become a common practice in listed firms. With respect to members’ competencies, Section 407 of the SOX (2002) requires listed public firms to include at least one member who is a financial expert, or to disclose reasons for not adopting this requirement. Since then, two research studies in the USA have examined the number of financial experts on audit committees in relation to the ownership structure, leverage, and firm characteristics. See Table 2-2 for the studies’ findings.

Table 2-2: Determinants of audit committees’ financial expertise

<table>
<thead>
<tr>
<th>Studies</th>
<th>Ownership structure</th>
<th>Leverage</th>
<th>Firm characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Carcello, Hollingsworth and Neal (2006)</td>
<td>Positive association (+) with level of institutional ownership</td>
<td></td>
<td>Positive associations (+) with firm size, level of litigious risk and firms’ financing activities</td>
</tr>
<tr>
<td>Dey (2008)</td>
<td>Positive association (+) with separation of ownership and management</td>
<td>Positive association (+) with debt to equity structure</td>
<td>Positive associations (+) with other agency conflict attributes, including firm size, industrial complexity, growth, level of operating risk, and free cash flows</td>
</tr>
</tbody>
</table>

Having financial experts on audit committees reflects the public expectation. However, what are the benefits of their financial expertise? Synthesis of the corporate governance impact of financial expertise will be discussed in section 2.3.3.

II.  Determinants of audit committee independence

Although independence is considered to be a crucial element for an audit committee to be effective in discharging its responsibilities, there has been disagreement about the ideal proportion of independent directors and what causes it to vary between firms. See Table 2-3 for a summary of the studies.
<table>
<thead>
<tr>
<th>Studies</th>
<th>Ownership structure</th>
<th>Leverage</th>
<th>Source of funding</th>
<th>BOD characteristics</th>
<th>Firm characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cotter and Silvester (2003)</td>
<td>Negative association (-)(^4) with debt to equity structure</td>
<td>Positive association (+) with board independence</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Piot (2004)</td>
<td>Positive association (+) with level of insider ownership</td>
<td>Weak association (-) with debt to equity structure</td>
<td>Positive association (+) in non-profit organisations with level of government funding</td>
<td>Positive association (+) with the size of non-profit organisations, but negative association (-) in universities and hospitals</td>
<td></td>
</tr>
<tr>
<td>Vermeer, Raghunandan and Forgione (2006)</td>
<td>Positive association (+) in non-profit organisations with level of government funding</td>
<td>No association (-) in non-profit organisations with long-term debt or donations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charitou, Louca and Panayides (2007)</td>
<td></td>
<td></td>
<td>Positive association (+) with firms’ complexity of financing activities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ruiz-Barbadillo, Biedma-López and Gómez-Aguilar (2007)</td>
<td>Negative association (+) with level of management ownership</td>
<td>Positive association (+) with board independence</td>
<td>Negative association (+) with CEO/director duality</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dey (2008)</td>
<td>Positive association (+) with separation of ownership and management</td>
<td>Positive association (+) with debt to equity structure</td>
<td>Positive associations (+) with overall agency conflict, including firm size, industrial complexity, growth, level of operating risk, and free cash flows</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rainsbury, Bradbury and Cahan (2008)</td>
<td>No association (-) with debt to equity structure</td>
<td></td>
<td>No association (-) with firms’ growth opportunity</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^4\)(+) indicates that the test result confirmed the expectation of the audit committee impact, whereas (-) indicates that the test result did not support the expected impact of the audit committee.
(3) Discussion

Firstly, firm size as a determinant of audit committee formation and composition is inconsistently measured, but results in relatively consistent, positive test results with a few exceptions. Fama and Jensen (1983) suggested that agency conflicts become more severe as firm size increases and that greater control of managerial actions is therefore required. If this is so, a positive relationship between firm size and desirable audit committee composition and control activities would be expected (Dey, 2008). Research has established that firm size was positively associated with audit committee existence (Piot, 2004; Iyer & Watkins, 2008). Firm size, however, was measured in different ways in these studies. Piot (2004) and Vermeer, Raghunandan and Forgione (2006) measured firm size as the book value of total assets. Carcello, Hollingsworth and Neal (2006) and Raghunandan and Rama (2007) used total market value (share price at the year-end times total shares outstanding) to measure firm size. Dey (2008) measured firm size as the natural logarithm of sales, but did not provide any explanation for adopting this specific measurement. By surveying the CFOs of 215 non-profit organisations, Iyer and Watkins (2008) suggested that the size of their budgets was positively associated with the formation of audit committees.

Vermeer, Raghunandan and Forgione (2006) examined the formation and composition of audit committees in 128 non-profit organisations in the USA. They found that the voluntary establishment of audit committees and the committees’ independence were positively associated with reliance on government funding rather than reliance on long-term debt or donors. They also provided evidence that contrary to expectation, universities and hospitals were less likely to have solely independent directors on the audit committee, even though they were usually large in size and subject to a high level of public scrutiny of their efficiency.

Secondly, leverage, usually measured as the ratio of long-term debt to total assets, is also presumed to be one of the important determinants for firms adopting an audit committee on a voluntary basis (Turley & Zaman, 2004). As agency conflicts rise with the level of debt, debt holders may require better governance mechanisms in place to safeguard their interests (Jensen & Meckling, 1976). Leverage is therefore normally hypothesised as being positively associated with the establishment of good quality audit committees. However, in circumstances of the

\[5\] Under a high leverage structure, owner–managers have an incentive to prioritise shareholders’ benefits to the detriment of the creditors’ benefits.
voluntary adoption of audit committees, only Dey (2008) confirmed that high leverage correlates with audit committee members being independent and having a high level of expertise. The other studies did not support the hypothesis that leverage is a significant determinant of audit committee formation and independence.

The mixed results of the association between leverage and audit committee variables are displayed in Table 2-4.

**Table 2-4: Post SOX(2000) studies on the relationship between leverage and audit committee attributes**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Country</td>
<td>Australia</td>
<td>France</td>
<td>U.S.A.</td>
<td>New Zealand</td>
</tr>
<tr>
<td><strong>Audit committee variables</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Formation</td>
<td>-----</td>
<td>Weak positive association</td>
<td>-----</td>
<td>No association</td>
</tr>
<tr>
<td>Independence</td>
<td>Negative association</td>
<td>Weak positive association</td>
<td>Positive association</td>
<td>No association</td>
</tr>
<tr>
<td>Expertise</td>
<td>-----</td>
<td>-----</td>
<td>Positive association</td>
<td>-----</td>
</tr>
</tbody>
</table>

Thirdly, audit committees’ formation and composition are also associated with firms’ industrial contexts, in particular their litigious risk, but this is not consistent across industries (Ashbaugh, LaFond & Mayhew, 2003). Firms with high litigious risk tended to emphasise more formal corporate governance settings, including audit committees (Ashbaugh-Skaife, Collins & LaFond, 2006b). Piot (2004) provided evidence that in the generally less litigious environment of France, the formation of audit committees was associated with the firms’ operating diversification. However, in New Zealand, where the corporate governance rules are also considered relatively less rigid, the formation and independence of audit committees was not associated with the firms’ growth opportunities (Goodwin, 2003). Carcello, Hollingsworth and Neal (2006) observed that subsequent to initial public offerings, firms were more likely to designate financial experts on their audit committees. Charitou, Louca and Panayides (2007)
confirmed that firms listed on both the Canadian and USA share markets tended to have more independent audit committees.

(4) Gaps in the existing qualitative research on the determinants of audit committee formation and composition

When observing audit committee establishment, (independence and financial expertise) and their determinants, some propositions regarding an audit committee’s nature can be discussed (Tsui, Subramaniam, & Hoy, 2006). Firstly, the audit committee, as a sub-structure of the board of directors, carries out its function through board delegation. Therefore, audit committee members are obliged to understand and represent the board’s expectations and report to the board about the outcome of its delegation. Little research has been done about the interaction between the audit committee and the board.

Secondly, the agency problem, ownership structure, and litigious/industrial risks are key issues of corporate governance. To perform their role in corporate governance efficiently, audit committee members need to interpret their delegated duties according to their specific organisational setting; such interpretation involves subjective and professional judgement. Little has been documented about how audit committee members reflectively interpret their role, their attributes, and their efforts in relating to their particular organisations. It is questionable whether financial or accounting expertise is the only desirable characteristic contributing to the performance of the audit committee role. This research study aims to address the above gaps by providing qualitative evidence about how individual audit committee members justify the existence of their committee and identify the contributing factors which help them perform their daily audit committee tasks.

2.3.3. Audit committee characteristics

(1) Recent developments

The two most common audit committee composition characteristics are members’ independence and competency. The body of research regarding audit committee members’ independence and financial accounting expertise has been recognised by, and incorporated into, several leading corporate governance regimes, for example, the SOX (2002) of the USA, the OECD Principles of Corporate Governance (2004), and the Combined Code on Corporate
Governance of the UK (Financial Reporting Council, 2003). Recently, qualitative audit committee research has expanded the discussion of audit committee members’ expertise beyond financial- or accounting-related qualifications and experience (Abbott, Parker, Peters & Rughunandan, 2003a; Lee, Mande & Ortman, 2004). Bédard, Chtourou and Courteau (2004) and Xie, Davidson and DaDalt (2003) found that audit committee members with corporate expertise were associated with high quality financial reporting.

Although audit committee composition research since SOX (2002) has been dominated by investigations into the determinants and impact of audit committee independence and expertise, there have been a growing number of studies that examined the relationship between the size of audit committees and their impact on corporate governance. The results were very inconsistent. For example, Karamanou and Vafeas (2005) concluded that larger audit committees were negatively associated with forecast-induced returns for firms in the USA; Bédard, Chtourou and Courteau (2004) found that there was no association between audit committee size and financial reporting quality for Canadian firms, whereas Pucheta-Martínez and Fuentes (2007) found that in Spanish firms, downsizing an audit committee reduced the likelihood of receiving a qualified audit report.

According to Beasley (1996), directors’ tenure is an important attribute of corporate governance. The average tenure of audit committee members has recently been introduced as a new variable into the existing audit committee literature – Yang and Krishnan (2005) and Mustafa and Meier (2006) established that the average length of tenure of audit committee members was associated with higher financial reporting quality and a lower likelihood of the misappropriation of assets. Directors holding multiple directorships in several organisations has become more common in recent years. There has been intense debate about whether multi-directorships are an indication of the reputation of the directors or a signal of directors being over-committed (Pritchard, Ferris & Jagannathan, 2003). On the one hand, audit committee members’ multi-directorships are contributing to better financial reporting quality (Vafeas, 2005; Yang & Krishnan, 2005). On the other hand, busy directors are less likely to accept auditors’ suggested adjustments (Hunton & Rose, 2008), or are more likely to leave the firm when earnings management or poor performance are disclosed (Dewally & Peck, 2009).
(2) Synthesis of audit committee characteristics

I. Independence

According to DeZoort et al (2002) an independent audit committee promotes the best interests of corporate stakeholders. The importance of having an independent committee in listed firms has been accepted by most of the world’s leading corporate governance regimes. According to section 301 of the SOX (2002), each member of an audit committee shall be independent. Section 301 further specifies that an independent director may not accept any consulting or other compensatory fee from the organisation he or she serves, or be an affiliated person of the organisation. The Combined Code on Corporate Governance (Financial Reporting Council, 2003) specifies that the board should establish an audit committee of at least three members, who should all be independent, non-executive directors. The OECD Principles of Corporate Governance (2004) emphasise that a corporate board of directors should establish an independent audit committee. The qualitative research on audit committee independence published since SOX (2002) is summarised in Table 2-5.

Table 2-5: Summary of post-SOX (2002) research into the corporate governance (CG) impact of audit committee independence

<table>
<thead>
<tr>
<th>Studies</th>
<th>Financial reporting quality</th>
<th>Audit quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abbott, Parker, Peters and Raghunandan, 2003a</td>
<td>Negative association (+)(^6) with auditor independence (measured as the ratio of non-audit service fees to audit fees)</td>
<td></td>
</tr>
<tr>
<td>Abbott, Parker, Peters and Raghunandan, 2003b</td>
<td>Positive association (±) with level of audit fees</td>
<td></td>
</tr>
<tr>
<td>Raghunandan and Rama, 2003</td>
<td>Negative association (+) with shareholder votes on auditor's ratification</td>
<td></td>
</tr>
<tr>
<td>Abbott, Parker and Peters, 2004</td>
<td>Negative association (+) with the likelihood of annual results restatement</td>
<td></td>
</tr>
<tr>
<td>Bédard, Chtourou and Courteau, 2004</td>
<td>Negative association (+) with the level of earnings management</td>
<td></td>
</tr>
<tr>
<td>Lee, Mande and Ortman, 2004</td>
<td>Negative association (+) with auditors’ resignation</td>
<td></td>
</tr>
<tr>
<td>Davidson, Goodwin-Stewart and Kent, 2005</td>
<td>No association (-) with the level of earnings management</td>
<td></td>
</tr>
</tbody>
</table>

\(^6\) (+) indicates that the test result confirmed the expectation of the audit committee impact, whereas (-) indicates that the test result did not support the expected impact of the audit committee.
Although members’ independence has long been accepted as good practice in corporate governance, it still remains one of the most common variables in the audit committee composition literature. As shown in Table 2-5, in many aspects the audit committee independence literature produced mixed results which failed to prove the fulfilment of expectation on independent directors safeguarding the interests of investors.

II. Expertise

Members’ expertise is another commonly tested composition characteristic of audit committees. It is expected that an audit committee should have some members who are financial accounting experts (section 407, SOX, 2002).

There has been some debate regarding precisely what the expected financial or accounting expertise is. For example, the rules of the SEC define an “audit committee financial expert” as a
person who has each of five attributes pertaining to a sufficient understanding of accounting principles, financial statements, internal control, and audit committee functions. According to the Combined Code of Corporate Governance in the UK (Financial Reporting Council, 2003), the board of a listed company should “satisfy itself” that at least one of its independent non-executives has recent and relevant financial experience. The Code is not specific about what constitutes “relevant experience”. However, according to the New Zealand Securities Commission (2004), ‘financial expert’ refers to current membership of the New Zealand Institute of Chartered Accountants (NZICA). It is evident, therefore, that in different jurisdictions, the meaning of ‘financial expert’ may vary. This may reduce the comparability of studies on audit committee financial expertise between different countries.

Bédard et al (2004) argue that, in order to fulfil their responsibilities, audit committee members should possess not only financial or accounting expertise, but also corporate governance expertise and firm-specific expertise. However, they only found a negative association between corporate governance expertise and the likelihood of aggressive earnings management; there was no association established between earnings quality and firm-specific expertise (Bédard et al, 2004). Xie, Davidson and DaDalt (2003) found the proportion of audit committee members with corporate or investment banking backgrounds to be negatively related to the level of earnings management. The impact of having financial experts on audit committees is also double sided. On the one hand, audit committee financial expertise tended to enhance the diligence of the committee and the quality of reporting and auditing (Abbott, Parker, Peters & Raghunandan, 2003; Bédard et al, 2004; and Baxter & Cotter, 2008). On the other hand, financially sophisticated directors can be aggressive and risk-taking, and therefore may act in a contrary manner (DeZoort, Hermanson & Houston, 2003a). The research results of the corporate governance impact of audit committee expertise are displayed in Table 2-6.

---

7 An understanding of GAAP and financial statements; (2) the ability to assess the general application of such principles in connection with accounting for estimates, accruals and reserves; (3) experience preparing, auditing, analysing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the company’s financial statements, or experience actively supervising one or more persons engaged in such activities; (4) an understanding of internal controls and procedures for financial reporting; and (5) an understanding of audit committee functions.

8 Be an experienced corporate director.

9 Have reasonably long experience with a particular firm.
<table>
<thead>
<tr>
<th>Studies</th>
<th>Expertise measurement</th>
<th>Corporate governance impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>McDaniel, Martin, Maines and Peecher, 2002</td>
<td>Being auditing managers or EMBA students</td>
<td>Positive association (+) with the competence of assessing financial reporting quality</td>
</tr>
<tr>
<td>DeZoort, Hermanson and Houston, 2003a</td>
<td>Being financially literate</td>
<td>Negative association (-) with the likelihood of recommending adjustments to financial statements</td>
</tr>
<tr>
<td>Raghunandan and Rama, 2003</td>
<td>Number of financial experts</td>
<td>No association with (-) shareholder votes on auditor's ratification</td>
</tr>
<tr>
<td>Abbott, Parker, Peters and Raghunandan, 2003a</td>
<td>Number of financial experts</td>
<td>Positive association (±) with the level of audit fee</td>
</tr>
<tr>
<td>Xie, Davidson and DaDalt, 2003</td>
<td>Corporate or investment banking background</td>
<td>Negative association with (+) the level of earnings management</td>
</tr>
<tr>
<td>Bédard, Chtoutrou and Courteau, 2004</td>
<td>Number of financial experts</td>
<td>Negative association with (+) the level of earnings management</td>
</tr>
<tr>
<td>Lee, Mande and Ortman, 2004</td>
<td>Number of financial experts</td>
<td>Weak association (-) with auditor's resignation</td>
</tr>
<tr>
<td>Abbott, Parker and Peters, 2004</td>
<td>Number of financial experts</td>
<td>Negative association with (+) the likelihood of annual result restatement</td>
</tr>
<tr>
<td>Davidson, Xie and Xu, 2004</td>
<td>Number of financial experts</td>
<td>Positive association (+) with the share price</td>
</tr>
<tr>
<td>Farber, 2005</td>
<td>Number of financial experts</td>
<td>Negative association (+) with the detection of fraud</td>
</tr>
<tr>
<td>Karamanou and Vafeas, 2005</td>
<td>Number of financial experts</td>
<td>Mixed association (±) with the decision of whether or not to issue a forecast</td>
</tr>
<tr>
<td>Defond, Hann and Hu, 2005</td>
<td>Number of financial experts</td>
<td>Positive association (+) with the share price</td>
</tr>
</tbody>
</table>

(+) indicates that the test result confirmed the expectation of the audit committee impact, whereas (-) indicates that the test result did not support the expected impact of the audit committee.
<table>
<thead>
<tr>
<th>Studies</th>
<th>Expertise measurement</th>
<th>Financial reporting quality</th>
<th>Audit quality</th>
<th>Audit committee diligence</th>
<th>Market reaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chen, Moroney and Houghton, 2005</td>
<td>Number of financial experts</td>
<td>No association (-) with the auditors' industry specialisation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mangena and Pike, 2005</td>
<td>Number of financial experts</td>
<td>Positive association (+) with the extent of interim disclosure</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yang and Krishnan, 2005</td>
<td>Number of financial experts</td>
<td>No association (-) with the level of quarterly earnings management</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwin-Stewart and Kent, 2006</td>
<td>Number of financial experts</td>
<td>Mixed (±) association with the level of audit fees</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Zhang, Zhou and Zhou, 2007</td>
<td>Number of financial experts</td>
<td>Negative association (+) with the disclosure of internal control weaknesses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chen and Zhou, 2007</td>
<td>Number of financial experts</td>
<td>Positive association (+) with the early dismissal of Arthur Andersen</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baxter and Cotter, 2008</td>
<td>Number of accounting experts</td>
<td>Negative association (-) with estimation errors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Krishnan and Visvanathan, 2008</td>
<td>Number of financial experts</td>
<td>Positive association (+) with conservatism</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bédard, Coulombe and Courteau, 2008</td>
<td>Number of financial experts</td>
<td>No association (-) with the precision of earnings forecasts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kelton and Yang, 2008</td>
<td>Number of financial experts</td>
<td>Positive association (+) with the transparency of internet-based financial reporting</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marciukaityte and Varma, 2008</td>
<td>Number of financial experts</td>
<td>Negative association (+) with large losses on restatement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mangena and Tauringana, 2008</td>
<td>Number of financial experts</td>
<td>Positive association (+) with the involvement of external auditors in interim reporting</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Having financial experts serving on the audit committee is expected to contribute to firms’ financial reporting quality. However, Baxter and Cotter (2008) found some evidence of a higher level of discretionary accruals in firms with a greater proportion of qualified accountants on their audit committees. This may also be interpreted as a contradictory effect of audit committee expertise.

Audit committee financial expertise is also expected to enhance audit quality, but the test results are also mixed. Abbott et al (2003a) and Goodwin-Stewart and Kent (2006) both found that the expertise of audit committee members is associated with higher audit fees. Chen, Moroney and Houghton (2005) argued that the proportion of audit committee members with financial qualifications was not related to the use of an industry specialist audit firm. According to Lee, Mande and Ortman (2004), there was only weak statistical evidence that as the proportion of financial experts on the audit committee increases, the likelihood of an auditor resignation decreases. Raghunandan and Rama (2003) proposed that the audit committee could influence the monitoring of auditor-client relationships and thereby influence shareholder perceptions about auditor independence and overall audit performance, but they did not find any association between audit committee financial expertise and the shareholders’ vote on auditor’s ratification.

(3) Gaps in the existing qualitative research on audit committee characteristics

The existing research gives rise to several questions. Firstly, how do audit committee members interpret the word ‘independence’ in the context of their role? As reflected by an auditing professional pronouncement, ‘independence’ is an appearance while ‘objectivity’ is a state of mind (The Institute of Internal Auditors, 2005). Qualitative research is capable of identifying the disclosed independent audit committee members in firms’ annual reports, but cannot prove that a presumed independent audit committee member is in fact acting objectively. This research seeks to obtain first-hand accounts from audit committee members of how they construct and interpret their ‘objectivity’ during their interaction with the management, the auditors and the board of directors.

Secondly, what types of expertise are assisting audit committee members to fulfil
their duties? Listed companies are diversified in many respects - jurisdiction, industries, and scale, as well as their various historical and cultural backgrounds. The audit committee is expected to enhance a firm’s financial reporting and audit quality. Financial reporting, however, is influenced by firms’ inherent business risks and the controls in place to reduce such risks (COSO Integrated Risk Management and Internal Control Framework, 1992). This research aims to obtain accounts of what factors assist audit committee members to perform their roles effectively. The expected responses will not be limited to the backgrounds or qualifications of audit committee members, but will include their personal attributes.

2.3.4. Audit committee diligence and activities

(1) Recent developments

DeZoort et al. (2002) were critical of the existing qualitative literature only measuring audit committee diligence by using the number of audit committee meetings held, as per the disclosed information. The qualitative research on audit committee activities and diligence has since been expanded, but meeting frequency (i.e. the number of audit committee meetings) remains the dominant proxy for audit committee diligence. Various studies (see Table 2-7) have shown that audit committee meeting frequency is associated with financial reporting quality and audit quality.

There have also been studies on audit committee activities other than meetings. Gaynor, McDaniel and Neal (2006) conducted a study with 100 participants of the KPMG Audit Committee Roundtable during 2003, specifically evaluating the audit committee members’ judgement on whether or not to approve non-audit services provided by firms’ auditors. Carcello, Hollingsworth and Neal (2006) surveyed 217 USA companies during 2001 and 2002 and established that firms’ internal audit budgets were higher when audit committees got involved in reviewing the budget. DeZoort, Hermanson and Houston (2003a) found that audit committee members were more likely to recommend adjustments to the financial statements when the auditor consistently supported such adjustments.

(2) Synthesis of audit committee diligence and activities

As discussed previously, audit committee meeting frequency remains the major
proxy for representing audit committee diligence. Despite some exceptions, audit committee diligence appears to contribute to improved financial reporting quality, audit quality, and level of disclosure. The qualitative research results of the corporate governance impact of audit committee diligence measured by meeting frequency are displayed in Table 2-7.

Table 2-7: Summary of post—SOX (2002) research into the corporate governance (CG) impact of audit committee diligence measured by meeting frequency

<table>
<thead>
<tr>
<th>Studies</th>
<th>Financial reporting quality</th>
<th>Audit quality</th>
<th>Market reaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abbott, Parker, Peters and Rughunandan, 2003a</td>
<td></td>
<td>Negative association (+)(^\text{11}) with the ratio of non-audit service fees to audit fees</td>
<td></td>
</tr>
<tr>
<td>Abbott, Parker, Peters and Raghunandan, 2003b</td>
<td></td>
<td>No association with level of (±) auditor’s fee</td>
<td></td>
</tr>
<tr>
<td>Anderson, Mansi and Reeb, 2004</td>
<td></td>
<td>Negative association (+) with the ratio of non-audit service fees to audit fees</td>
<td></td>
</tr>
<tr>
<td>Bédard, Chtourou and Courteau, 2004</td>
<td>No association (-) with the level of earnings management</td>
<td>Negative association (+) with yield spread</td>
<td></td>
</tr>
<tr>
<td>Abbott, Parker and Peters, 2004</td>
<td>Negative association (+) with the likelihood of annual result restatement</td>
<td>No association (-) with the likelihood of annual result restatement</td>
<td></td>
</tr>
<tr>
<td>Farber, 2005</td>
<td>Negative association (+) with detected fraud</td>
<td>No association (-) with the analyst following and institutional share holding</td>
<td></td>
</tr>
<tr>
<td>Chen, Moroney and Houghton, 2005</td>
<td></td>
<td>No association (-) with the auditors’ industry specialisation</td>
<td></td>
</tr>
<tr>
<td>Vafeas, 2005</td>
<td>Negative association (+) with the level of earnings management</td>
<td>Negative association (+) with the level of shareholders’ participation</td>
<td></td>
</tr>
<tr>
<td>Krishnan and Ye, 2005</td>
<td></td>
<td>Negative association (+) with the level of shareholders’ participation</td>
<td></td>
</tr>
</tbody>
</table>

\(^{11}\) (+) indicates that the test result confirmed the expectation of the audit committee impact, whereas (-) indicates that the test result did not support the expected impact of the audit committee.
<table>
<thead>
<tr>
<th>Studies</th>
<th>Financial reporting quality</th>
<th>Audit quality</th>
<th>Market reaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bronson, Carcello and Raghunandan, 2006</td>
<td>Positive association (+) with voluntary disclosure of management reports on internal control</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwin-Stewart and Kent, 2006</td>
<td>Positive association (±) with the level of audit fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Koh, Laplante and Tong, 2007</td>
<td>Negative association (+) with the level of abnormal accruals</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chen and Zhou, 2007</td>
<td>Positive association (+) with choosing a Big4 successor auditor</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baxter and Cotter, 2008</td>
<td>No association (-) with earnings quality</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kent and Stewart, 2008</td>
<td>Positive association (+) with the extent of disclosures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Li, Pike and Haniffa, 2008</td>
<td>Positive association (+) with the disclosure of intellectual capital</td>
<td></td>
<td></td>
</tr>
<tr>
<td>O’Sullivan, Percy and Stewart, 2008</td>
<td>Positive association (±) with the disclosure of forward-looking information</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owens-Jackson, Robinson and Shelton, 2009</td>
<td>Negative association (+) with the likelihood of financial reporting fraud</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(3) Discussion

As stated by DeZoort *et al* (2002), the diligence of audit committees has been predominantly measured in terms of audit committee meeting frequency. Despite the inconsistency of the results, it has been established that audit committee meeting frequency is associated with financial reporting quality, audit quality, and firms’ disclosure practices.

Several observations can be made from the research. Firstly, can an active audit committee improve the quality of financial reporting? The test results are mixed. Vafeas (2005) and Koh, Laplante and Tong (2007) established that audit committee meeting
frequency is associated with higher earnings quality. On the contrary, Bédard, Chtourou and Courteau (2004) and Baxter and Cotter (2008) found that audit committee meeting frequency was not significantly related to earnings quality. It is expected that active audit committees will result in a high quantity and/or quality of disclosure. Firms’ disclosure of financial and non-financial information may also reflect the level of sophistication instead of the conservatism of either the firm, or the committee members themselves. O’Sullivan, Percy and Stewart (2008) established that audit committee meeting frequency is positively associated with the disclosure of forward-looking information. Furthermore, Li, Pike and Haniffa (2008) tested a sample of 100 UK listed firms between 2004 and 2005 and confirmed their hypothesis that a positive relationship existed between the level of intellectual capital disclosure and frequency of audit committee meetings. They found that disclosure of ‘intellectual capital’ included human, structural, and relational information that was valuable for investors, as such information helped reduce uncertainty about future prospects and facilitated a more precise valuation of the company.

Secondly, the findings of research studies, intended to investigate the relationship between audit committee meeting frequency and audit quality, are also inconsistent and subject to various interpretations. Chen and Zhou (2007) found that firms with more frequent audit committee meetings were more likely to choose a Big4 auditor. Goodwin-Stewart and Kent (2006) found that more frequent audit committee meetings were related to higher audit fees in their database of 401 Australian firms in 2000. In a further study on ASX companies in 2000, Chen, Moroney and Houghton (2005) found that the frequency of audit committee meetings did not indicate the use of an industry specialist audit firm. Choosing Big4 audit firms or paying a high level of audit fees signal two sides of the same coin. On one hand, it may be interpreted that active audit committees are more demanding of auditors’ reputations and the scope of their work. On the other hand, spending more on the audit does not automatically result in a higher quality of audit and financial reporting, considering the involvement of Big4 Accounting firms in several corporate financial scandals. Further discussion about using audit fees as a measure of audit committee corporate governance impact can be found in section 2.3.5.

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12 The level of intellectual capital disclosure was used as a measure of disclosure transparency.
(4) Gaps in the existing qualitative research on audit committee diligence and activities

This study argues that meeting frequency is a signal of the liveliness, rather than the diligence of audit committees. The lack of a set of comprehensive measures for audit committee diligence may lie in the nature of the qualitative research, as it is debatable whether it is logical to measure audit committee diligence without considering what the committees have been assigned as duties by their organisations.

Secondly, this research study also questions the underlying assumption that audit committees only function through audit committee meetings. As stated by Spira (2005), audit committee meetings are “a private performance to a public audience” (p. 23). Only a part of the audit committee’s function is carried out by ceremonial process, i.e. in the formal meetings. Gendron and Bédard (2005) and Turley and Zaman (2007) also concluded that there were comprehensive informal processes of audit committees which contributed to the overall achievement of audit committee objectives. Therefore, studies on audit committee meeting frequency only provide limited evidence about audit committee diligence. This research will therefore examine audit committee members’ perceptions of diligence by endeavouring to develop an understanding of how members perform their jobs to achieve the audit committee’s desired outcomes. More specifically, this research aims to obtain an understanding of how audit committees resolve issues affecting their assigned responsibilities.

Thirdly, from the preceding discussion, it is evident that little is known about how audit committees interact with other parties which work with them. From the literature review, it is seen that audit committees work with the management, the external auditors, the internal auditor, and the board of directors, including ‘meeting behind closed doors’ (Spira, 2005, p. 4). This research examines this further by inviting the interviewees to describe situations in which audit committees interact with each of the above-mentioned parties, enabling a clear picture to emerge of the various tasks performed by audit committees, why they perform those tasks and how they complete those tasks. Finally, an analysis of those tasks and interactions will be related to the audit committee objectives.

2.3.5. Audit committee corporate governance impacts

(1) Recent developments
Since Turley and Zaman (2004), the qualitative studies on audit committee corporate governance effects have been expanded beyond audit function, financial reporting quality, and firm performance. Synthesising the audit committee literature after 2002, the corporate governance impacts of audit committees include: a) financial reporting quality; b) audit quality; c) share market reaction; d) disclosure practices; and e) internal audit function. Furthermore, Anderson, Mansi and Reeb (2004) argued that the cost of debt is lower in firms with larger and more active audit committees. Although agency theory remains the dominant theoretical framework, there has been a broad range of measurements developed to test the above-mentioned impacts. The results, however, are mixed. Most of the studies investigating the corporate governance impacts of audit committees have been discussed previously in this chapter, when reviewing the determinants of audit committee formation and composition, audit committee composition characteristics, and audit committee diligence and activities.

(2) Synthesis of the measurement of audit committee corporate governance impacts

According to Turley and Zaman (2004), measuring financial reporting quality is difficult, but can be achieved by identifying relevant signals. These signals include regulatory investigations and sanctions in respect of fraudulent annual reports, earnings management, and audit qualification. It is argued that the practice of earnings management is related to the strength of internal corporate governance mechanisms (Davidson, Xie & Xu, 2004), which can be represented by the strength of the audit committee. Therefore, it is expected that the likelihood of earnings management would be negatively associated with the presence, independence, expertise, and the activities of audit committees (Vafeas, 2005). Earnings management can be measured by the level of income-increasing or income-decreasing abnormal accruals (Bédard, Chtourou & Courteau, 2004), small increases in earnings (Davidson, Xie & Xu, 2004), level of discretionary accruals (Cohen, Gaynor, Krishnamoorthy and Wright, 2007) and working capital accruals (Dechow & Dichev, 2002). The mixed results of these recent qualitative studies on an audit committee’s impact on a firm’s financial reporting quality, as signalled by the level of earnings management, are listed in Table 2-8.
### Table 2-8: Summary of post-SOX (2002) research into financial reporting quality signalled by earnings management

<table>
<thead>
<tr>
<th>Studies</th>
<th>Establishment</th>
<th>Size</th>
<th>Independence</th>
<th>Financial/accounting expertise</th>
<th>Meeting frequency</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>Xie, Davidson and DaDalt, 2003</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Negative association (+) with members with corporate governance and investment banking backgrounds</td>
</tr>
<tr>
<td>Bédard, Chtourou and Courteau, 2004</td>
<td>No association (-)</td>
<td>Negative association (+)</td>
<td>Negative association (+)</td>
<td>No association (-)</td>
<td></td>
<td>Negative association (+) with members’ governance expertise. Negative association (+) with audit committees that are mandated to oversee the financial reporting process</td>
</tr>
<tr>
<td>Davidson, Xie and Xu, 2004</td>
<td>Negative association (+)</td>
<td>Negative association (+)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vafeas, 2005</td>
<td></td>
<td></td>
<td></td>
<td>Negative association (+)</td>
<td></td>
<td>Negative association (+) with multi-membership on various audit committees</td>
</tr>
<tr>
<td>Peasnell, Pope and Young, 2005</td>
<td>No association (-)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yang and Krishnan, 2005</td>
<td>No association (-)</td>
<td>No association (-)</td>
<td>No association (-)</td>
<td>No association (-)</td>
<td></td>
<td>Positive association (-) with members’ level of shareholding Negative association (+) with average tenure of members</td>
</tr>
<tr>
<td>Koh, Laplante and Tong, 2007</td>
<td></td>
<td></td>
<td></td>
<td>Negative association (+)</td>
<td></td>
<td>Positive association (-) with family members present on the audit committee</td>
</tr>
<tr>
<td>Jaggi and Leung, 2007</td>
<td>Negative association (+)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baxter and Cotter, 2008</td>
<td>Weak to no association(-)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

13 (+) indicates that the test result confirmed the expectation of the audit committee impact, whereas (-) indicates that the test result did not support the expected impact of the audit committee.
One measure of financial reporting quality is the likelihood of annual result restatements. According to Abbott et al (2004), audit committee independence, financial expertise, and meeting frequency are significantly and negatively associated with the occurrence of annual result restatements. Archanbeault, DeZoort and Hermanson (2008) argued that audit committees’ contributions to the financial reporting quality could be impaired by remunerating members with stock-options. Both long-term and short-term incentive compensations provided to audit committee members are positively associated with the likelihood of annual result restatements.

Defective financial reporting may result in audit report qualification and regulatory investigation and enforcement. Farber (2005) investigated 87 USA firms under SEC investigation and enforcement between 1982 and 2000, and found that these firms had fewer financial experts on their audit committees and held fewer audit committee meetings. Owens-Jackson, Robinson and Shelton (2009) further argued that the likelihood of firms being sanctioned by the SEC for fraudulent financial reporting was negatively associated with the independence of the audit committee.

According to Chambers (2005), the audit committee’s oversight of the external audit function reflects the original reason for forming an audit committee. The external audit function has been evaluated in many ways, with audit quality proxied by the level of external auditors’ remuneration, independence, reputation, industrial specialisation, and/or suspicious auditors’ resignations (Turley & Zaman, 2002).

With respect to audit fees, there are different arguments about whether an effective audit committee should result in higher or lower auditor’s remuneration (Turley and Zaman, 2002). If an audit committee hires more prestigious audit firms, or has broader audit coverage, the audit fees are higher (Abbott et al, 2003). On the other hand, if the audit committee is more competent and active, the members will strive to reduce the level of risks perceived by the auditors, resulting in a lower audit fee (Steward & Munro, 2007). Given the different interpretations about the level of auditors’ remuneration, the qualitative research results linking the audit committee variables to audit fees are inconclusive. These are illustrated in Table 2-9.
Table 2-9: Summary of post-SOX (2002) research on external audit quality signalled by level of audit fees

<table>
<thead>
<tr>
<th>Studies</th>
<th>Audit committee related variables</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Existence</td>
</tr>
<tr>
<td>Abbott, Parker, Peters and Raghunandan, 2003b</td>
<td>Positive association (+)(^{14})</td>
</tr>
<tr>
<td>Goodwin-Stewart and Kent, 2006</td>
<td>Positive association (+)</td>
</tr>
<tr>
<td>Knechel and Willekens, 2006</td>
<td>Positive association (+)</td>
</tr>
<tr>
<td>O’Sullivan and Diacon, 2006</td>
<td>Positive association (+)</td>
</tr>
<tr>
<td>Boo and Sharma, 2008</td>
<td>More negative association (-) in regulated firms than in non-regulated firms</td>
</tr>
</tbody>
</table>

\(^{14}\) (+) indicates that the test result confirmed the expectation of the audit committee impact, whereas (-) indicates that the test result did not support the expected impact of the audit committee.
In addition to using auditors’ remuneration, audit quality may also be measured in other ways. According to Chen, Moroney and Houghton (2005), independent audit committees tend to hire industry-specialised auditors, but the committees’ financial expertise and meeting frequencies are not associated with an auditor’s industrial specialisation. This result may reflect the previously mentioned argument that competent and active audit committees reduce the auditor’s workload and need for specialisation.

External auditors’ retention and reputation is also used to reflect audit quality. Piot (2004) provided evidence that the existence of an audit committee in French listed firms was associated with the auditor’s reputation. Lee, Mande and Ortman (2004) established that the existence of an audit committee reduced the likelihood of an auditor’s resignation. Therefore, a functioning audit committee effectively resolves the stand-offs between the auditors and the management. Following the auditor’s resignation, fully independent audit committees chose a successor auditor of higher reputation than those recommended by non-independent audit committees. However, only weak statistical evidence supports the argument that audit committees’ financial expertise reduces the likelihood of auditor resignation. Chen and Zhou (2007) observed 821 firms which recruited Arthur Andersen and dismissed the firm between 2001 and 2002, prior to the Enron fraud being revealed to the public. They established that firms with independent and competent audit committees dismissed Arthur Andersen earlier, and firms with larger and more active audit committees were more likely to choose a Big4 successor auditor.

Following the enhanced regulatory requirements for disclosure, for example, the ASX, NZX, and LSX listing rules, listed firms are required to disclose a statement of corporate governance. It is believed that the impact of audit committees on firms’ disclosure practices is an important issue. Chau and Leung (2006) and Barako, Hancock and Izan (2006) established that the existence of an audit committee is positively correlated to the level of voluntary corporate governance disclosure in Hong Kong and Kenya, where the adoption of an audit committee is only recommended. Chen, Carson and Simnett (2007) argued that firms with better corporate governance structures (i.e. having an audit committee) were more likely to disseminate interim financial information to shareholders. Mangena and Pike (2005) investigated the motivation for, and influence of, the extent of interim disclosure and found that increased shareholdings by audit committee members reduced the level of interim disclosure. Furthermore, audit
committee financial expertise had a positive impact on the level of interim disclosure, whereas the size of the audit committee had no impact on the level of interim disclosure.

It is expected that a functioning audit committee can enhance the firm’s overall disclosure transparency. Kelton and Yang (2008) found that diligent audit committees with higher levels of financial expertise were associated with increased levels of internet disclosure. Kent and Stewart (2008) established that ASX firms with more frequent audit committee meetings tended to have more disclosure about the impact of adopting IFRs since 2005. With respect to size, only smaller audit committees and small audit committees with fewer audit committee members who were financial experts tended to have more disclosure on the impact of adopting IFRs.

It is believed that good corporate governance improves the quality of information available to financial analysts (Byard, Li, & Weintrop, 2006). Disclosure practice therefore can also be investigated through the forecast information released by firms. The presence and the independence of an audit committee were positively associated with the disclosure of forward-looking information (O’Sullivan, Percy, & Stewart, 2008). However, according to Byard, Li and Weintrop (2006), audit committee independence did not result in forecast accuracy in USA firms between 1999 and 2002. Karamanou and Vafeas (2005) further found that increased audit committee independence was associated with lower forecast accuracy. This finding was also supported by Bédard, Coulombe and Courteau (2008), who reported no association between the presence and composition characteristics of an audit committee and the precision of management forecasts.

Market reaction is also an indication of the assessment of firms’ corporate governance, as perceived by the shareholders. Investors believe in better corporate governance under a strong audit committee than under a relatively weak audit committee (Kaplan & Mauldin, 2008). According to Davidson, Xie and Xu (2004), DeFond, Hann and Hu (2005), and Farber (2005), share price was positively related to audit committee financial expertise and diligence. In contrast to the market value, which is the assessment of firms through the perception of shareholders, firms may also be valued by using an objective index (Chan & Li, 2008). Brown and Caylor (2006) found no association between audit committee composition and firm value using an objective index. Chan and Li (2008) established that the independence of an audit committee leads to higher firm value, but this is only when a majority of independent directors serve on
the board.

It is also argued that internal control and the internal audit function should be overseen by the audit committee (DeZoort et al, 2002). The Sarbanes-Oxley Act of 2002 required listed firms to have an internal audit function and section 404 of the Act further provided that firms must disclose an assessment of the internal control by the auditors. After the commencement of the Act, Zhang, Zhou and Zhou (2007) found that firms were more likely to be identified with an internal control weakness if their audit committee’s financial expertise was low. Krishnan and Visvananthan (2007) further argued that firms that reported internal control weaknesses were characterised by audit committees that met more frequently and had a lower level of financial expertise. According to Vermeer, Raghunandan and Forgione (2006), under a voluntary basis, non-profit organisations were more likely to have an internal audit function when the financial expertise of their audit committees was high. Arena and Azzone (2009) confirmed the positive impact of a close link between internal auditors and the audit committee on the effectiveness of the internal audit function.

(3) Gaps in the existing qualitative research on audit committee corporate governance impacts

It is generally accepted that an effective audit committee should enhance corporate governance (DeZoort et al, 2002). However, ‘governance’ has not been previously defined and there is no consensus about its meaning. Sir Adrian Cadbury (1992) described corporate governance as the way in which organisations are directed and controlled. The New Zealand Securities Commission (2003) defines corporate governance as the set of structures and behaviours by which a company or other entity is directed and managed. According to the International Standards for the Professional Practice of Internal Auditing (2008), governance is a combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organisation towards the achievement of its objectives. Observing the major corporate governance regulatory regimes, namely the Cadbury Committee Code of Best Practice (1992), the Combined Code on Corporate Governance (Financial Reporting Council, 2003), the OECD Principles of Corporate Governance (2002), and the Sarbanes-Oxley Act of 2002, there are overlapping and differentiated areas that are expected to be covered by corporate governance. There are also two distinctive styles of
corporate governance regulation. One is represented by the Sarbanes-Oxley Act, which is described as black-letter law (Piper, 2005), emphasising compliance and enforceability, which are backed by legal enforcement. The other style is promoted predominantly in commonwealth nations as setting rules for benchmarks and providing guidelines for best practice. Those guidelines are recommended for adoption, but any departure can be justified on a case by case basis.

Given the broad range of corporate governance definitions and the different regulatory regimes for safeguarding corporate governance, evaluating the outcome of governance is a complex matter. The previously synthesised audit committee corporate governance impacts, namely financial reporting quality, audit quality, disclosure practice, internal control, and internal audit, cannot necessarily be regarded as a comprehensive assessment of corporate governance impact. Furthermore, given that the research results are inconsistent and inconclusive, this begs the question as to what corporate governance impacts an effective audit committee should have.

2.4 Summary

Most of the existing research on audit committees has been based on large samples selected from archival data or surveys, but has rarely investigated what has happened within audit committees. In summarising the literature review of the existing research, the following areas can be identified as gaps within the existing body of knowledge.

The qualitative research associated the determinants of audit committee establishment and composition with the characteristics of their boards, the agency conflict, leverage, and litigious risks. However, little is known about how audit committees interact with their boards. Furthermore, little has been documented about how audit committee members reflectively interpret their roles, their attributes, and their efforts in relating to their particular organisation. This research provides an opportunity for audit committee members to interpret the role of audit committees and of themselves as individual members, and to describe the occasions, either routine or ad hoc, when their committees report to their boards on their delegated duties.

Regardless of the inconsistency of the research results, it has been established by the qualitative research that an audit committee should be equipped with independent and financially literate members. In addition, committee members’ multi-directorships and
the average length of tenure have also been examined in recent studies. Given the inconsistent qualitative evidence, several questions regarding an audit committee’s composition arise. Firstly, how do members interpret the word ‘independence’ within the context of their specific committees? Secondly, what expertise or attributes assist audit committee members to fulfil their duties? This research seeks to obtain first-hand accounts from members of how they construct and interpret independence during their interactions with management, the board, and the auditors. This research also aims to document the accounts of the factors that have assisted the audit committee members to perform their roles effectively, including their personal backgrounds, experience, qualifications, and any other relevant attributes.

As stated by DeZoort et al (2002), the diligence of audit committees has been narrowly measured as audit committee meeting frequency. This research argues that the difficulty of not being able to establish a set of comprehensive measures for audit committee diligence may lie in the nature of the qualitative research. Their research also refutes the underlying assumption that audit committees only function through audit committee meetings. This research examines audit committee members’ perceptions of diligence, with a research question aimed at understanding how members carry out their jobs to achieve the audit committee’s desired outcomes. Furthermore, this study aims to obtain an understanding of how audit committees resolve issues around their assigned responsibilities, either on a routine or an ad hoc basis.

The existing qualitative audit committee research identified the corporate governance impacts of audit committees as the financial reporting quality, audit quality, disclosure practice, internal control, and internal audit. Separately, however, none of these impacts reflects a comprehensive assessment of corporate governance. The test results are also inconsistent and inconclusive. Therefore, this study intends to provide further evidence on the insight of the audit committee operation and effectiveness.

To align all of the above gaps in the existing body of knowledge on audit committees, this research invites the participants to describe a situation in which the audit committee interacts with each of the board of directors, the management, and the auditors. This will enable a clear picture of the various tasks performed by audit committees, why they perform those tasks, and how they complete those tasks, to be drawn. Finally, the analysis of those tasks and interactions will be considered within the context of the audit
committee objectives.

A detailed explanation of the research design is provided in Chapter Four, Research Design. Before the research design of this study can be fully understood, however, it is necessary to discuss the theoretical framework that underlies the research design. Accordingly, Chapter Three, Theoretical Framework will discuss: 1) the theoretical frameworks and findings of the existing qualitative audit committee research, 2) the sociological theories that guide the gathering, analysis and interpretation of the data, and 3) the descriptive theories of audit committees, which underpin the interview questions of the research.
Chapter Three: Theoretical Framework

3.1. Introduction

This chapter describes the theoretical framework on which the study is based. It discusses: 1) the theoretical frameworks of the existing audit committee qualitative research, 2) the sociological theories and the methodological approach that guide the gathering, analysis, and interpretation of the data in the study, and 3) the descriptive theories of audit committees which underlie the interview questions of the research.

3.2. On the notion of theory

According to Mitchell & Cody (1993), knowledge is theory-laden and research methods are theory-driven. The word ‘theory’, however, has been defined in a variety of ways by scholars and philosophers, for example, as a logically interrelated series of propositions that are used to specify the empirically meaningful relationships among a set of concepts (Babbie, 2005). Similarly, Argyris and Schon (1974) defined theory as a set of interconnected propositions referring to a common subject (a ‘referent’). This notion of theory is also known as “scientific theory”, which emphasises that a theory has a descriptive nature. This particular definition of scientific theory has been widely used in qualitative research (Weis, 1998). Following this notion of theory, qualitative research aims to document, describe and interpret the data. The patterns presented by such data form predictions for future research, which will verify, modify, or reject such patterns.

In a different vein, Corbin and Strauss (1998) believed that theory provides a model of why the world is the way it is. They argued that whereas theory is a simplification of the world, it nonetheless is aimed at clarifying and explaining aspects of a phenomenon. Silver (1983) developed this theme further; criticising the scientific view of theory, stating that it had eliminated the true beauty, the emotional significance of theory, and its relevance to everyday life. She defined theory as a unique way of perceiving reality, as an expression of someone’s insight into some aspect of nature, being of a perceptive and explanatory nature, rather than a descriptive one. Weis (1998) argued further that no single theory was intended to explain everything about everyday life. Rather, a theory was designed to explain a particular phenomenon, and it had no conceptual apparatus to explain other phenomena (Klein & White, 1996). Following this
notion of theory, qualitative research aims to provide a fresh and a different perspective of an aspect of a phenomenon (Henstrand, 2006).

As ‘theory’ has been ‘imprecisely’ defined (Flinders & Mills, 1993), the particular notion of theory employed is therefore ‘chosen’ by the particular type of research. This study favours Silver’s (1983) conceptualisation of theory. It is not that this research has adopted a particular theory; rather, this research has evolved from a journey similar to those of Silver (1983), Henstrand (2006), and many other researchers’ approaches taken towards a particular phenomenon of everyday life. The following section documents the approach for building the theoretical framework. Since this study involves examining the effectiveness of audit committees using qualitative research theory, two specific theoretical frameworks adopted by existing qualitative research on audit committees are discussed. The research design and data analysis framework adopted for the research are also discussed.

As mentioned previously, qualitative research aims to provide a fresh and a different perspective of an aspect of a phenomenon. Although the studies on audit committees have been dominated by the use of quantitative paradigms, there have been a number of qualitative studies aimed at obtaining an insight into the audit committee operation. The following section discusses two theoretical frameworks of the existing qualitative research on audit committees.

3.3. Theoretical framework underpinning of the existing qualitative research on audit committees

Among the qualitative audit committee studies, Spira (1998; 2002), and Gendron and Bédard (2005) constructed their research method and data analysis using sociological theoretical frameworks. In this section, these two theoretical frameworks are outlined and discussed in order to explain and justify the theoretical framework used in this study.

3.3.1 Spira (1998; 2002) - investigating audit committees through actor-network theory

Spira (1998; 2002) challenged the assumption that audit committees are established to improve the auditor’s independence and thus improve the financial reporting quality. She started her argument with an outline of audit committee evolution
in the broad context of corporate governance development on an international scale. Based on a scrutiny of the cause and effect relationships of several events of different corporate governance regimes, such as the setting up of the Cadbury Committee (1992) and the increasing popularity of audit committees in public companies, she argued that the establishment and activities of audit committees was the outcome of power relationships of actor networking. Based on the actor-networking theory ('ANT') (Callon, 1983), her research concluded that audit committee meetings and the questioning process usually demonstrated in audit committee daily activities were ‘ceremonial’ and ‘play an important part in offering comfort and reassurance to investors and lenders’ (Spira, 1998, p. 1).

Complementary to institutional theory, ANT provides explanations of how networks\textsuperscript{15} overcome resistance and internalise the desired outcome (Callon, 1983). ANT is most prominently associated with the French sociologists Bruno Latour and Michel Callon. The theory describes a networking between human and non-human actors. The actors are defined as “discrete individual, corporate, or collective social units” (Wasserman & Faust, 1994, p. 17). The actors are tied together into networks built and maintained in order to achieve a particular goal, for instance, achieving audit committee effectiveness. Such a process of networking is regarded as ‘translation’ (Spira, 1998, p. 58). In the process of translation, non-human actors\textsuperscript{16}, for example, in the audit committee context, the Cadbury Committee Report (1992), or the audit committee charter of individual companies, play an important role, as well as human actors. This is regarded as the ‘punctuation’ effect (Spira, 1998, p.58). Using this framework, the development of the audit committee mechanism and the institutionalisation of regular audit committee activities may be mapped out as in Figure 3-1.

\textsuperscript{15} This study interprets ‘network’ in Spira’s (1998; 2002) studies to be at both the micro level, i.e. the individual firm, and the macro level, i.e. the stakeholders of financial reporting.

\textsuperscript{16} The reports, or charters, however, still need to be developed by actors, human in this case. So they are not devoid of the influence of actors.
Figure 3-1: Theoretical Framework of Spira (1998 and 2002)

**Problematisation**: an actor seeks to develop influence in order to solve a problem.

**Interessement**: the actor interposes itself between the actors that it seeks to enrol and the rival associations of these actors in other networks.

**Enrolment**: the outcome of successful interessement in that the actors, especially those from the rival associations, are enrolled.

**Mobilisation** (punctualisation): the network established becomes more transportable (institutionalised).

**Obligatory points of passage**: the network established becomes functionally indispensable.

ANT adapted from Spira (1998)

**Problematisation**: organisations, e.g. sponsors of the Cadbury Committee, call for a reaction to the increasingly negative exposure of corporate financial scandals.

**Interessement**: setting up of the Cadbury Committee or Treadway Committee in reaction to the emergency focus on the financial aspects of corporate governance. The Cadbury solution is to interpose the audit committee, composed of independent directors, between the auditors and the executive directors, who can be interpreted as the ‘rival associations’.

**Enrolment**: firms are willing to incur the costs of setting up an audit committee to enrol the accounting profession (including the sponsors of the Cadbury Committee) to avoid the possible burden of legislation. At a micro (firm) level, two distinctive networks, the executive and non-executive directors, are both keen to enrol the auditors.

**Mobilisation**: the formation of an audit committee was promoted by the Cadbury Committee Report (1992), or other equivalent documents, or professional pronouncements. At the firm level, audit committee charters were issued. These documents became influential instruments of networking associated with audit committees.

**Obligatory points of passage**: the shifting of power between the above mentioned networks was a continuous theme of the audit committee. In order to get the work done, some parties within and outside audit committees circumvent the requirements of the Cadbury Report (1992) by interpreting them by ‘letter’ instead of by ‘spirit’.

The interpretation of research theoretical framework adopted by Spira (1998)
Spira’s (1998; 2002) studies focused on the role of rituals in audit committee meetings, examining to what extent audit committees’ effectiveness was embedded in the routine activities, such as asking questions and meeting with auditors without the management’s presence. Spira (1998) interviewed audit committee members of UK listed companies. Based on her qualitative investigation of the audit committees’ operations, Spira (1998; 2002) argued that the expectation of establishing independent audit committees to improve audit quality and financial reporting quality was ‘unproven’, but audit committees do assist companies to present an image concerning the quality of the statutory audit and financial reporting. Therefore audit committee formal activities, i.e. audit committee meetings, were primarily ceremonial, being a ‘private performance to a public audience.’ In addition to revealing an insight into audit committee processes, Spira’s (1998) study has contributed theoretically to the development of audit committee research methodology.

3.3.2 Gendron and Bédard (2005) - the constitution of audit committee effectiveness

According to Gendron and Bédard (2005), neither the existing qualitative nor qualitative research into audit committee effectiveness has focused on the meaning of the word ‘effectiveness’. They argued that firstly, the meaning of audit committees was internally constructed, rather than objectively measured, and secondly, the meaning of audit committee effectiveness varied according to different contexts (Gendron & Bédard, 2005). Therefore, their focus was on the process that constitutes the meaning of audit committee effectiveness.

The theoretical framework adopted by Gendron and Bédard (2005) was largely drawn from Schutz’s (1967) social constructivist approach towards theoretical developments. A major focus of social constructionism is to uncover the ways in which individuals and groups construct their perceived social reality through their interactions. It aims to explain the ways through which social phenomena are created, institutionalised, known, and made into tradition by humans. Gendron and Bédard justified their theoretical foundation for qualitative investigation by referring to the actors’ reflectivity and the role this plays in the process of constructing meanings of particular social phenomena. Therefore, audit committee members and other parties (for example, internal
auditors, external auditors, and executives) who attended audit committee meetings, ‘ascribed meaning to the committee’s effectiveness’ (Gendron & Bédard, 2005, p. 215). Based on 22 interviews of audit committee meeting attendees from three Canadian listed companies, Gendron and Bédard (2005) found that the constructionist process of audit committee meeting attendees involves ‘two layers of meaning, the symbolic and the substantive’ (p. 215). The main conclusions drawn by Gendron and Bédard (2005) are demonstrated in Figure 3-2.

**Figure 3-2: The interpretation of the constitution of audit committee effectiveness by Gendron and Bédard (2005)**

According to Gendron and Bédard (2005), the constitution of the meaning of audit committee involves a heterogeneous set of emotions that vary from confidence to anxiety.
In contrast to Spira (1998; 2005), Gendron and Bédard (2005) went beyond the rituals within the meetings, to include informal processes outside audit committee meetings.

### 3.3.3 Other qualitative audit committee research

Turley and Zaman (2007) and Sarens, de Beelde and Everaert (2009) utilised the case study method to qualitatively explore audit committee operations. The key focus of Turley and Zaman (2007) was on the role of an informal process outside audit committee meetings, whereas Sarens, de Beelde and Everaert (2009) mainly investigated the interactions between internal auditors and the audit committee members. However, these research studies did not discuss the sociological theories underpinning their research design and data analysis. The research results of Turley and Zaman (2007) and Sarens, de Beelde and Everaert (2009) are incorporated with discussions in Chapter Six, Research Findings and Discussion.

### 3.3.4 Summary

The existing qualitative research on audit committee effectiveness has a common theme, namely, the interpretation of the interactions embedded in an audit committee’s daily life. These studies focus on a particular group of audit committee meeting attendees in their entirety rather than focusing on individual members. Therefore, none of the previously discussed qualitative studies were able to provide an explanation of the role of an ‘audit committee’, the role of ‘committee members’, or why audit committee members perform certain activities from the perspective of the individual audit committee members.

This study argues that the ultimate effectiveness of audit committees relies on members’ attributes and efforts. The abovementioned interactions within specific audit committees are only vehicles for members’ attributes and efforts in order to perform the audit committee function. Therefore, this research is intended to investigate how individual audit committee members justify: (1) the objectives of the overall audit committee mechanism; (2) their role as committee members; (3) and why they perform certain activities. In other words, to perform their audit committee roles, members must make sense of their role in relating to their particular audit committees. In addition, they should be able to justify why they do what they do regarding the objectives of audit committees. Therefore, investigating intention and the intentional processes of individual
audit committee members who live through the daily life of their committee will be of value to the existing body of knowledge regarding audit committees. Such a research objective can be achieved only by employing an interpretative approach. Drawing upon the primary principle of phenomenology, any given social phenomenon is intended by the people who live through it. Such intentional influence is abstracted by processes of making sense. This research is intended to capture and interpret such intentional processes and thereby to provide a fresh explanation of audit committee effectiveness. The research will thus contribute to the literature by extending the existing knowledge of audit committee members making sense of achieving the intended outcome of their roles.

3.4. Research roadmap

The philosophical stance of theory as discussed in section 3.2, (On the notion of theory) forms the foundation of research; it defines what research question(s) to ask; meanwhile theory is built upon concepts, constructs and propositions, which have been described as the "building blocks" of theory (Babbie, 2005; Silver 1983; Henstrand, 2006). As a researcher moves from concepts to the level of theory, there is also a movement from concrete experiences to a level of abstract description (See Figure 3-3, The building blocks of theory).

**Figure 3-3: The building blocks of theory, adapted from Henstrand (2006)**

![Diagram of building blocks of theory]

As stated previously, the motivation for this research is to answer the general research problem: “What substantially gives rise to an effective audit committee?” It is an exploratory study that aims to identify qualitative factors that contribute to audit
committee effectiveness in carrying out its function. While this research does not claim to create ‘theories’ for audit committee effectiveness, it is expected that it will be possible to draw a conclusion on the determinants of audit committee effectiveness. As illustrated in Figure 3-4, the research roadmap reflects the building blocks of theory.

**Figure 3-4: The research roadmap**

<table>
<thead>
<tr>
<th>The building blocks of theory</th>
<th>Research roadmap</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Theory/abstract</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Proposition</strong></td>
<td>An overall conclusion on the insight of ‘What gives rise to an effective audit committee?’</td>
</tr>
<tr>
<td><strong>Construct</strong></td>
<td>Determinants of audit committee effectiveness</td>
</tr>
<tr>
<td><strong>Concept</strong></td>
<td>Assessment on the effectiveness of an audit committee</td>
</tr>
<tr>
<td><strong>Sensation/Concrete</strong></td>
<td>Concepts of ‘audit committee’, ‘audit committee objectives’, ‘audit committee effectiveness’</td>
</tr>
</tbody>
</table>

The general research problem is investigated by answering four interrelated, specific research questions, namely:

1. What do audit committee members perceive the desired objectives of an audit committee to be?
2. What do the members bring to an audit committee in order to achieve its desired objectives?
3. How do members help attain the desired audit committee objectives?
4. How do members assess the extent to which the audit committee objectives have been achieved?

The theoretical roadmap as illustrated in Figure 3-4 aims to answer the four research questions. How these questions are answered, is in turn driven by the theoretical
framework. Adopting such a theoretical roadmap shapes this thesis in the following ways: it maps the scope of the research, develops the research questions, designs the interview questions, and assists in the data analysis.

3.5. Methodology

Theory is highly related to research methodology (Henstrand, 2006). According to Corry (1997), the philosophical stance of theory informs the methodology and provides a context for the process and for grounding its ‘logic and criteria’ (p. 3). The perceptual and explanatory notions of theory, along with the preceding research questions, determine the research methodology. This research argues that it is particularly important to understand audit committee members’ perceptions of audit committee effectiveness through the lenses of phenomenology. As the fundamental doctrine of phenomenology, the central structure of an experience is its intentionality. ‘Intentionality’ refers to the conscious relationship one has to an object (Sokolowski, 2000). An experience is directed towards an object by virtue of its content or meaning (which represents the object), together with appropriate enabling conditions (Embree, 2007). It is because audit committee effectiveness is not only performed by people, but also in a public setting. By discussing the intentionality embedded in audit committee everyday life, this research facilitates and reclaims a public sense of thinking and reasoning, which has been missing in the existing body of knowledge about audit committee effectiveness.

3.5.1 Constructionist responsive interviewing

The responsive interviewing technique developed by Rubin and Rubin (2005) is adopted as the model for the research design. The responsive interviewing model has its roots in interpretive constructionism (Rubin & Rubin, 2005). Constructionism researchers focus on meaning and power because their epistemological position dictates that meaning and power are all that one can really claim to know about. Constructionism research is aimed at accounting for the ways in which phenomena are socially constructed (Burr, 1995). Burr (1995) identifies several basic assumptions of the social constructionist position: firstly, one should observe taken-for-granted knowledge through critical lenses; the ‘truth’ is only known through human experience. Secondly, any given phenomenon is embedded in its historical and cultural specificity which emerges from the social interaction within a group of people at a particular time and in a particular
environment. Categories of understanding, then, are situational. Finally, knowledge and social action go together - reality is socially constructed by interconnected patterns of communication behaviour. Within a social group or culture, reality is defined not so much by individual acts, but by complex and organised patterns of ongoing actions.

According to Rubin and Rubin (2005), the responsive interview model is based on the fact that both the interviewer and interviewee are people, with feelings, personalities, interests, and experiences. It emphasises the ‘presence’ (p. 31) of the interviewer in the interviewing process, rather than the ‘subjective’ recording of a question and answer type of conversation. Without professing to be entirely ‘neutral’ or an ‘automaton’, the researcher asks the interviewees - the audit committee members - to tell stories they experienced in performing their duties in their particular audit committee. The researcher then, based on a particular description or explanation, may probe for further clarification. Therefore, the interviewee is virtually taking the interviewer though his/her particular experience.

Essential to the responsive interviewing model is that the interviewer and interviewee are in a relationship in which there is mutual influence in both directions. The initial interview questions are expressed in a broad way to give the interviewees the opportunity to answer from their own experience (Rubin and Rubin, 2005). The interviewee’s answers then direct the researcher as to what to pursue further. The openness revealed after the interviewees start to describe their experience makes it possible - even natural - for the interviewer and interviewee to become conversational partners to suggest topics, concerns, and meanings that are important to the themes under exploration.

The responsive interviewing model proved to be highly effective during the research. Starting with stories about, or even anecdotes in their lives, audit committee members were relaxed and focused on the topics they believe highly important and relevant to the effectiveness of their audit committees. At the same time, the interview data are contextual, logical, and vivid with emotions and subjectivity. The researcher kept probing important statements captured during the interviews, as accounts of the determinants of audit committee effectiveness emerged. The analysis and discussion of the research results are detailed in Chapter Six, Research Results and Discussion.
3.5.2 The role of positive and normative accounting theories

Although heading in different directions, both positive and normative theories try to explain the behaviour of financial reporting. Audit committees as a corporate governance mechanism bear the responsibility and expectation for oversight of the financial reporting process (Beasley, Carcello, Hermanson, & Neal, 2009). Therefore, the role of positive and normative accounting theories cannot be ignored in the theoretical framework of this research study. Given that qualitative research on audit committees has failed to provide consistent and conclusive results of all of the factors identified as associated with audit committee effectiveness, no single positive and normative accounting theory can be relied on to guide this qualitative research. However, both positive and normative theories play important roles in designing the initial interview questions of the research.

Positive accounting theories, as represented by Watts and Zimmerman (1979), are often cited as the theoretical basis for disclosure and discretionary management behaviour studies. A literature review by Milne (2001) shows that Watts’ and Zimmerman’s theory is largely concerned with the predictors of lobbying behaviour and disclosure behaviour based on the assumption of self-interested managers’ wealth maximising. Following this line of reasoning, one can predict that one of the audit committee’s roles should be providing another layer of assurance of preventing financial reporting from being utilised in pursuing management self-interest. However, as discussed in Chapter Two, there is no concrete evidence that the audit committee has achieved this responsibility. This research does not predict audit committees’ responsibilities, but offers a chance for the audit committee members to describe and explain their responsibilities. There are also interview questions initially set out to ask about the audit committee members’ experience during the interaction with the management, the directors, and other internal or external auditors, who directly interact with the audit committee members during their daily lives.

The major contribution of the research from a normative accounting theory perspective lies in debating the pros and cons of various ways of improving the quality of financial reporting. According to Kabir (2005) there are two dominant strands of qualitative accounting research which follow normative accounting theory. These are stock market-based research in accounting and research in earnings management. The
first category of research investigated stock market reactions to releases of earnings’ information to stock markets. The decision-usefulness notion claims that the value in financial reporting lies in its facilitation of various economic decisions, especially investment and credit decisions. The earnings management studies investigated managers’ motivations to manage reported earnings and found that managers were exposed to various incentives to manage reported income (Bergstresser & Philippon, 2006). Accountants have traditionally emphasised the objectivity of accounting measurement (Deegan & Samkin &., 2008). Ijiri (1975) goes a step further and emphasises the linkage between accountability and accounting practices. Normative accounting research has also failed to prove concretely that the existence and identified characteristics of audit committees are associated with more reliable financial reporting.

As mentioned above, oversight of the financial reporting process is merely one of the major responsibilities of the audit committee. Without taking into account the dominant notions about the quality of financial reporting, for example, conservatism or reliability, the interview questions of this research investigate what is regarded as good or acceptable performance of audit committees and to whom an audit committee is responsible.

In summary, previous qualitative research, either normative or positive, plays a vital role in scoping the initial themes of the research questions. Such initial themes, namely interacting with directors, management, and auditors, the assessment of acceptable performance, and the accountability of audit committees, are also familiar to all corporate directors, especially to audit committee members. These initial themes are also important for approaching and recruiting the interviewees, for, with a familiar initial theme set for the semi structured interviews, the interviewees are more likely to be focused, rather than seeking topics from their memories, as suggested by completely unstructured interviews. Further description and discussion of each individual interview question is provided in Chapter Four, Research Design.

3.5.3 Reflective analysis

Qualitative research tends to document the participant’s personal perceptions, but one can only get close to that personal perception, because the personal perception embedded in the interview data is complicated by the researcher’s own conceptions.
Thus; a two-stage interpretation was involved: stage one: the interviewees are trying to make sense of their life in their audit committees in answering the interview questions; and stage two the researcher is then making sense of the participants’ responses.

The interview data analysis is largely based on Embree’s (2007) reflective analysis. According to Embree (2007), one’s encountering includes components of ‘experiencing’, ‘believing’, ‘valuing’, and ‘willing’ in broad categories. To facilitate the data analysis, the interview data that are of an ‘experiencing’ nature are coded as ‘descriptive accounts’ because they describe what happens. The data that are of an ‘intentionality’ nature are coded as ‘explanatory accounts?’ because they describe the participants’ reasons. The descriptive accounts are classified into ‘pictorial’ and ‘perceptional’. Pictorial accounts are either the descriptions of the procedural settings of the audit committee, or contextual information about the particular organisation or a particular incident. Perceptonal accounts are represented by ‘expecting’, a perception of future encountering, ‘remembering’, a perception of past experience, and ‘perceiving’, a perception of current encountering or experience.

The intentional factors are filtered out from the explanatory accounts and further classified into willing, valuing, and believing. Cognitions (or the intentionality) are always value laden, including the basic components of ‘willing’, ‘valuing’, and ‘believing’ (Embree; 2007). The key difference between the explanatory account ‘believing’, and ‘valuing’ or ‘willing’, is that believing (something to be true) more likely ‘comes from what others have communicated to us’ (Embree 2007, p. 183). Whereas ‘valuing’ (something to be either right or wrong) is comparatively closer to a deduction of past experience; and willing (to do or not to do something) can be regarded as an intended realisation of ‘believing’ and ‘valuing’ in the future. If audit committee effectiveness is intended by the committee members, the participants’ value loaded accounts are of great interest to this research. The interview data that are coded into these three broad nodes usually have a deductive form. In this research, the data analysis of explanatory accounts tended to draw distinctions between the three categories in order to understand the reasoning of the participants, but not to argue for or against.

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17 The reflection of an indirect experience.
18 The reflection of a direct experience.
Figure 3-5 shows the structure of the nodes of the second round of coding.

**Figure 3-5: Reflective analysis adopted in this research**

The tree structure demonstrated in Figure 3-5 cannot fully display the determinants of audit committee effectiveness. It is necessary to further abstract the determinants of audit committee effectiveness into identities and attitudes. These identities and attitudes are embedded in a number of grounds, namely, culture (the behaviour pattern), gender, power position (for example, being an audit committee chairman), or a particular incident or environment (for example, the adoption of IFRS in New Zealand). These determinants are interwoven into each other as illustrated in Figure 3-5.

Embree (2007)’s reflective analysis is a complex data analysis framework proposed for the social psychology research within the broad paradigm of phenomenology. However, the objective of the current research is not to analyse the audit committee members’ behaviours from the psychological perspective, but to investigate their basic intentionally or the reasoning for their perceptions of audit committee effectiveness.

The detailed discussion of the data analysis is documented in Chapter Six.
3.5.4 Reflectivity

Subsequent to the data analysis, several conclusions are drawn in answering the research questions. Once the qualitative determinants of audit committee effectiveness have been abstracted and summarised, the researcher’s reflectivity is discussed in evaluating the results. Reflectivity refers to an awareness of the researcher's contribution to the construction of meanings throughout the research process and acknowledges the reality that it is extremely difficult for the researcher to remain neutral, i.e. 'outside' the subject matter, while conducting research. Reflectivity requires the researcher "to explore the ways in which a researcher's involvement with a particular study influences, acts upon and informs such research" (Nightingale & Cromby, 1999, p. 228).

In Chapter Seven, reflectivity is considered and discussed in two respects: the researcher’s personal reflectivity and methodological reflectivity. ‘Personal reflectivity’ involves reflecting upon the ways in which one’s own values, experiences, interests, and social identities have shaped the research. It also involves thinking about how the researcher may have affected and possibly changed the way in which audit committee effectiveness is understood.

The discussion of ‘methodological reflectivity’ aims at answering questions such as: how has the research question defined and limited what can be found. How could the research question have been investigated differently? To what extent would this have given rise to a different understanding of the phenomenon under investigation (Willig, 2001)? The discussion of methodological reflectivity enables the researcher to reflect upon the assumptions (about the world and about knowledge) of the audit committees that have been made in the course of the research. Following on the reflective analysis, the limitations of the study are discussed and opportunities for future research are identified.

3.6 Summary

The theoretical framework of the research mirrors Henstrand’s (2006) building blocks of theory. Under the qualitative research paradigm, the research problem of this study is defined as ‘what substantially gives rise to an effective audit committee?’ The methodology of the research is determined by this theoretical foundation. Qualitative
data is obtained through Rubin’s and Rubin’s (2005) responsive interviewing technique. The data analysis is drawn from the model of Embree’s (2007) reflective analysis.

Positive and normative accounting theories are strongly related to the content of audit committee responsibilities and are therefore relevant in formulating the interview questions. These theories are mirrored in the discussion of the research results.

Finally, the researcher’s personal reflectivity and the methodological reflectivity are discussed in evaluating the research results. The relationship between the building blocks of theory, research roadmap, and the theoretical framework adopted by this research is illustrated in Figure 3-6.
Figure 3-6: The relationship between the building blocks of theory, the research roadmap and the theoretical framework

The building blocks of theory

Theory/abstract

Proposition

Construct

Concept

Sensation/Concrete

Research roadmap

An overall conclusion on the insight of ‘What gives rise to an effective audit committee’

Determinants of audit committee effectiveness

Assessment on the effectiveness of an audit committee

Concepts of ‘audit committee’, ‘audit committee objectives’, ‘audit committee effectiveness’

Audit committee members’ descriptive and explanatory accounts

Theoretical framework of this research

Researcher’s personal reflectivity

Methodological reflectivity

Responsive Interviewing

Positive and normative accounting theories

Reflective analysis
Chapter Four: Research Design and Data Collection

4.1 Introduction

This chapter describes and explains the following:

- the research design and interview questions
- the pilot interview
- the research sample and population, and
- the procedural stages of data collection.

4.2 The research design and interview questions

4.2.1 The relationship between interview questions and research questions

In this section, the relationship between interview questions and research questions is discussed in order to explain the research design. The general research question of this thesis is ‘what gives rise to an effective audit committee?’ Based on the inconclusive results of the audit committee literature discussed in Chapter Two, the research question is answered by addressing and answering four interrelated, specific research questions, namely: (1) what do audit committee members perceive the desired objectives of an audit committee to be? (2) what do the members bring to an audit committee in order to achieve its desired objectives? (3) how do members help attain the desired audit committee objectives? (4) how do members assess the extent to which the audit committee objectives have been achieved? Twenty-one (21) interview questions were prepared to cover these four research questions. The questions were organised into four topics, namely:

1. perceptions of responsibilities of the audit committee
2. operation of the audit committee
3. relationships with audit committee stakeholders, and
4. perceptions of the environment around the audit committee.

The full questionnaire can be found in Appendix B.
The interview questions are semi-structured, allowing a certain level of scope limitation, as well as a certain degree of openness for responses by the interviewees (Wengraf, 2001). The interview questions are subject to a certain level of scope limitation because they are supposed to act as informants aimed at obtaining qualitative data that is relevant to the research questions.

According to Rubin and Rubin (2005), to explore the shared values or norms of the interviewees, the interviewer often asks the interviewee to describe a typical event or ordinary occurrence. Such interviews should give the interviewees the opportunity to describe what is important to them. In the interview questionnaire, eleven (11) out of twenty one (21) questions ask the interviewees, i.e. the audit committee members, to describe typical occurrences in performing their audit committee tasks. These 11 questions proved to be effective, as the audit committee members who participated in the interviews told stories and made anecdotal comments about events which they believed to be typical in performing their audit committee roles. As it is not possible to observe the real board meetings, including audit committee meetings\(^{19}\), stories within an organisational context are substitutes to observed incidents. The data collected via these questions are contextual and demonstrate a sense-making process by interviewees in perceiving what had happened, why those events happened and the intentional factors which justified their behaviour during those events. The interview responses obtained from those questions thus also serve as informants for all four of the research questions. The relationship between the interview questions (IQ) and research questions (RQ) is illustrated in Figure 4-1. Each of the twenty-one interview questions is designed to be an informant for one or more of the research questions.

### 4.2.2 Interview question design

In this section, each of the interview questions is explained with regard to its relevance to the gap in the existing body of knowledge and how it serves as an informant of one or more particular research questions. As mentioned previously, the interview questionnaire has four main themes or topics. The first topic investigates audit committee members’ perceptions of audit committee responsibilities.

\(^{19}\) Such meetings usually discuss share price sensitive information, therefore participation from outside parties is prohibited by the law.
IQ*: interview questions that invite story-telling and are relevant to all of the research questions.

The very first interview question is: ‘what motivated you to become an audit committee member?’ The qualitative research shows that audit committee members possess certain characteristics, for example, they are either an independent director or they have the financial or accounting expertise required to fulfil the duty of overseeing the financial reporting and auditing processes (Abbott et al, 2003a; Baxter & Cotter, 2008). As discussed in Chapter Two, the
qualitative research has not been able to consistently prove that such characteristics are positively associated with high quality financial reporting and auditing. It is also unknown how certain attributes link to particular audit committee duties that are consciously intended to. This interview question is designed to obtain information about how audit committee members justify their presence in the audit committee, i.e. what are the intended objectives of the audit committee and what type of attributes do members possess that can contribute to those intended objectives? This interview question therefore acts as an informant for research question one, ‘what do audit committee members perceive the desired objectives of an audit committee to be?’ and research question two, ‘what do the members bring to an audit committee in order to achieve its desired objectives?’.

Interview question 1.2 is: ‘Are you assigned any specific responsibility by the audit committee? Why are you assigned with this responsibility?’ This question develops the preceding discussion further: if certain audit committee members’ attributes (or characteristics) are associated with certain audit committee objectives, are members assigned with specific duties to utilise those attributes? In answering this interview question, the audit committee members are given another chance to make sense of the link between their presence and the intended audit committee objectives. In contrast to research question 1.1, which emphasises the audit committee members’ intention, this question is aimed at the audit committee members’ perception of performing audit committee duties. This question therefore acts as an informant for research question two, ‘what do the members bring to an audit committee in order to achieve its desired objectives?’ and research question three ‘how do members help attain the desired audit committee objectives?’

Interview questions 1.1 and 1.2 lead to interview question 1.3, which is: ‘what do you think helps you most in achieving your assigned responsibility? Please describe how this helped you in a specific situation. Was this typical?’ This question is asking for a description of a situation or an occurrence when the audit committee member perceived that his or her attribute or effort specifically resulted in an intended outcome. In answering this question, audit committee members are given an opportunity to demonstrate a complete sense making process of what was intended to happen, what did happen, how certain attributes or efforts took effect, and to evaluate what happened in comparison to what was intended. Therefore, this research question is acting as an informant for all four research questions. In answering this research

According to Sokolowski (2000), ‘intending to’ means the conscious process of relating an experience to an object, in other words, ‘intending to’ is a process of making sense of experience.
question, it was evident that the interviewees usually selected an event that was important to
them. By asking ‘was it typical?’, the events referred to in the responses were classified further
into either an anecdotal event of significance, or alternatively, an event of frequent occurrence.

Interview question 1.4: ‘Have you encountered any difficulties or conflicts in achieving your assigned responsibility? If so, please specify.’ This question is intended to complete the
circle for the audit committee members to explain the efforts and attributes that have contributed
to them performing their duties. Compared with the previous question, it is more focused,
targeting any difficulties and conflicts experienced by the audit committee members. At the
same time, the question is aimed at obtaining an account of a specific situation or event that may not necessarily be intended by the audit committee member. Such difficulties and conflicts
could be ad hoc, or even imposed on the members, and they could be either external or internal.
As discussed in Chapter Two, qualitative research has been trying to establish that audit
committee performance is associated with members’ independence. The rationale for such an
hypothesis is that having independent directors (audit committee members) can prevent agency
problems. This research question is also related to the studies that associate audit committee
existence and composition with a firm’s industrial context or level of litigious risks. Without
specifying the issues of ‘independence’ or ‘risks’ in this interview question, it is expected that
interviewees would give examples of difficulties or stand-offs between different parties caused
by, for example, conflicts of interest, or the pressure of increased regulatory requirements. This
research question also acts as an informant for all four research questions.

The last interview question in topic one is: ‘On a scale of 1 to 10, with 10 being the best,
how well do you believe you achieved your assigned responsibility? Please explain why you
chose this score.’ This question provides an opportunity for the interviewee to evaluate his/her
performance as an audit committee member. The rating is not intended to measure the
member’s performance, but rather as an initiator of further conversation. The key intention of
the question is to identify how interviewees justify the evaluation of their performance. As
discussed previously in Chapter Two, an audit committee bears the responsibility for overseeing
the financial reporting and auditing processes and the practices of internal control and risk
management (DeZoort et al, 2002). Such responsibilities, however, reflect public expectations
rather than being a matter of fact (Beasley, Branson, & Hancock, 2008). This interview question
is designed to obtain an insight into how audit committee members perceive their duties and to
what extent they believe they have fulfilled their duties. It emphasises interviewees’ self-
evaluations. In other words, this interview question is interested in: a) what has been used as a benchmark against which the audit committee members can evaluate their performance; b) why they choose such benchmarks; and most importantly, c) the sense making process of audit committee members’ evaluations.

Topic two of the interview questionnaire focuses on audit committee meetings. The qualitative research has adopted meeting frequency as a measure of audit committee diligence (Raghunandan & Rama, 2007). This is because it is common practice for the board of directors, as well as its sub-committees, to carry out their duties in the form of meetings and the outcome of their work is represented by meeting minutes and resolutions. According to Spira (2002), audit committee meetings are ceremonial; she described such meetings as a ‘private performance for (a) public audience’ (p. 45 and p. 221).

Cohen and Holder-Webber (2006) argue that research on boardroom behaviours is extremely rare, and that little insight has been documented about what exactly happens during board meetings. Interview question 2.1 ‘Please describe the process for discussing and resolving issues in your audit committee”, and interview question 2.5, which asks the interviewee to describe either a regular or the most recent audit committee meeting he/she attended, are aimed at eliciting an account of a specific occurrence or situation. Based on the description given, the researcher further probed the reasoning and ordinariness of such an occurrence by asking ‘why?’ or ‘how typical is this?’

As discussed in Chapter Three, the intentionality of audit committee members’ performances is an underlying assumption of this research. When interviewees describe audit committee meetings as seen through their eyes, the factual accuracy is of less importance than the completeness of the sense-making process (Rubin & Rubin, 2005). This is because such accounts reflect the interviewees’ assessments of what is true and significant to them.

Interview questions 2.2, 2.3, 2.4, and their sub-questions are aimed at obtaining an insight into audit committee performance outside audit committee meetings. Exploratory data shows that on average, the audit committee in New Zealand listed companies met four times during the financial year ending 31 March, 2007. Little evidence shows that audit committees accomplished all of their duties either during formal committee meetings, or vice versa. Both Gendron and Bédard (2005) and Turley and Zaman (2007) reported that there were informal

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21 For details see Chapter Five, Research Findings and Discussion.
audit committee activities outside the formal committee meetings of firms investigated. Research questions 2.2, 2.3, and 2.4 have the following aims:

- To identify the activities that are performed outside audit committee meetings; the nature of such activities, and who is involved.

- To understand the magnitude of the audit committee activities both during and outside audit committee meetings; whether the audit committee meetings outweigh the performance outside the meetings, or vice versa.

These questions are not intended to measure the time that audit committee members have spent either attending meetings, or working outside the meetings, but rather to reveal the diversification of audit committee activities. The responses to these interview questions also indirectly reflect the objectives of various audit committees. The questions also investigate the sense-making process and intentionality of interviewees, i.e. why they perform those activities, what has happened, and what is important to them regarding their audit committee’s role. Therefore the factual accuracy of the interview responses is again of less importance than the logical deductions flowing from the story-telling.

Topic three of the interview questionnaire investigates the relationship between audit committee members and other parties who work with them, namely the management, the internal auditors, external auditors, and the board of directors. In contrast to topic two which focuses on the audit committee meetings as routine activities of audit committees, topic three aims to obtain an account of specific occurrences which involve stand-offs, conflicts, or difficulties in performing the audit committee’s role. Question 3.1 asks the interviewee to describe a specific occasion when the audit committee needed to work between the management and the external auditors to resolve an issue or conflict.

According to DeZoort et al (2002), an audit committee has the responsibility for overseeing the internal control process of an organisation. As per principle 5 of the OECD (2004) Principles of Internal Control, having a formal internal audit function is regarded as one of the best practices of internal control. According to the professional pronouncement issued by the Institute of Internal Auditors, the internal audit function should report to the audit committee (the Institute of Internal Auditors, 2010). Question 3.2 asks the interviewee to describe a situation of working between the internal auditor and management, especially when there is a particular issue that needs to be resolved by the audit committee.
In criticising the inconsistency and lack of conclusiveness of the qualitative research, Turley and Zaman (2004) and Spira (2002) point out that qualitative research on audit committees largely borrowed the theoretical framework (or hypotheses) used in qualitative research on the board of directors. For example, the argument that the independence of an audit committee is associated with financial reporting quality derives from the proposition that the independence of the board of directors is associated with financial reporting quality. Since the audit committee is a subcommittee of the board of directors, it is unknown whether the composition characteristics of the audit committee or the composition characteristics of the board influence the performance of the audit committee. Audit committees assume their delegated responsibilities according to the audit committee charter filed with the board of directors (Guthrie & Turnbull, 2006). Question 3.3 offers an opportunity for the audit committee members to describe the interactions between the audit committee and the board of directors. Such interactions are described along with a specific occasion when the audit committee reports to the board, especially when there is an outstanding issue that needs to be resolved.

Topic three also aims to reveal the diversification of audit committee activities. The questions request the interviewee to describe a complete occurrence, with sufficient contextual information. Because of the assumption that all behaviours are intentional, the interviewee’s response should contain the sense-making process of how an audit committee member perceived what had happened on those occasions, the reason(s) for what had happened, and why they did certain things to resolve the issue. The three interview questions act as informants for all four of the research questions.

Topic four of the interview questionnaire is titled: ‘perceptions of the environment around the audit committee’. This topic investigates the audit committee members’ perceptions of events or changes associated with audit committees, but not necessarily the committee duties per se. This topic is associated with all four research questions.

Question 4.1: ‘has your relationship with other executives changed since you were nominated as an audit committee member? Please give an example. What do you think might be the reason?’ One of the common hypotheses tested by the qualitative research is that an independent audit committee is positively associated with better financial reporting and auditing quality (Klein, 2002). As previously discussed in interview question 1.4, this research intends to capture a justification of whether the independence or objectivity of audit committee members
can reduce the agency problem. Without specifying the issues of ‘independence’ or ‘objectivity’, question 1.4 investigates the conflicts or difficulties encountered by audit committee members when performing their audit committee duties. Question 1.4, however, may or may not lead to interviewee responses that contain issues or stand-offs between audit committee members and management. Interviewees may identify and describe other difficulties or conflicts. To overcome this possibility, question 4.1 specifies the scope of the discussion. Interviewees are requested to comment on their relationships with the management prior to and after they served on the audit committee. If any changes in the relationships are identified, the interviewees are invited to relate an account of how they sensed that the relationships had changed and explain the reasons that they believe triggered such changes.

Cohen and Holder-Webber (2006) argue that audit committee performance should be motivated by both reward and punishment. According to Adams and Ferreira (2008), audit committee members with higher fees attend board meetings more frequently. Adams and Ferreira (2008) is thus far the only qualitative research study investigating the remuneration of audit committee members and their diligence, providing some evidence of the impact of motivation. The investigation of audit committee members’ motivation is very limited. Interview question 4.2: ‘do you believe your remuneration for serving on the audit committee is reasonable?’ is not only aimed at an evaluation of remuneration reasonableness but, when the interviewees justify their evaluation, an account of their perception of the magnitude of their audit committee duties and the achievement of audit committee objectives may also be revealed.

According to another commonly tested hypothesis in the qualitative research, the determinants of audit committee establishment and composition are associated with litigious risks exposure (Carcello, Hollingsworth & Neal, 2006). Given the inconsistent results of the research, many commentators criticise the practice of the audit committee as box ticking (Turnbull, 2005). Interview question 4.3 is: ‘how have the increasing regulations and guidelines governing audit committees affected your work on the audit committee? Please give an example.’ In answering this question, interviewees are given an opportunity to discuss the impact of the regulations on the performance of their audit committee duties. They are also requested to justify their reaction to such impact. Their discussion is expected to be supported by examples, i.e. specific incidents that they have experienced.
The last interview question is ‘if you are nominated to serve on the audit committee again, will you accept it? Why, or why not?’ This question is designed to encourage interviewees to reflect on the first interview question in the questionnaire, which asks what motivated them to become audit committee members. In closing the interview process, interviewees are provided with an opportunity to re-examine their experience of serving on an audit committee. It is believed that after answering the previous 20 interview questions, the interviewees will have taken the interviewer through all the important issues relating to performing the role of audit committee members. This process is intended not only to obtain a description of their actual, perceived experience of various incidents, but also to invite the interviewees to explain why those incidents happened and, most importantly, to justify how they reacted to those incidents. As a final contribution to the interview, it was expected that interviewees could reflect on what they have said before, and complete the picture of their lived experience as audit committee members in reaching a conclusion. This conclusion goes beyond particular incidents, and is justified by their vision of their own futures as audit committee members.

In summary, the four topics of the audit committee members’ interview questionnaire are addressed by using Rubin’s and Rubin’s (2005) responsive interview model, whereby the researcher asks the interviewees, the audit committee members, to tell stories about their experiences in performing their duties in their particular audit committee. The researcher then, based on a particular description or explanation, may probe for further clarification. Therefore, the interviewee is taking the interviewer through his/her particular experiences.

4.3 The pilot interview

To test the interview questionnaire, a pilot interview was conducted on 23 August, 2007. The pilot interviewee was an academic staff member of Lincoln University, who had had professional experience as a chartered accountant and auditor, and had worked with audit committee members of New Zealand listed companies. The pilot interviewee confirmed that, with minor exceptions, the length of the interview questionnaire was appropriate.

The pilot interviewee further confirmed that:

- the interview questions were clear and unambiguous
the interview questions were focused and those questions designed for inviting story-telling about particular incidents flowed naturally.

Based on his experience, the pilot interviewee suggested that the word ‘conflict’ in question 1.4 might be better expressed as ‘stand-off’. This is because, at the board room level, any tension between auditors, management, and the board of directors was usually associated with technical accounting issues, therefore it was primarily an argument about which accounting treatment was more appropriate, rather than a ‘conflict’.

Although the actual interview question was not amended, the pilot interviewee’s opinion was taken into account when analysing the research results. As discussed in Chapter Three, positive accounting theory predicts that one of the audit committee’s roles should be to prevent financial reporting from being utilised in pursuing management self-interest (Milne, 2001). Therefore, investigating how audit committee members interpret ‘conflicts’ associated with their duties is critical. It is noteworthy that similar views to the pilot interviewee were reflected by the actual interview responses of audit committee members, namely, that most of the ‘conflicts’ arising in the course of their duties involved technical accounting issues, with some exceptions. A detailed discussion of this issue can be found in Chapter Six.

4.4 The research sample and population

According to the current NZX listing rules, all listed companies are required to establish an audit committee with a majority of independent members. At least one member of the audit committee should be a chartered accountant. The names of audit committee members shall be publicly disclosed.

The sample selection was based on a systematic study of the annual report disclosures of the companies listed on the New Zealand Stock Exchange (NZX) for the 2005/2006 and 2006/2007 financial years respectively. One hundred and seventy two companies’ annual reports were obtained from the NZX for the 2005/2006 financial year, while 164 companies’ annual reports were obtained for the 2006/2007 financial year.

By examining the annual reports and/or by tracking the investors’ relationship sections of the above-mentioned listed companies’ websites, a database of 152 companies’ audit
committees, involving 482 current members, was created. Listed companies that are not currently operating in New Zealand at the time of the study were excluded from the database. Of the 482 directors serving on the audit committees of listed companies, 334 members were currently based in New Zealand. Although the amount of information available regarding audit committees varies greatly, all of the 152 companies contained in the database publicly disclose the names of their audit committee members. Furthermore, all of the 152 companies claimed that they have created formal audit committee charters, but only 89 companies’ charters were publicly available to be downloaded.

One hundred and fifty companies had at least one current New Zealand Chartered Accountant serving on their audit committee, while the other two companies explained in their annual reports that their entire boards only included three directors who were not chartered accountants and their audit committees were deemed to include the entire board. Two companies disclosed that their audit committee chairpersons were also the chairman of the company, which was a departure from the Security Commission’s guidelines (2004).

During the 2005/2006 and 2006/2007 financial years, the available information indicated that the frequency of audit committee meetings ranged from twice to nine times a year, with a mean of four times a year. One particular company, which experienced financial stress, receivership, and de-listing during 2005/2006, reported nine audit committee meetings. The average annual income of audit committee members was between $40,000 and $45,000. It was common practice to remunerate audit committee chairpersons more than members.

Of the 334 New Zealand audit committee members, 41 served on two or more audit committees. This reduced the numbers of directors that were potential interviewees to 293. Between August and October 2007, invitations were sent to those 293 potential interviewees. Fourteen rewritten refusals were obtained, either by mail or by email. Twenty nine favourable responses were received by post. As a result of following up on the favourable responses during 2008, 21 interviews were arranged and conducted. The reasons for eight favourable responses not resulting in interviews were as follows:

- One audit committee member wrote very brief answers on the original interview questionnaire posted to him. During the follow-up telephone conversation, he explained that he could not conduct a face-to-face interview.
Two audit committee members who had originally accepted the interview invitation, subsequently decided not to accept a face-to-face interview. Those two audit committee members were from the same organisation.

One audit committee member, who had recently resigned from the board of a listed company, also declined the interview invitation during the follow-up telephone conversation.

One audit committee member was in the process of relocating to Australia, while another was already living in Australia.

One audit committee member could not be contacted via the email address provided.

One audit committee member, due to family reasons, could not arrange an appropriate time to conduct the interview within the timeframe of the data collection period.

The 21 interviews lasted from 34 to 77 minutes. Seven of the interviews were carried out in Auckland, eight in Wellington, three in Christchurch, and the rest in Dunedin, Kapiti, and Ashburton. Of the 21 interviewees, one was female and was also the only interviewee who had relocated to New Zealand from overseas. Five of the participants were not qualified accountants. Three of the participants, one of whom was the chairman of the company, were not currently acting as the audit committee chairman. Of the 21 interviewees, 19 were serving on two or more audit committees, resulting in 33 different organisations being referred to during the interviews.

4.5 The procedural stages of data collection

Between August and October 2007, invitations were sent to the 293 potential interviewees. The invitation package included:

- a covering letter
- a copy of the interview questionnaire
- a standard research project information sheet in the format specified by Lincoln University, and
• a consent form with a stamped, addressed envelope.

These documents are included in appendices A, B, C, and D of this thesis.

The covering letter introduced the background information of the research project and the objective of the research, the invitation for participation in the interviews and the procedure for acceptance if the potential interviewee wished to participate.

The standard research project information sheet served two purposes; firstly, it explained, in detail, the research objectives, possible contributions and rationale for the research design. Secondly, it detailed the interview and follow-up procedures, as well as those for ensuring the confidentiality of the interviewees and their organisations.

All data gathered in the study were strictly confidential and all of the participants were assured of complete anonymity in any publication of the research results. The identity of the participants would not under any circumstances be made public, or revealed to any parties other than the researcher and her supervisors. These principles were incorporated in the following detailed data collection procedures:

• Each interview was taped and transcribed.

• Pseudonyms were assigned to each interviewee and organisation in the interview transcripts and in any text content quoted or discussed in any publication.

• The interview transcript was reviewed and edited by the interviewee. Shortly after each interview had been completed, the interviewee received a copy of the transcript to confirm the accuracy of the conversation and to add to or clarify any points.

• During the interview, the interviewee was permitted to decline answering any of the interview questions.

• The interviewee could withdraw from the interview at any time by advising the researcher in person, by telephone, or in writing.

The above interview procedures were strictly followed during the data collection process. The recorded interview clips were transcribed word-by-word by the researcher and fully reviewed by her supervisor. As stated previously, after the interview transcripts were edited,
they were posted back to the interviewees, who were asked to review the transcripts of the interview and confirm, or amend them. Of the twenty one interviewees, thirteen replied to acknowledge the receipt of the transcripts and four interviewees replied with detailed notes. There were, however, no material amendments to the interview transcripts. Both the confirmed and unconfirmed interview transcripts were considered during the data analysis.

To further guarantee the confidentiality of the research data, the researcher and her supervisors are the only people having access to the tapes (or other storage devices) recorded during the interviews. The tapes (or other storage devices) and the transcripts will be kept for six (6) years from 2007. After six years, the tapes (or other storage devices) and the transcripts will be destroyed under the supervision of the researcher, or any person authorised by the researcher, or her supervisors.

4.6 Summary

Drawing on the gaps in the existing body of knowledge about the effectiveness of audit committees (Chapter Two) and the theoretical framework established for the research (Chapter Three), the research design largely follows Rubin’s and Rubin’s (2005) responsive interviewing methodology. Chapter Four has explained and discussed the design of the interview questionnaire, the sample and the population, and the procedural stages of the interview data collection.

An interview questionnaire consisting of four topics and 21 questions was designed. Drawing on Rubin’s & Rubin’s (2005) responsive interview model, the researcher asked the interviewees - the audit committee members - to tell stories they experienced in performing their duties in their particular audit committee. The interviewee then, based on a particular description or explanation may be probed for further clarification. Therefore, the interviewee is thus virtually taking the interviewer though his/her particular experience. All of the 21 interview questions are developed from the qualitative research areas supported by both positive and normative accounting theories.

The sample selection was based on a review of the annual report disclosures from companies listed on the New Zealand Exchange (NZX) for the 2005/2006 and 2006/2007 financial years. During 2008, 21 interviews were conducted, which were transcribed word-by-word. The transcripts were initially processed in Microsoft Word and then transferred into NVivo 8 and 9 for coding. Of the twenty one interviews, seven were carried out in Auckland,
eight in Wellington, three in Christchurch, and the rest in Dunedin, Kapiti, and Ashburton. Of the 21 interviewees, one was female, with the rest male. Five of the participants were not qualified accountants. Three of the participants were not currently acting as the audit committee chairman; one of these was the chairman of the company. Several interviewees were serving on two or more audit committees. Therefore during the interviews, 33 different firms were referred to.

Chapter Five describes the procedures used for the data analysis.
Chapter Five: Data Analysis

5.1 Introduction

The aim of this qualitative data analysis is to explore in detail how audit committee members were making sense of the meanings of particular experiences and events in performing their roles. As discussed in Chapter Three, the data analysis depends on, and is complicated by, the researcher’s own conceptions. Thus; a two-stage interpretation is involved: the interviewees are trying to make sense of their life in their audit committees during the process of interviewing; the researcher is then trying to make sense of the participants’ logic (Smith & Osborn, 2007). This two-stage interpretation was performed by the three-round coding data analysis approach explained in this chapter.

The data analysis was processed by NVivo 8 and then NVivo 9. The 21 recorded interviews were transcribed word-by-word, initially in Microsoft Word, resulting in a transcript master file of 426 pages. The transcripts were then confirmed and entered into NVivo 8 as 21 ‘sources’, according to the chronological sequence of the 21 interviews. The interviewees were numbered from 01 to 21. The data coding processes were repeated for three rounds. In each round the interview transcripts were read through and coded into different sets of codes or nodes (hereafter used interchangeably). Different sets of codes were developed and built upon each other. Eventually different queries were made in order to organise the subsequent writing-up of the research results.

The rest of this chapter discusses and explains the three round coding approach.

5.2 Overview

Qualitative research tends to document the participants’ personal perceptions, but one can only get close to that personal perception, because the personal perception embedded in the interview data is complicated by the researcher’s own conceptions. Thus; a two-stage interpretation was involved: the interviewees are trying to make sense of their life in their audit committees in answering the interview questions; the researcher is then making sense of the participants’ responses. The interview data were analysed by three rounds of coding, which reflects the two-stage interpretation. The first round coding involves assigning passages to categories. The researcher went through all transcripts and collected numerous illustrative quotes to categories based on the structure of the interview questionnaire. The second round
coding involves refining and restructuring coded interview text from the first round. Most importantly, the interview data coded in the first round were re-defined according to their properties based on Embree’s (2007) reflective analysis. Several themes were identified and clustered during the second round coding. The first and second round coding documents the first stage interpretation. Subsequently, the third round coding (the second stage interpretation) reflects the researcher’s sense making of the interviewees’ logic. In this round of data analysis, interview data were further summarised into core categories. Figure 5-1 illustrates the relationship between the two-stage interpretation and the three rounds of coding.

![Figure 5-1: The three round coding approach](image)

| **Stage one interpretation**: the participants’ sense making of their life in audit committees | **First round coding**: interview data were coded according to the answers to the interview questions. In this round, key experiences and events were identified as important by the participants. Data analysis is discussed to the extent of categorising themes of responses provided by the interviewees. |
| **Second round coding**: interview data were coded according to Embree’s reflective analysis to understand how participants explain and evaluate the experiences and events they identified. Themes were identified and clustered to facilitate the discussions of the sense-making process (i.e. the reasoning) of the interviewees. |
| **Stage two interpretation**: the researcher’s sense making of the participants’ responses | **Third round coding**: themes were further clustered into broad categories based on the researcher’s reflection. The intended orientations are discussed and the interview questions answered. |

### 5.3 The first round of coding – responses to the interview questions

In this round the transcripts were coded according to the researcher’s judgement on the relationship of the interview data to the themes of each of the interview questions. There were 17 nodes designed based on the four general topics and 21 interview questions (see the interview questionnaire in Appendix B). Some interview questions were designed to funnel the subsequent question, therefore did not transform into a node. An example of such questions is: ‘Do you need to do additional work by yourself in addition to attending the scheduled audit committee meetings in order to achieving your assigned responsibility?’ The expected response to this question can be either ‘yes’ or ‘no’, then if the response was ‘yes’, the interviewer was
then led to ask the interviewee to describe a particular example of what he/she does outside the audit committee meetings.

All the nodes were arranged into tree structure (see the screen print displayed in Figure 5-2.)

Figure 5-2: Nodes in the tree structure – first round coding

In this round of coding, nodes were numbered for the convenience of matching them to the actual sequence of the questions asked during the interviews. As illustrated in Figure 5-2, the tree-structured nodes were developed based on the interview questionnaire. After each transcript was coded, the researcher viewed the transcripts by the density of coding, to see whether any interview responses remained uncoded. The uncoded texts were mainly questions asked by the researcher including her clarification with the interviewees. Table 5-1 below summarises the tree nodes created in the first round coding.
During the process of coding and data analysis, sub-themes emerged. Therefore, more codes were developed in order to manage the interview data, for example, ‘agenda of audit committee meetings’, ‘internal control’, and ‘external reporting’. Table 5-2 summarises the free nodes created during first round coding. These further developed nodes were not incorporated.

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22 ‘Reference’ was the term used in NVivo 8 and 9 referring to the cluster (sentences or paragraphs) of interview text data that have been coded under a particular node.

23 A free node is the container of coded text that does not fit in the tree node structure in Table 5-1.
into the tree-node systems, because usually they were relevant to the answers for several interview questions.

**Table 5-2: Free nodes created in the first round coding**

<table>
<thead>
<tr>
<th>Free Nodes (codes)</th>
<th>No. of interviews</th>
<th>No. of references</th>
</tr>
</thead>
<tbody>
<tr>
<td>ranked by the number of interviewees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Auditing matters</td>
<td>21</td>
<td>163</td>
</tr>
<tr>
<td>Agenda (audit committee meeting agenda)</td>
<td>21</td>
<td>153</td>
</tr>
<tr>
<td>Experience (previous professional experience)</td>
<td>19</td>
<td>132</td>
</tr>
<tr>
<td>Financial reporting</td>
<td>19</td>
<td>91</td>
</tr>
<tr>
<td>Background (interviewees’ professional background)</td>
<td>19</td>
<td>76</td>
</tr>
<tr>
<td>IFRS transition</td>
<td>17</td>
<td>108</td>
</tr>
<tr>
<td>Consensus</td>
<td>14</td>
<td>32</td>
</tr>
<tr>
<td>Risk management</td>
<td>13</td>
<td>88</td>
</tr>
<tr>
<td>Debate</td>
<td>12</td>
<td>43</td>
</tr>
<tr>
<td>Internal control</td>
<td>12</td>
<td>37</td>
</tr>
<tr>
<td>Compliance</td>
<td>11</td>
<td>50</td>
</tr>
<tr>
<td>Vote</td>
<td>10</td>
<td>19</td>
</tr>
<tr>
<td>Charter</td>
<td>9</td>
<td>35</td>
</tr>
<tr>
<td>Dividends (AC recommending dividends to the board)</td>
<td>8</td>
<td>18</td>
</tr>
<tr>
<td>Independence</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>Recruiting auditors</td>
<td>3</td>
<td>42</td>
</tr>
</tbody>
</table>

The identification of free nodes was performed by the ‘text search’ query function of NVivo 9. The results of ‘text search’ were checked and modified by the researcher to include synonyms, for example, the text search for ‘risk management’ expanded to ‘risk appetite’ and ‘risk register’. It was noteworthy that most of these free nodes (key words) were directly mentioned in the interview responses, except for auditing matters. In Table 5-2, the free nodes were ranked according to their coding frequency. Nodes (key words) that were shared by a number of interviewees and were of high frequencies indicate the common themes that emerged from the interview data. It indicates that although the interviewees were from different organisations and had different backgrounds, they have developed a shared language in performing their audit committees’ tasks.
Some significant findings which can be highlighted when interpreting the data in Table 5-2 are:

- The event of the IFRS transition taking place between 2005 and 2007 was of great importance to audit committee members in New Zealand listed companies. This theme was shared by 17 out of 21 interviewees.

- Professional experience and background were of great importance to the interviewees, most of the (19 out of 21) interviewees linked their professional experience and background to their role as audit committee members.

- Audit committee meetings were perceived to be dominated by the themes of ‘agenda’, ‘debate’, ‘consensus’, and ‘vote’. These themes reflected the findings of previous qualitative audit committee research findings that audit committee meetings were of a ceremonial nature (Spira, 1998; 2005).

- Recruiting auditors is regarded as one of responsibilities of the audit committee (DeZoort et al, 2002). Although only three interviewees discussed such experience, it was mentioned all together 42 times in the interview data. This may be interpreted as interviewees perceived such experience as of great importance to their audit committees.

- Eight interviewees discussed their audit committees’ involvement in recommending dividends to the board of the directors. Recommending level of dividend has not been evidenced by the existing literature of audit committees.

- The existing audit committee literature, as well as regulatory corporate governance requirements, emphasise that audit committees should consist of independent directors. The interview data show that the theme of directors’ designated independent status was mentioned only by four interviewees, six times in total.

The above represent key findings based on themes identified through analysis of the frequency of shared key words by interviewees. In Chapter Six, the research findings of the first round of coding will be discussed in detail.
5.4 The second round of coding – reflective analysis

Figure 5-3 shows the screen cuts from NVivo 9 for the structure and nodes of the second round of coding.

Figure 5-3: Nodes in the tree structure – second round of coding

The second round of coding and data analysis is based largely on the model of reflective analysis developed by Embree (2007), which was illustrated in Figure 3-4 in Chapter Three.

The essential theme of reflective analysis lies in the ‘intentionality’ of people, i.e. all experiences are regarded as ‘intentive processes’. By deeming the performance of audit committee members to be intentional, the second round of coding, i.e. the reflective analysis, will discuss and analyse the reasons for the participants’ responses, which were identified in the first round of coding.

According to Embree (2007), one’s encounters include broad categories of ‘experiencing’, ‘believing’, ‘valuing’, and ‘willing’. To facilitate the data analysis, the interview data that are of

24 The coding structure depicted in Figure 5-3 is more of a roadmap of data analysis than a concrete theoretical foundation.
an ‘experiencing’ nature are coded as ‘descriptive accounts’, because they describe what happens. The descriptive accounts are classified further into ‘perceptional’ and ‘pictorial’.

Perceptional accounts were represented by ‘expecting’, a perception of future encounters; ‘perceiving’, a perception of current encounters; and ‘remembering’, a perception of a past experience. ‘Remembering’ accounts are the closest description to a factual incident, whereas ‘perceiving’ accounts usually represent the interviewee’s general perception of ‘how things should be’. Perceptional accounts may or may not indicate a factual incident. The ‘expecting’ accounts however, represent an anticipated outcome rather than a factual incident. Using the participant’s description of audit committee meetings as an example, a typical ‘remembering’ account is represented by interviewee 05 referring to his audit committee meeting papers and describing the audit committee meeting as: ‘…that meeting was as a result of a review by the incoming chief executive of aspects of the loan book. A recommendation was that we required… the company required additional provisioning on a particular loan book…’

Interviewee 01 provided a ‘perceiving’ account about the audit committee meetings in his company, saying: ‘Right, this is where we are probably a wee bit weak. (smiling) As I said, we don’t say “Hey, next Tuesday morning is the audit committee meeting”. We just say, “oh, okay we will discuss it in our general meeting”. I will probably say, “Okay, I will take note of that and talk to the accountant”, because, we know our compliance rules.’ An ‘expecting’ account was identified in the transcript of interviewee 03, (who, when discussing the possible outcome of a particular audit committee meeting, said: ‘If, for instance, the Securities Commission thought that the other finance companies had transactions that looked different in general, and our one looks out of line, I have got no doubt that, either with or without a request from the shareholders to have a look at that, they will come and want some information of how that transaction was arrived at, and certainly will be looking at the auditors and the auditors’ comfort around it.’

Pictorial accounts were originally designed to capture either descriptions of the contextual information about the particular organisation or a particular incident, coded either under the node ‘organisational context’, or, coded under the node ‘procedural’ describing the procedural settings of the audit committee. Interviewee 10 provided a typical ‘organisational context’ account, saying: ‘we don’t have internal audit. It’s only a small company. Hum… we are probably close enough… well… yeah… close enough to know the accounting and control very well.’ An example of a procedural account described by interviewee 09 is: ‘what I always did was when I received my audit committee papers; I always flicked them through very quickly to see what was
coming up.’ As shown in Figure 5-3, an additional node ‘anecdotal’ was created for the pictorial accounts. This is because when the tree structure in Figure 3-5 (in Chapter Three) was established, it was expected that participants would describe only the usual settings of their audit committees, as documented by the existing audit committee literature. During the interviews, participants revealed several incidents which were significantly different to the ‘expected’ incidents. A typical example of such an anecdotal account is when interviewee 04 described how one of his fellow directors negligently sold shares which was prohibited by the insider trading regulations, so his audit committee quickly became involved in dealing with immediate remedial procedures and in liaising with the regulatory body to make sure that the company would not suffer any adverse impacts from this incident.

The interview data of an ‘intentionality’ nature that are coded as ‘explanatory accounts’ describe the participants’ reasons for their responses. The intentional factors are filtered out from the explanatory accounts and classified further into ‘willing’, ‘valuing’, and ‘believing’. The key difference between ‘believing’, ‘valuing’, and ‘willing’ is that ‘believing’ (something to be true) more likely ‘comes from what others have communicated to us’ (Embree 2007, p. 183), whereas ‘valuing’ something to be either right or wrong is closer to a deduction from past experience; ‘willing’ to do or not to do something can be regarded as an intended realisation of ‘believing’ and ‘valuing’ in the future. If audit committee effectiveness is intended by the committee members, the participants’ value laden accounts are therefore relevant to this research.

5.5 The third round of coding - the researcher’s reflection

The first round of coding and data analysis documented the interviewees’ responses to the interview questions, i.e. it revealed ‘what they said’. The second round of coding and data analysis discussed the interviewees’ intuitive justification of their responses, i.e. it explained ‘why they said what they said’. The third round of coding and data analysis focuses on the researcher’s reflection on the differences between interviewees i.e. it discusses the intentionality of the interviewees from an outsider’s perspective. In this round of data coding, themes were clustered further into broad categories based on the researcher’s reflection. The intended orientations of the interviewees are discussed through the lenses of the researcher.
5.6 Summary

This chapter has presented the data analysis approach used in the study, explaining each of the three round coding used and the rationale for each. The approach involves a detailed examination of the interviewees’ real-world experiences of serving on audit committees. It is concerned primarily with the individual’s personal perception or account of being an audit committee member, but also incorporates an active role by the researcher in that process. The research findings and discussion thereof will be presented in Chapter Six.
Chapter Six: Research Findings and Discussion

6.1 Introduction

The chapter is organised into four sections: an analysis of participants’ responses to the interview questions (the first round of coding); a reflective analysis (the second round of coding); the researcher’s reflection (the third round of coding); and a summary of the research findings.

6.2 Responses to the interview questions (the first round of coding)

6.2.1 Perceived audit committee responsibilities

(1) Motivation for serving on the audit committee

In answering the interview question: ‘what motivated you to become an audit committee member?’, participants were given the opportunity to express their opinion of why and how they became audit committee members. In answering these interview questions, participants reflect on their experiences during the process of interviewing. They also reflect on how they understand the audit committee’s role before and after they serve on it and their justification for why or why not they act as a member. Based on the first round coding, 130 references (sentences or paragraphs) from 21 interviewees were coded under the category of ‘motivation for serving on the audit committee’.

From the 130 references identified, three main themes can be identified; firstly, most of the interviewees (12 out of 21) relate their role in audit committees to the regulatory requirement of having an audit committee in all listed companies in New Zealand. For example, interviewee 04 said: ‘Well, about ten years ago or so, (Corporate Governance) Best Practice demanded companies… public companies… listed companies to have an audit committee. I was the accountant on the board of company E. So it was logical for me to be in charge of putting an audit committee together, doing an audit (committee) charter and then I became the chairman.’

Secondly, 18 out of 21 interviewees suggested that it was their background; particularly an accounting, finance, or legal background, that made them most suitable for being an audit committee member. For example, interviewee 02 explained: ‘…when I became a board member, I...

25 Node No.1.0 on the tree node structure displayed in Table 5-1.
member of this company, I was the only board member with a finance degree. So I was invited to chair the audit committee because you need at least one accounting expert. That’s why. Basically I just agreed to because I was the most appropriate person.’

Thirdly, 11 of the interviewees believe that taking on a sub-committee’s role, especially the audit committee’s role, was a part of their directorship. They do not regard their position as a choice they take, but a director’s responsibility they cannot avoid. A typical example is as suggested by interviewee 08: ‘I was asked (laugh)… you know, in most companies, it was not something that people necessarily seek. You know? What normally happens was (that) the board look around the composition of the board members and say, ‘well, who was best suited?’ It was obviously (laughing)… not what I am willing to do it. But was just a part of the function of the board, taking on the sub-committee’s responsibilities.’

It was noteworthy that these three themes were not independent or mutually exclusive. It was common that an interviewee would discuss two or more factors that contributed to their decision to serve on the audit committee. Table 6-1 summarises the interviewees’ responses to what motivated them to serve on the audit committee.

Table 6-1: Motivation for serving on the audit committee

<table>
<thead>
<tr>
<th>Motivation</th>
<th>No. of interviewees (frequency)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Reacting to regulatory requirement to have an audit committee</td>
<td>12</td>
</tr>
<tr>
<td>2. Having suitable background, which makes him/her the most suitable person</td>
<td>18</td>
</tr>
<tr>
<td>3. As a part of directorship</td>
<td>11</td>
</tr>
<tr>
<td>Mentioned one motivation</td>
<td>4</td>
</tr>
<tr>
<td>Mentioned two motivations</td>
<td>13</td>
</tr>
<tr>
<td>Mentioned all three motivations</td>
<td>4</td>
</tr>
</tbody>
</table>

Interviewees 03, 07, 16, and 20 suggested that the independent director status was one of the reasons for them to serve on the audit committees, in order to fulfil the regulatory requirements for listed companies in New Zealand. For example, interviewee 16 described his
situation as: ‘Company N didn’t form an audit committee until it became a public company. (When the company was listed), I was the only independent director who was a qualified accountant. So I became the audit committee chairman.’ Interviewee 07 described his audit committee chairman as an independent director; he said: ‘We have the expertise, particularly the chairman, who is a partner of an auditing firm. He is an independent director. So that ticks all the boxes.’ It is noteworthy that directors’ independence as an important attribute of audit committee members was only mentioned by these four interviewees in answer to this particular interview question. This theme never appeared elsewhere in the entire interview data.

(2) Perceived audit committee objectives for being an audit committee member

During the process of coding the interview data, the researcher realised that the interviewees frequently referred to audit committees’ general objectives when discussing their motivations for being a member as well as the specific tasks they performed. For instance, interviewee 04 said: ‘… what is the primary role of an audit committee? It is to ensure the integrity of the financial statements, both the internal management report and the external financial statements. So in the end, an accountant is really necessary (to any audit committee).’

According to DeZoort et al (2002), an audit committee oversees firms’ financial reporting, internal control and risk management. It is also expected that an audit committee will contribute to enhancing the quality of auditing (Abbott et al, 2003a; 2003b). Based on the existing body of knowledge on the expected outcomes of audit committees, four sub-nodes were initially created to categorise interviewees’ comments on the general objectives of audit committees, namely: ‘financial reporting’, ‘internal control’, ‘risk management’, and ‘auditing matters’. As the coding process progressed, a new node ‘compliance’ was created to capture the general objectives of audit committees. Table 6-2 displays the results of coding. Complementary to the existing qualitative research discussed in Chapter Two, this research revealed that dealing with compliance issues is perceived as a common responsibility of audit committees. This finding reflects the impact of growing regulatory requirements faced by firms.

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26 Node No.1.1 on the tree node structure displayed in Table 5-1.
27 See Table 5-1, 20 interviewees and 109 references are coded in this node.
28 There is no interview question which specifically asks the interviewee to describe the general objectives of audit committees.
Table 6-2: Perceived objectives of audit committees (ACs)

<table>
<thead>
<tr>
<th>Nodes (codes)</th>
<th>No. of interviews</th>
<th>No. of references</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1 Perceived objectives of ACs (see also Table 5-1)</td>
<td>20</td>
<td>109</td>
<td></td>
</tr>
<tr>
<td>Sub-nodes:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Financial reporting</td>
<td>19</td>
<td>91</td>
<td>Interviewee 07:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>“In my case, I am the chairman of the audit committee. It is because my background is a chartered accountant. The board actually asked me to look very closely at all the aspects of the financial statements, and to make sure that they do satisfy the requirements of financial reporting.”</td>
</tr>
<tr>
<td>• Internal control</td>
<td>12</td>
<td>37</td>
<td>Interviewee 11:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>“The audit committee is in charge of monitoring the internal control.”</td>
</tr>
<tr>
<td>• Risk management</td>
<td>13</td>
<td>88</td>
<td>Interviewee 06:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>“Because that (my audit committee’s responsibility) covers that area, and the other thing, other areas that after Sarbanes-Oxley, that a lot of audit committees have got into this what is called wider risk management. Okay?”</td>
</tr>
<tr>
<td>• Auditing matters (including both internal auditing and statutory auditing)</td>
<td>21</td>
<td>163</td>
<td>Interviewee 18:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>“I (an audit committee chairman) have sort of taken on those responsibilities of keeping liaison with auditors, and to make sure to comply with their recommendation and so on.”</td>
</tr>
<tr>
<td>• Compliance</td>
<td>11</td>
<td>50</td>
<td>Interviewee 01:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>“…the audit committee actually should be helping them to make sure that the business... what is doing is... and what is happening is compliance to the Act (the Companies Act).”</td>
</tr>
</tbody>
</table>

It is apparent that when interviewees were discussing the general objectives, the above themes were usually overlapping. Interviewee 05 suggested that: ‘Huh… I mean an audit committee… if you define it, it is ‘auditing’. I mean it is auditing risk (the risk management practice, according to the context)... it is auditing compliance... Compliance with the IFRS, if you like… that is a reasonable expectation from the shareholder.’ In some cases, the interviewees were aware of such overlaps and were not able to draw a clear boundary between
different objectives. A typical example is interviewee 21: “well…the financial reporting is probably a part of compliance… well rather than calling it ‘compliance’… haha… sorry we mentioned it several times, but in a different sense now. It is the routine side of the business, such as reviewing financial performance, improving assets, and making sensible decisions of capital expenditure… you know… making sure the systems are in place to making sure things”\(^{29}\)… I mean… when I use the word ‘compliance’ here, probably the ‘mechanical things’ are a better word rather than ‘compliance’… just to differ it from the compliance in terms of the regulations.” As represented by the interview data quoted from interviewee 21 above, there was a diverse range of specific tasks performed by the participants in regard to their audit committee’s role. These specific tasks are discussed in the next section.

(3) **Specific tasks performed as an audit committee member**\(^{30}\)

When interviewees were asked whether they were assigned any specific responsibilities and why, the responses had a common theme of either referring to the delegated duties from the board of directors or referring to the audit committee charter (evidenced in 15 interviews with 56 references). A typical example was suggested by interviewee 05: ‘I thought of a particular responsibility that I was assigned. … in general terms, most companies’ [audit committees] have a charter. So it is usually in terms of your responsibilities, you know…it’s the responsibility you assume as a result of agreeing to the charter…’

The list displayed in Table 6-3 consists of a diverse range of activities performed by audit committee members. The primary expectation placed on an audit committee is to oversee the company’s financial reporting (DeZoort et al, 2002). Hines (1988) described the role of financial reporting as ‘communicating’ a firm’s economic ‘reality’ (p. 251). Such economic reality covers every transaction - every event that has an economic impact on a firm. It is difficult, however, to draw a clear-cut boundary between financial reporting and factors contributing to financial reporting, such as auditing, internal control, and risk management, as well as the firm’s strategic visions.

\(^{29}\) The researcher coded ‘making sure the systems are in place to making sure things’ as ‘internal control’.

\(^{30}\) Node No. 1.2 in Table 5-1.
Table 6-3: Specific tasks performed by the interviewees as audit committee members

<table>
<thead>
<tr>
<th>Specific tasks</th>
<th>First group: duties delegated by the board of directors:</th>
<th>Second group: audit committee formalities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mediating management and auditors’ relationships</td>
<td>No. of interviews: 21</td>
<td>No. of interviews: 21</td>
</tr>
<tr>
<td>Reviewing financial reports for both internal and external use</td>
<td>No. of references: 206</td>
<td>No. of references: 206</td>
</tr>
<tr>
<td>Reviewing and making recommendations on issues related to the transition from NZ GAAP to NZ IFRS</td>
<td>No. of interviews: 17</td>
<td>No. of references: 108</td>
</tr>
<tr>
<td>Liaising with the external auditors</td>
<td>No. of interviews: 17</td>
<td>No. of references: 92</td>
</tr>
<tr>
<td>Verifying auditors’ recommendations</td>
<td>No. of interviews: 12</td>
<td>No. of references: 43</td>
</tr>
<tr>
<td>Monitoring internal control</td>
<td>No. of interviews: 12</td>
<td>No. of references: 37</td>
</tr>
<tr>
<td>Researching and reporting on accounting and auditing issues</td>
<td>No. of interviews: 8</td>
<td>No. of references: 10</td>
</tr>
<tr>
<td>Leading and monitoring the internal audit function</td>
<td>No. of interviews: 6</td>
<td>No. of references: 25</td>
</tr>
<tr>
<td>Reviewing fund raising documents, such as prospectuses</td>
<td>No. of interviews: 5</td>
<td>No. of references: 14</td>
</tr>
<tr>
<td>Making recommendations on accounting treatment of transactions</td>
<td>No. of interviews: 4</td>
<td>No. of references: 29</td>
</tr>
<tr>
<td>Reviewing publicly disclosed information</td>
<td>No. of interviews: 4</td>
<td>No. of references: 10</td>
</tr>
<tr>
<td>Meeting compliance requirements of financing and investing activities</td>
<td>No. of interviews: 4</td>
<td>No. of references: 8</td>
</tr>
<tr>
<td>Recruiting auditors</td>
<td>No. of interviews: 3</td>
<td>No. of references: 42</td>
</tr>
<tr>
<td>Seeking external independent advice</td>
<td>No. of interviews: 3</td>
<td>No. of references: 14</td>
</tr>
<tr>
<td>Implementing and supervising internal control practices in certain areas</td>
<td>No. of interviews: 2</td>
<td>No. of references: 31</td>
</tr>
<tr>
<td>Recruiting and supervising the CFO</td>
<td>No. of interviews: 2</td>
<td>No. of references: 11</td>
</tr>
<tr>
<td>Monitoring financial performance indicators</td>
<td>No. of interviews: 1</td>
<td>No. of references: 1</td>
</tr>
<tr>
<td>Establishing formal internal audit functions</td>
<td>No. of interviews: 1</td>
<td>No. of references: 1</td>
</tr>
<tr>
<td>Participating in strategic settings and reviews</td>
<td>No. of interviews: 1</td>
<td>No. of references: 1</td>
</tr>
<tr>
<td>Developing the business model according to the corporate strategy</td>
<td>No. of interviews: 1</td>
<td>No. of references: 1</td>
</tr>
<tr>
<td>Preparing for audit committee meetings</td>
<td>No. of interviews: 21</td>
<td>No. of references: 272</td>
</tr>
<tr>
<td>Contributing to the audit committee meeting agenda</td>
<td>No. of interviews: 19</td>
<td>No. of references: 66</td>
</tr>
<tr>
<td>Chairing the audit committee</td>
<td>No. of interviews: 17</td>
<td>No. of references: 231</td>
</tr>
<tr>
<td>Confirming and following up issues on meeting minutes</td>
<td>No. of interviews: 17</td>
<td>No. of references: 33</td>
</tr>
<tr>
<td>Initiating and finalising the audit (committee) charter</td>
<td>No. of interviews: 5</td>
<td>No. of references: 15</td>
</tr>
<tr>
<td>Participating in formal audit committee performance evaluation</td>
<td>No. of interviews: 1</td>
<td>No. of references: 1</td>
</tr>
</tbody>
</table>
When describing these tasks, it was evident that some interviewees blurred the boundaries between acting as an audit committee member and acting as the only financial or accounting expert on the board. For example, developing the business strategy model, or recruiting and supervising the CFO, were not regarded as the duties of the audit committee (DeZoort et al., 2002). Furthermore, carrying out these tasks may undermine the objectivity of audit committee members, who were being held accountable for these tasks and for overseeing the financial reporting simultaneously. As discussed previously, the interviewees constructed the meaning of the audit committees’ general objectives as a function of ‘overseeing’ or ‘watching over’ either management or auditors. But in discussing their specific tasks, some interviewees seem to be not only overseeing, but also getting directly involved in performing the tasks. The researcher argues that all audit committee members are wearing two hats: (1) primarily they are corporate directors, responsible for the overall wellbeing of their firms, whereas (2) they are audit committee members delegated by the board to oversee management or auditors. These two roles are not mutually exclusive. Some interviewees were struggling to adjust between these two roles. Interviewee 16 suggested: “One of the difficulties with some of our directors is that I don’t think they realise the purpose of an audit committee. Yes? And that is… (long pause) so because of that reason, I have to be quite strong in some situations to say, ‘This is an audit committee meeting, this is not a meeting for the board!’”

A different way of viewing the audit committee members’ activities is to divide the list in Table 6-3 into two groups, the first of which contains tasks that may be regarded as duties delegated by the board of directors. The second group of activities comprises audit committee formalities. It can be argued that the board-delegated tasks are duties of the board with or without an audit committee, whereas the committee formalities merely formalise the performance of the delegated tasks, or make the performance of the delegated tasks more visible by documenting them in an audit committee meeting agenda and/or minutes.

(4) Factors that help most in performing audit committee tasks

A common theme emerged when the interviewees were asked to describe what had helped them the most in achieving the desired audit committee objectives. Nineteen of the twenty-one interviewees stated that either their background or their experience helped them the most. ‘Experience’ and ‘background’ was perceived in different ways by the interviewees, however, they all reflected a general theme that what happened before in their lives, helped

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31 Node No.1.3 in Table 5-1.
them most in performing their audit committees’ tasks. In many cases, the meanings of ‘experience’ and ‘background’ are the same. Table 6-4 summarises the coding of experiences and background.

**Table 6-4: Backgrounds and experience that helped the interviewees the most in performing their audit committee tasks**

<table>
<thead>
<tr>
<th>Nature of the background or experience</th>
<th>No. of interviews</th>
<th>No. of references</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Broad business experience</td>
<td>16</td>
<td>58</td>
<td>Interviewee 14: “I’ve been a company director since 1976… I found that because of the experience, you are very alert of… what needs to be done. You pick up issues very quickly.”</td>
</tr>
<tr>
<td>Being a chartered accountant</td>
<td>17</td>
<td>36</td>
<td>Interviewee 08: “I guess it is part of my professional background. And not that I was there for an audit practitioner, but nonetheless, having been in the public practice for a long time and having gone practising in a whole wide range of industries, that coupled with my board experience, which is now twenty plus years probably…yeah… with various companies. I think it is just the experience.”</td>
</tr>
<tr>
<td>Being a corporate director</td>
<td>14</td>
<td>33</td>
<td>Interviewee 11: “The fact is that I had quite a lot of experience in the practicality of the company directorships. So perhaps I understand the director’s responsibility probably a little bit more fully than some of the newer directors.”</td>
</tr>
<tr>
<td>Experience of chairing several audit committees</td>
<td>4</td>
<td>22</td>
<td>Interview 04: “…because I chair six audit committees. You might find, for example, there is a new piece of legislation out that could cause a risk for you. You get briefed in one audit committee for this particular thing, and then what you do is, you make sure it gets on every others’ agendas.”</td>
</tr>
<tr>
<td>Nature of the background or experience</td>
<td>No. of interviews</td>
<td>No. of references</td>
<td>Examples</td>
</tr>
<tr>
<td>----------------------------------------</td>
<td>------------------</td>
<td>------------------</td>
<td>----------</td>
</tr>
<tr>
<td>Experience in the IFRS transition process</td>
<td>6</td>
<td>17</td>
<td>Interviewee 03: “The experience with other companies. So the fact that I had been on the audit committee of company C and D. I had gone through the IFRS transition. And I was chairman of a power company that they also had gone through the IFRS transition…”</td>
</tr>
<tr>
<td>Experience with other companies' audit committees</td>
<td>5</td>
<td>14</td>
<td>Interviewee 16: “From my experience I also know… how I would like it to happen within company U. I had good and bad experiences with other audit committees so I have been trying to make use of that experience to make sure that we do things better.”</td>
</tr>
<tr>
<td>Background and experience with the finance industry</td>
<td>4</td>
<td>13</td>
<td>Interviewee 07: “I guess it is because… when I was an executive, it was vitally important, in my view, that we had a very high standard of offer documents, for example, the prospectus…and that’s what I had as a priority, or a focus, when I was the chief executive. And therefore I built up a fair amount of expertise in it.”</td>
</tr>
<tr>
<td>Being CEO or CFO</td>
<td>2</td>
<td>5</td>
<td>Interviewee 10: “It’s the knowledge and the experience that build up the confidence. Because I have been the financial controller and the CEO, I know how management think!”</td>
</tr>
<tr>
<td>Being a law practitioner</td>
<td>2</td>
<td>6</td>
<td>Interviewee 20: “Well, I think the legal background helps you, because you have an understanding of the issues… huh… that are likely to arise that will be covered by the audit committees… as such, environmental, health and safety, human resources… you know, the employment practices… that sort of things.”</td>
</tr>
<tr>
<td>Being auditors</td>
<td>2</td>
<td>4</td>
<td>Interviewee 05: “I think the auditing… the understanding of numbers and I think the experience over years as an auditor, gives you a feel of that the auditors are right, or (sometimes) the management is right, because auditors can be too conservative.”</td>
</tr>
</tbody>
</table>
According to the interview data quoted in Table 6-4, interviewees tend to link their past experience to their enhanced confidence in making judgements on audit committee related tasks. It is noteworthy that 17 out of 21 interviewees discussed their past or current chartered accountant status believing that their accounting expertise contributed to their judgement ability with respect to audit committee agenda items. The typical example identified was the transition from New Zealand GAAP to IFRS.

It is noteworthy that the transition from New Zealand GAAP to IFRS was a significant one-off incident that took place in New Zealand. Very little evidence was provided on how the accounting expertise had assisted the interviewees in other situations. This study argues that having a chartered accountant on the audit committee merely in compliance with the principles of corporate governance best practice, may make only a limited contribution to the effectiveness of the audit committee, in contrast to the predictions of many of the qualitative research studies.

In addition to their experience as qualified accountants, other experiences and background, for instance, the experiences of being executives, and the experience with a specific industry, were also perceived as contributing to the audit committee’s responsibilities. This may be related to the previous discussion on the diverse range of tasks performed by the participants. Furthermore, several interviewees suggested that it is the confidence in making judgements they built up over their experiences, rather than the experience or the background per se that assisted their performance. As suggested by interviewee 06: ‘because what you need to know is… all information has (a) been correctly recorded; and (b) that there is as little possible avenue for making losses whether it is from fraud or incompetence whatever. Unless you have experience in keeping an eye on what is going on from a financial point of view, you just wouldn’t be able to satisfy yourself.’

The above findings may contribute to the existing body of knowledge on audit committees in two ways. Firstly, it is possible that it is the confidence built up on experience that has contributed to the effectiveness of audit committees. Secondly, the existing audit committee literature focuses on measuring members’ level of expertise as holding the certified accountant status or equivalent. This measure might be expanded into the areas of experience of general directorship, industry specific experience, or experience of being corporate executives.
Difficulties encountered in performing the audit committee’s tasks

Interview question 1.4 is: ‘Have you encountered any difficulties or conflicts in achieving your assigned responsibility? If so, please specify’. The question is designed to obtain an insight into specific situations or events that are important to the interviewees. As discussed in Chapter Two, qualitative research has been trying to establish that audit committee performance is associated with members’ independence. This interview question is also related to the studies that associate audit committee existence and composition with a firm’s industrial context or level of litigious risks. Without spelling out the issues of ‘independence’ or ‘risks’ in this interview question, it is expected that interviewees would give examples of difficulties or stand-offs between different parties caused by, for example, conflicts of interest, or the pressure of increased regulatory requirements.

The interview data revealed several themes relating to the difficulties perceived by the audit committee members. See Table 6-5.

Table 6-5: Difficulties perceived by the interviewees

<table>
<thead>
<tr>
<th>Nature of the difficulty</th>
<th>No. of interviews</th>
<th>No. of references</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>No perceived difficulties</td>
<td>5</td>
<td>11</td>
<td>Interviewee 14:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>“No I haven’t. I always have the fullest co-operation from everybody, including our major shareholders.”</td>
</tr>
<tr>
<td>Understanding complex business activities</td>
<td>5</td>
<td>43</td>
<td>Interviewee 12:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>“Haha… Difficulties? (pause) There are always difficulties! (Strongly emphasising) You know, the matters you are dealing with are normally quite complex. Ah… well… It took a lot more understanding than debates. You know we partially got it by legal advice… and also the auditors’ (advice) as well. But you know… it’s just… you need to make sure that what we are doing is right.”</td>
</tr>
</tbody>
</table>

32 Node No.1.4 in Table 5-1.
<table>
<thead>
<tr>
<th>Nature of the difficulty</th>
<th>No. of interviews</th>
<th>No. of references</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resolving complex technical accounting issues</td>
<td>4</td>
<td>58</td>
<td>Interviewee 10: “… there were some treatments of provisions or accruals in our business that are always very messy. For instance, what the current status of our harbour is and how much work needs to be done, how much needs to be taken into account, and what the appropriate treatment, etc. And those changed during the last few years as well as the accounting standards have changed, in particular the IFRS.”</td>
</tr>
<tr>
<td>Not being supported by management</td>
<td>3</td>
<td>51</td>
<td>Interviewee 03: “The CEO and the CFO were promoting aggressively a particular outcome, a particular proposal that they believed the (IFRS) transition number needed to be. And I felt that information in relation to the transition number and the methodology that we were getting from the management was incomplete in terms of the total information. And there was bias to reflect the outcome that they were looking for.”</td>
</tr>
<tr>
<td>Finding an external auditor</td>
<td>1</td>
<td>6</td>
<td>Interviewee 01: “Actually, I tell you one thing that was difficult was actually getting an auditor. People are so scared of auditing now. The medium sized companies (audit firms) do not want to do it. The big companies have a rating system, and we are not ranked on it. We didn’t come out. So it is quite hard to get, or to find the external auditors.”</td>
</tr>
<tr>
<td>Nature of the difficulty</td>
<td>No. of interviews</td>
<td>No. of references</td>
<td>Examples</td>
</tr>
<tr>
<td>--------------------------</td>
<td>-------------------</td>
<td>------------------</td>
<td>----------</td>
</tr>
<tr>
<td>Lack of experience in serving on the audit committees</td>
<td>1</td>
<td>4</td>
<td>Interviewee 12: “I don’t know whether we are an efficient audit committee or not, because I don’t have the visibility of another one. You know… from that point of view… it would be really good to have a benchmark… you know what I mean? I’ve always been having this question in my mind, are we doing the right thing? Are we effective? I think we are doing our best, but I also think with the right experience we can do better.”</td>
</tr>
<tr>
<td>Inexperienced management</td>
<td>1</td>
<td>4</td>
<td>Interviewee 09 “Well…. I’ve got two different examples to compare. And it is the ability of the CFO. One of the CFOs that I am working with hasn’t really had much experience as a CFO, so he is relying on me an awful lot…”</td>
</tr>
<tr>
<td>Balancing the role of audit committee chairman and a normal director</td>
<td>1</td>
<td>3</td>
<td>Interviewee 16: “Because what you get together, we always… well everybody joins in by phone… if they are not here in Wellington at the time. Hum… and sometimes the boundary of what the audit committee should be dealing with and discussing, and what the full board should be dealing was… huh… a little bit blurred. I think it shoots home more to me than to other directors, because of my role as the chair of the audit committee. I take it quite seriously.”</td>
</tr>
</tbody>
</table>

Based on the research findings of the quantitative audit committee literature, it was expected that interviewees would discuss their difficulties in dealing with management and/or the pressure caused by increased regulatory requirements. The examples provided in Table 6-5, interviewee data obtained from this research, not only provided qualitative empirical evidence on the previous research findings, but also revealed new insight on how audit committee members perceived certain situations and events where they experienced significant difficulties.

Firstly, the interview data supported the expectations that interviewees were likely to encounter stand-offs with the management if they are acting ‘independently’. This has been reflected by the example quoted from interviewee 03 in Table 6-5. The incident discussed by interviewee 03 is of a significant nature. The interviewee continued to describe the situation in
great detail. As a result, altogether 14 references (clusters of text) in this particular interview were coded under the node of ‘difficulties encountered when serving on the audit committee’. Even when the situation was eventually resolved at the board level, the interviewee still felt pressure from the management, he said: ‘And they (management) almost, I think, convinced him (chairman of the board) that their position was defensible and correct, and so it made it quite a (huh)… more difficult process for the audit committee recommendation to be approved at the board level, especially with, you know, the management sitting around the board table saying that ‘we don’t agree with that!’’. From this perspective, the existence of an audit committee as a mechanism independent to the management, and by function separated from the entire board plays an important role in assuring financial reporting integrity. In addition to this particular incident, interviewee 06 discussed his experience of recommending the board to establish a formal internal audit function in the company which was opposed by the managing director. Interviewee 18 revealed an incident that the internal auditor brought up an issue on an audit committee meeting without discussing it with management prior to the meeting. Therefore management were ‘offended’. Immediate mediation was required by the audit committee.

Secondly, the perceived difficulties of audit committees’ tasks are related to the litigious environment of the industries in which their firms operate. Firms with high litigious risk tended to emphasise more formal corporate governance settings, including audit committees (Ashbaugh-Skaife, Collins & LaFond, 2006b). This is also reflected in the interview data of this research discussing the audit committee’s difficulties as ‘understanding the complex business activities’ or ‘resolving the complex technical accounting issues’ in Table 6-5. Under these circumstances, regulatory requirements or the accounting standards are perceived by the interviewees as difficult or in conflict.

Thirdly, in relation to the increased litigious pressure associated with listed companies, audit committee members face new challenges which have not been discussed by the existing audit committee research studies. Interviewee 01 described his difficulties in finding an auditor after the company experienced financial difficulties accompanied by the increased regulatory requirement for listed companies. Interviewee 09 discussed that inexperienced executives became a burden to the audit committee. Interviewees 12 and 16 both served on newly listed companies, and they both faced the challenges of managing newly formed audit committees.

In summary, although the difficulties experienced by the audit committee members to a certain extent fulfilled the expectation that they would confront the management if necessary, the
litigious environment also played an important role in the challenges faced by the audit committee members as predicted. However, the difficulties, conflicts, or challenges were most importantly related to their specific firms. The nature of the incidences perceived as difficult by the interviewees were of a diverse range. Given the above, coupled with a broad range of activities performed by the audit committees, assessing the audit committees’ performance is not simple.

(6) **Assessing audit committee performance**

During the interview, participants were asked to score their performance and explain why they chose a specific score. The rating is not intended to measure the member’s performance, but as an initiator of further conversation. The key intention of the question is to identify how interviewees justify the evaluation of their performance. Existing audit committee research studies suggested that an audit committee oversees firms’ financial reporting and auditing processes, as well as the practices of internal control and risk management (DeZoort et al, 2002). Such responsibilities, however, reflect public expectations rather than being a matter of fact (Beasley, Branson, & Hancock, 2008). This interview question is designed to obtain an insight into how audit committee members perceive their duties and to what extent they believe they have fulfilled their duties.

The interview data obtained from the research revealed that participants adopted three benchmarks to assess their performance: (1) providing assurance to the board; (2) improving their firms’ practices; and (3) comparing to other companies. Most participants also suggested that there is room to improve in their audit committees. A summary of the interview data is provided in Table 6-6.

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33 Node No.1.5 in Table 5-1.
Table 6-6: Assessing the performance of audit committees

<table>
<thead>
<tr>
<th>Performance measures (qualitative)</th>
<th>No. of interviews</th>
<th>No. of references</th>
<th>Examples</th>
</tr>
</thead>
</table>
| Providing assurance to the board  | 13                | 25               | Interviewee 10:  
“There is no issue that we are not able to sell to the board. You know…we have no authority to make any decision except for at the board level. We make good recommendations to the board. And I cannot think of any recommendation from the audit committee that has been overturned by the full board. And although there are some minor issues with the external auditors, the relationship is good. There are healthy tensions between them and the management.” |
| Improving their firms’ practices  | 7                 | 37               | Interviewee 02:  
“So we changed all those since I came in and there were a number of problems at the start, which we worked hard to get them fixed within a very short space of time, employing the current chief financial officer and getting it done. Then we had no more problems in the most recent five years. The pilfering and the write-offs *(of the retail store inventories)* that we used to do was many millions of dollars with staff ripping us off, and burglars or thieves coming in and stealing things. That percentage is tiny now.” |
| Comparing to other companies’ audit committees | 6 | 11 | Interviewee 09:  
“But what actually worries me and scares me is that we do have some audit committees who are chaired by people that don’t have the same sort of background that I’ve got…you know… in terms of the difficulty; because it is an onerous job. It really is and it is so important. So I think that because of me… I think I’ve done well, but also I’ve done … they *(the responsibilities)* have been achieved because of the focus of the agendas, the support, again of both the other directors and the management team.” |
| Room to improve                    | 14                | 23               | Interviewee 17:  
“We are competent. But we must keep continuing to improve in each round of the business cycle… to make it better.” |
The evaluation of their audit committee performance by members was of a more qualitative than quantitative nature. The audit committee outcomes suggested by the existing audit committee research studies, for instance, ‘financial reporting quality’ and ‘audit quality’ are not directly reflected by the interview data. As discussed in (1) motivation for serving on the audit committee, participants perceived serving on audit committees as either reacting to compliance requirements or as a part of their directorship. They then subsequently assessed their performance as providing an assurance to the board on their compliance responsibilities.

This research study argues that an effective audit committee is influential, rather than independent. Many interviewees described concrete improvements in their organisations that they believed their audit committee played a part in achieving. It was through these improvements that the interviewees tended to assess the effectiveness of their audit committees.

Furthermore, six interviewees benchmarked the performance of audit committees against their experience or observations of the audit committees of other organisations. This reflected their perception that their past experience contributed to enhancing their confidence in audit committee related judgement.

In summarising the first interview category, participants perceived their motivation for serving on the audit committees as a satisfaction to regulatory requirements and a fulfilment of their directors’ duties. An audit committee was perceived as, on behalf of the board, overseeing firms’ financial reporting, internal control, risk management, auditing related matters, and compliance. A diverse range of activities was identified as audit committee tasks by the interviewees. However when discussing these tasks, interviewees blurred the boundary between acting as an audit committee member or acting as a director. Past experience or background was perceived as a dominant factor that helped the interviewees in performing their audit committee responsibilities, because the experience enhanced their confidence in making significant judgements. A firm’s compliance and litigious environment posed significant challenges for interviewees. Finally, interviewees tended to assess their performance by evaluating the assurance they provided to the board, the improvement they made and benchmarking their performance to other audit committees. In the next section, interview data on audit committee operations are discussed to interpret the processes of audit committee meetings as well as outside audit committee meetings.
6.2.2 Perceived audit committee operations

In this section, an insight into audit committee meetings is discussed, focusing on the features of audit committee meetings perceived by the participants, the process of resolving issues in audit committee meetings, and the tasks performed by members outside audit committees’ meetings.

(1) Features of audit committee meetings

Node 2.0 ‘General sense of audit committee meetings’ in Table 5-1 was created during the process of analysing the interview responses to summarise the following themes relating to some general features of audit committee meetings described by the interviewees. These themes are illustrated in Table 6-7.

Table 6-7: Features of audit committee (AC) meetings

<table>
<thead>
<tr>
<th>Features of AC meetings</th>
<th>No. of interviews</th>
<th>No. of references</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC meetings are driven by the agenda</td>
<td>21</td>
<td>153</td>
<td>Interview 04: “The agenda… is very clear. We set it. I agree on the agenda as chair. The agenda has a very set format. And all of the committees I am on, the formats are the same.”</td>
</tr>
<tr>
<td>AC meetings have formal settings</td>
<td>17</td>
<td>90</td>
<td>Interviewee 20: “The process is like most of the formal… committee meetings. The issues are tabled in the agenda. We discuss them and debate them. And then we resolve them by consensus… yeah… all by consensus. We also keep the minutes.”</td>
</tr>
<tr>
<td>All participants of the AC meetings are well-informed before the meetings, so there is no surprise during the meeting</td>
<td>16</td>
<td>74</td>
<td>Interviewee 02: “Okay, the resolving of the issues doesn’t start at the audit committee meeting. It is inevitably starting before that. The topics that are going to be discussed or issues that are going to be resolved were well known, or reasonably well known in advance.”</td>
</tr>
</tbody>
</table>

34 Node No. 2.0 in Table 5-1.
AC meetings are usually scheduled right before the board meetings

<table>
<thead>
<tr>
<th>Features of AC meetings</th>
<th>No. of interviews</th>
<th>No. of references</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interviewee 12: “We hold our audit committee meetings completely separate to our board meetings. Hum… four times a year generally. Often on the day before our board meetings. There is a formal agenda to go through, and the formal minute from the previous meeting.”</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

The interview data summarised in Table 6-7 demonstrate that the participants perceive the formal features of audit committee meetings as being important to them. The audit committee meetings were perceived as a formal channel to document the committees’ works which were subsequently reported to the board. This finding is in line with the existing audit committee studies that the audit committee meeting is a long standing institutionalised practice (Turley & Zaman, 2007).

Although 12 interviewees on 43 occasions (see Table 5-2) mentioned debating issues during the audit committee meetings, it is noteworthy that several interviewees emphasised that it was important that all issues to be discussed during the meeting must be well circulated to all participants before the meeting. In addition to the transcript quoted from Interview 02 in Table 6-7, two other examples are worth mentioning.

Interviewee 15, an audit committee chairman suggested: ‘I will always let them (the participants) know the issues that I am going to raise. So they know what is coming, and they can prepare for it, rather than ambush the meeting… when you want to achieve anything, alright?’

Interviewee 18 mentioned a specific incident when the internal auditors brought to the audit committee meeting an issue which had not been well circulated before the meeting. He said: ‘the other day, the internal auditor looked at a new computer system that we have been putting in. …he made a comment about it during the meeting, but that caused an eruption because it wasn’t discussed with the executives but brought it straight to the audit committee (meeting). You know… I had several phone calls after the meeting. I’m not sure how much time I spent just to find out and to follow up about where it got to. Well they (the management) got offended because he (the internal auditor) didn’t consult their opinion first.’
Interview evidence suggests that the audit committee meetings *per se* are not intended by the participants for ‘debating’ and ‘resolving’ issues, but to document (formally finalise) the resolution which then is recommended to the board. The true process of debating and resolving happened outside the meetings. Furthermore, it is noteworthy that interviewees described the general atmosphere differently. Several interviewees emphasised that the meetings were formal and there were ‘robust debates’ during the meeting, but three interviewees specifically described the atmosphere of audit committee meetings as relaxed. Interviewee 10 said: ‘It’s only three of us you know… it’s very amicable. In fact it’s almost… probably because of that. It’s almost light-hearted. Huh… not to say that it is not serious, but the way we go about it is… you know… there are jokes on the meetings… yeah… it’s a sort of fun meeting.’ It seemed that the sense of seriousness and the relaxed atmosphere of the audit committee meetings are contradictory. But both of them reflected the level of comfort in attending the audit committee meetings. Nevertheless, the participants had already prepared and anticipated the outcome of the meeting. The meeting process would finalise their work, either in a sense of seriousness or in a relaxed atmosphere that they felt comfortable with. In the next section, how issues are ‘resolved’ during the audit committee meetings is discussed.

**(2) Processes of resolving issues in the audit committee meetings**

Based on the interpretation of interview data in the previous section, although the participants mentioned that debate took place during the audit committee meetings, the issues that were debated had been well circulated and well prepared before the meetings. Therefore the formal meetings’ process is to formalise and document the resolutions. How are those resolutions finalised?

Firstly, the interviewees, in several instances, explained their role as providing an opportunity for different parties to voice their opinions. Furthermore, it is perceived as important for the meetings to achieve a balanced and unanimous view. An example of this, that was described by interviewee 03, related to a finance company which was involved in providing for the impairment of an investment, with the management taking a very different stance from the external auditor: ‘… you have the auditors, you have the management, of course, and you have the shareholders… (shaking his head) so it was interesting.’ A number of interviewees strongly rejected a show-of-hands (voting) approach for resolving issues during audit committee meetings. Obtaining unanimous agreement on specific issues was of great importance to

35 Node No.2.1 in Table 5-1.
interviewees. If there was disagreement, the only acceptable solution was to seek more information and to keep the issue on the committee meeting agenda, until a consensus-based agreement could be reached. A chairman explained: ‘Because we are all sensible people, if we all understand the same set of facts, and we apply the same logic to those facts, we come up with (the) same answer.’

Secondly, interview evidence suggested that issues resolved during audit committee meetings are usually related to public disclosure. In other words, audit committee meetings are utilised by the directors to assure the information that is to be disclosed to the public. The participants of this research were asked to describe an audit committee meeting, either the last one they attended or an unscheduled meeting. 20 out of 21 interviewees chose to describe a common scheduled meeting. Several interviewees described the scheduled meetings as ‘routine’, having an agenda with a ‘set format’. Seven suggested that audit committee meetings were related to information to be publicly disclosed rather than to focus on auditing and accounting issues.

- Interviewee 02 said: ‘There were two scheduled meetings we have every year. Sometimes we had two, three, four or five. Probably five would be the most of the scheduled meetings. There are always two scheduled meetings before the release of the half year and annual results.’ He then specifically clarified that it was before the release of the results, rather than before the approval of the audited accounts.

- Interviewee 10 shared with the researcher the agenda of the last audit committee meeting he attended, saying: ‘we edited those (pointing at the agenda item ’press release and announcement’)… you know. As you can see the last item in this section was about the ‘insiders trading’… the Securities Exchange’s new insider trading law. We were acknowledging it and dealing with the press release at the end of the year on this issue.’

- Interviewee 20 said: ‘the key audit committee meeting papers include the details of the provisions and accruals… those accounts sort of stuff… the press release draft, and the NZX release in terms of all the financials, dividends recommendation that we…huh… that was proposed by the management but for us to approve.’

36 14 out of 21 interviewees discussed the process of achieving consensus during the audit committee meetings.
Interviewee 04 described a special unscheduled audit committee meeting, because he believed that that meeting was ‘interesting’. The event that triggered this unscheduled meeting is that one of his fellow directors sold shares under circumstances that were prohibited under the insider trading regulations. He said, ‘The director sold some shares when he shouldn’t have. We had a significant risk… a risk around the fact that there was insider trading and it is in breach of the Securities Act for that sort of stuff. So the audit committee acted very quickly when they found out that the director sold the shares. We called the audit committee meeting, smacked the director over the hand for being a naughty boy, and wrote to the Stock Exchange and the Securities Commission clearing what happened. It was a mistake, da-la-da-la… so that was it. Well, a lot of discussions about what the director has done and why. … what happened was we needed to deal with the Stock Exchange and the Securities Commission immediately. So we did. They (the authorities) both came back. They said that’s fine. There was no problem.’

The evidence suggested that audit committee meetings played an important role in the information presented by the firm to the public including the related authorities. Prior to the information being released to the public, directors utilise the audit committee to achieve a common agreement and a level of comfort on the quality of information.

Thirdly, eight interviewees specifically suggested that their audit committees had a private meeting with the auditors. For instance, interviewee 16 described: ‘The second part of the meeting was the auditors talked through their process, at that stage, it was established that they are going to give us an unqualified opinion. Then we talked about that. Then we asked the executive directors and the finance staff to leave. Then we had a session of independent directors and the audit partner on his own. There were a couple of points he raised in that forum, but nothing new really. Then we sent the auditor, he left.’ The other six interviewees were of a similar impression. Although a formal session was set aside for the audit committee and auditors to meet privately without the management present, very few suggested that any specific issues raised in these sessions were remarkable. Such private meeting sessions, as a gesture to the public or to the management, are perceived as important for the participants, but audit committee members do not utilise it as a channel of communication.

In summary, the interview evidence from this research supported the claim by Spira (1998; 2005) that audit committee meetings are of a ceremonial nature. They are to finalise and formalise resolutions during the meetings, but the process of assessing the situation and reaching
an agreement on the issues is usually achieved before the meetings. Audit committee meetings are utilised as an important mechanism for members to reach a level of assurance on the quality of information externally disclosed. Given the above, processes outside the audit committee meetings assume importance. These informal processes will be discussed in the next section.

(3) **The tasks performed by members outside audit committee meetings**

As discussed previously, it is expected that a large amount of audit committee tasks are performed outside formal audit committee meetings. The interview data confirmed this expectation. All interviewees claimed that the time they spent on working outside audit committee meetings outweighed the time they spent attending the audit committee meetings. However, the workload outside the audit committees was perceived as unevenly divided between audit committee chairpersons and the ordinary audit committee members. Both the tasks performed by the audit committee chairpersons and the time they spent on those tasks are significantly more that the tasks performed by the ordinary audit committee members. Interviewee 10 chaired two audit committees, and served on another audit committee but not as the chairperson. She described the uneven difference in the amount of work between the chairperson and an ordinary member as: ‘varies enormously! As I said, this audit committee *(where she is just a member)* is the simplest one. I’ve got one that I am the chair of, and I would spend… because we have so many issues, shareholders’ issues, IFRS issues, and God knows what. I would spend… at least 200 hours a year on it!’ Interviewee 03 suggested that the workload for chairpersons working outside meetings was four or five times that of a normal member.

The tasks performed by ordinary audit committee members outside audit committee meetings were perceived as focusing on two areas: (1) reading audit committee meeting papers, and (2) research or study on issues to be discussed during the audit committee meetings. For instance, interviewee 13 said: “there is always reading and reviewing the minutes and stuff before we are going to the meeting… Huh… just refreshing your memory and knowledge.” The interviewees also suggested that an ordinary audit committee member did not work with other people. All the liaisons fell on the shoulders of the audit committee chairperson.

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37 Nodes No. 2.2 and 2.3 in Table 5-1.
Among the 21 interviewees, there were 17 audit committee chairpersons and four ordinary audit committee members. The following discussion focuses on the interview responses given by the 17 audit committee chairpersons.

On one hand, audit committee chairpersons are in charge of feeding the information to the committee meetings. Two interviewees suggested that they personally prepare the meeting agenda and the other interviewees had assistant personnel physically preparing the meeting agenda and supporting papers. But all of the audit committee chairpersons agreed that they were responsible for the meeting agendas and supporting papers. Such responsibilities involve studying or researching, and sometimes even seeking independent opinions on specific issues. As described by interviewee 03: ‘The expectation is that the information that is going to be required by the audit committee is driven by the chairman to achieve, to make sure that the information is to come through, and it is the appropriate information. And the follow-ups… If there are concerns or there is further information that a particular member wants, and also, queries from the board to the audit committee, will go through the chairman.’

All of the audit committee chairpersons interviewed believed that they were relied upon by the other audit committee members. Therefore, they perceived that the preparation before the audit committee meetings was very important for them in order to fulfil this expectation. Interviewee 10 said: ‘Because you’ve got to go into the meeting prepared. I mean, that’s the key expectation. There is no… absolutely no point of being a director or an audit committee member that does not go to the meetings prepared! I take the responsibility both as chair, either I am a chairman or simply because of my (accounting) background… Yes, I know it is a joint responsibility, but I know the others are looking to me…’

One may challenge that if the audit committee chairperson is in charge of feeding the information into committee meetings, the chairperson may dominantly decide on the scope and the content of the information. In this regard, two interviewees specifically suggested that the preparation of audit committee meetings by the chairman should be only up to an appropriate extent. No ‘decisions’ should be made outside audit committee meetings, but all the resolutions should be done within the formal meeting. Interviewee 16 emphasised that: ‘This is a key issue! The chairman should approve the agenda. But I don’t think the chairman should read the (supporting) papers before it is sent out. I think the chairman should get the papers at the same time as everyone else.’ The meeting would be perceived as: ‘the discussion about if the information (in the supporting paper) is satisfactory, do we agree with it? If not, why not? Then
the discussion should be documented in the minutes’. Interviewee 14 supported such an idea and believed that it would be ‘dangerous’ for the audit committee chairman to make decisions on agenda items outside the audit committee meetings.

Given the above, the interview evidence suggested that a large amount of audit committee meeting preparation work falls on the shoulders of audit committee chairpersons. Interviewees perceived that the chairpersons assumed the expectation of driving the meeting agenda and collecting the supporting information. Agenda items were perceived as well circulated prior to the meeting. Then when members arrived at the meeting, there would be no surprising new information raised. The debate, consensus and meeting documentations were also perceived to be important to audit committee members. Because the meeting agenda and information were well read by the audit committee meeting attendees, the debates which took place during the audit committee meetings were substantially assessing the quality of the information, based on which the consensus opinion would be formed. Audit committee members sought a level of assurance through the consensus opinions agreed and documented in meetings.

Audit committees are not expected to assume executive power, but rather to oversee management and auditors. In the next section, the relationships between audit committees and the board of directors, the auditors, and the management will be discussed.

6.2.3 Relationships with audit committee stakeholders

Topic three of the interview questionnaire investigates the relationship between audit committee members and other parties who work with them, namely the management, the internal auditors, external auditors, and the board of directors. In contrast to topic two, which focuses on the audit committee meetings as routine activities, topic three aims to obtain an account of specific occurrences, which involve stand-offs, conflicts, or difficulties in performing the audit committee’s role.

Topic three also aims to provide an insight into audit committee activities. The questions request the interviewee to describe a complete occurrence of interacting with the aforementioned parties, with sufficient contextual information. The interviewee’s responses are expected to reveal how an audit committee member perceived what had happened on those occasions, the reason(s) for what had happened and why they did certain things to resolve the issue.
(1) **Reporting to the board of directors**

Research participants were asked to describe the process of their audit committees reporting to the board of directors. Interviewee 10 claimed that she believed the board of directors is the only stakeholder of audit committees. This suggests that reporting to the board is perceived as an important process of audit committees.

Twenty out of twenty-one interviewees firmly stated that all the recommendations made by their audit committees were accepted by the board. The process of reporting was described in detail by interviewee 02: “When we finalised it (the audit committee meeting), we passed a resolution that we would recommend to the board that they proceed to adopt the accounts and to proceed with the release, and approve the dividend of whatever rate we approved. And then we concluded the meeting and we signed off the minutes of the previous meeting…then the recommendations were accepted totally and the key recommendations are that they (the board of directors) sign the financial statements, they make a release to the stock exchange, and they agree to pay dividends at a certain rate, those sorts of things.” As mentioned previously, audit committee meetings were perceived to be commonly scheduled immediately prior to the board meetings. Interviewee 15 also suggested that the minutes of audit committee meetings usually formed an agenda item of the subsequent board meetings. Based on the above, audit committees’ reporting to the board forms another ceremonial formal setting of corporate governance. Such evidence is also reflected in the description provided by interviewee 18, he said: “Only at the next board meeting. So it goes from the audit committee to the next board meeting. And in the next board meeting, there is a time set aside for the audit committee report. And it takes as long as it takes, you know? It is treated seriously. You know? It was given whatever time is required to work through the issues. So it is done thoroughly at the subsequent board meeting.” Interview evidence suggested that audit committee members assumed their responsibilities based on the delegation from the board, and then the members perceived reporting to the board as the conclusion of their delegated responsibilities.

Interviewee 17 described a particular incident when the recommendation made by his audit committee was overturned by the board. He said: ‘look, I’m not all comfortable with this. But in that company, they asked the audit committee to have a look at the year end result, and make a recommendation on what the dividend should be. And twice now, the board has rejected our recommendations on dividend, which is quite important you know. We just had

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38 Node No.3.1 in Table 5-1.
to… huh… it is a little bit frustrating for me when that happens, because if that is the case, they really shouldn’t ask us to recommend. This happened the last two times that after we recommended the dividend, they changed it in the board meeting. So that’s the example. It frustrates me if they do that, because they do that less than the objective reasons of the company, in my point of view, but for the perceptions of the company… you know… all those sort of things. I think that you should set your dividends to distribute your profit, for goodness sake. You should have a good firm base for why you should do that, you know. It is really about what is projection in the future, what do you need to retain in the firm to go where you want to go. It is not about how we should keep this group of shareholders wonderfully happy right now. But the board had drawn on the second thing, you know. So they all felt good. They changed the recommendations twice, once for the interim dividend, and once for the final dividend. So last year it happened twice.” During the process of interviewing, the researcher sensed that the interviewee became emotional as his description continued. He finally concluded that: “I don’t think it is the audit committee’s responsibility. The dividend should be a board decision!”

The preceding interview evidence suggests that recommendations made by the audit committees were expected without exception to be accepted by the board. As emphasised by interviewee 20: “We make recommendations all the time. That was basically what the audit committee was doing… so the recommendations we make are all accepted by the board.” It seemed to him that all recommendations should be naturally accepted by the board.

Several interviewees explained their confidence in this regard. Firstly, five interviewees suggested that the board of directors were well informed on the audit committee matters and when they report to the board, there was no surprise, Interviewee 03 said: “They (the board members) are likely, even though they haven’t been on the audit committee, to be kept reasonably well informed and their views were well thought of by the chairman of the audit committee to be taken into account in case they have a particular stance or particular concern about it. That can be addressed in the audit committee meeting, rather than waiting until the recommendation comes up to the board.” Once again, the theme of ‘no surprise’ and ‘well informed beforehand’ appeared. Interview evidence implies that the substantial content-based debate has taken place behind the scenes, during the board meetings, the reporting from the audit committee chairperson is of a ceremonial nature. Such a reporting process was perceived as finalisation or documentation rather than solving issues.
Secondly, audit committee members perceived their positions on the board to represent a certain level of authority, interviewee 04 claimed that: “There is discussion (when the audit committee is reporting to the board), but they (the board) always accept it (the recommendations). And the reason for that is very simple. That is three or four of the older and more experienced board members sit on the audit committee. So when they sit on the board, we got three or four out of six saying we should do this, the others are not going to argue.” Such evidence suggested that having competent members serving on the audit committee not only provided a level of confidence for the board to rely on their judgement, but also demonstrated to the board meeting attendees, especially the management, a level of authority of the audit committees.

The interview data obtained from this research for the first time revealed an insight into how audit committees report to the board. Several findings can be discussed here. Firstly, audit committees report to the board on their delegated duties. The recommendations made by the audit committees were perceived to be naturally accepted by the board without any exception because of the competence and the authority demonstrated by the audit committee members. Furthermore, the audit committee members were not prepared to accept any responsibility if the board turned down their recommendations. The authority demonstrated by the audit committees to the other parties was perceived to be important to the participants. In the next section, the audit committee’s mediating of the management-external audit relationship will be discussed in detail.

(2) Mediating between the external auditors and management

Qualitative research has hypothesised that the presence, independence, financial expertise, and diligence of audit committees are associated with higher quality financial reporting or auditing (Turley & Zaman, 2004). Question 3.2 asks the interviewee to describe a specific occasion when the audit committee needed to work between the management and the external auditors to resolve an issue or conflict. The interview data suggested that the participants perceived that in very rare cases the external auditors’ opinion was not followed by the management. The interview data are summarised in Table 6-8.

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39 Node No.3.2 in Table 5-1.
<table>
<thead>
<tr>
<th>Have the recommendations by the external auditors been followed by the management?</th>
<th>No. of interviews</th>
<th>Examples</th>
</tr>
</thead>
</table>
| Yes, without any further comments | 8 | Interviewee 02: “Yes, we are very conservative.”
|  |  | Interviewee 06: “In particular, our current auditors from (name suppressed), they are very, very good. They almost invariably iron the things out with the chief financial officer well before the audit committee meeting even so yeah, I’m pretty happy with that.” |
| Yes, but robust debates took place during the audit committee meeting | 4 | Interviewee 07: “I think the answer to that is “Yes.” The external auditors, I guess, carried more weight than internal auditor did in the management’s views. That is not to say they won’t have any vigorous debate with them when they are suggesting things. But there is a very good relationship between the external auditors and the finance people, CFOs and so on. They all attempt to resolve the different views and they always did.”
<p>|  |  | Interviewee 12: “We had some debates, as I recall. It is really to test the validity of the recommendations that the auditors are making. And you’ve got to make sure that the recommendations they made actually make sense. So it is testing and validating what they are recommending. Generally, if they recommend something, they have a good reason to recommend it.” |
| Yes, but some immaterial recommendations on the management letter (internal control related) required compromise from the auditors | 3 | Interviewee 01: “I actually had to go back to them and say that, “Look, I appreciate your recommendation. We can only have one accounts person working here. We have a wee bit of a problem…” So we actually resolve it with them rather than internally. We wrote a procedure and say, “Will this meet your requirement?” And they say “that’s fine, that’s good as gold.”” |
| Yes, the audit committee required the management to form an action plan in responding to the auditors’ management letter | 2 | Interviewee 08: “Goes a little bit further than that, we actually require any recommendations that come from the external auditor to be put into a bit of an action plan. You know? And the CFO reports on a regular basis as to the progress of putting into place those recommendations. That actually goes to the main board; (a) the auditors recommended it; (b) the management says that they will do it and it will be done.” |</p>
<table>
<thead>
<tr>
<th>Have the recommendations by the external auditors been followed by the management?</th>
<th>No. of interviews</th>
<th>Examples</th>
</tr>
</thead>
</table>
| The audit committee rules, and management must follow | 2 | Interviewee 10:  
“We have different views about provisions and accruals. And they... well... the management were saying one thing, and the external auditors were saying another. And we (the audit committee) were going to make this call and that’s it. And we recommend it to the board and the board then signed it. It has not always been exactly what the external auditors wanted. But the management must do whatever the audit committee ruled, that’s what happens.”

Interviewee 19:  
“Hum... what happened is I always ask if the management’s response (emphasising by tapping the desk) has been written after the subjects (raised from the management letter). In other words, we can compare the recommendations from the external auditor with the response from the management. But the decision of how much will be done or what will be done is the audit committee’s decision, not the management. Well... it (the dispute) is possible. But I’m not aware of any....” |
| The audit committee urged the external auditors to modify the disclosure in the annual reports | 1 | Interviewee 04:  
“The external auditor says something; technically it is correct. It’s what you’ve got to do. So the audit committee will generally agree with the external auditor. But every now and then, the external auditor will want something that is so... huh... what would I describe it as? It is, well, technically correct, but makes absolutely no sense at all. All you’ve got to do is to look at any set of accounts for an electricity company. And look at the eight pages of notes that it has around “derivatives” ... So I went back to the auditor and say here is the eight pages of notes, ‘Explain what they mean? Because I don’t understand; nobody else understands them; nobody who reads the accounts understands them!’ And I got those eight pages of notes down to about two pages of notes that actually made sense.” |
<table>
<thead>
<tr>
<th>Have the recommendations by the external auditors been followed by the management?</th>
<th>No. of interviews</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, but the audit committee member had doubts about the competence of the external auditors</td>
<td>1</td>
<td>Interviewee 05: “Being in a company that has no comparable industry in this country, means that you are often teaching the auditors. That is very frustrating. The turn-over of external auditors is very frustrating, because next year you get some audit staff, particularly the junior audit staff, who have never seen the way we handle our inventories. You have to teach them about the business. But that would be one of questions… every year we have the planning meeting with external auditors: “Are we going to have the same people as we have last year?” Meaning: “or are we going to have to teach them about our business?””</td>
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As a dominant theme identified in the interview data, most (15 out of 21) audit committee members perceived that the external auditors’ recommendations were debated, well understood, and followed by the management. In addition, two interviewees specifically discussed that their audit committees exercised the power to urge management to form an action plan to follow the auditors’ recommendations. This can be interpreted that the practices of debating recommendations, forming a resolution, and documenting the follow ups have been institutionalised as an important process perceived by the audit committee members.

It is noteworthy that there were two examples quoted in Table 6-8 where the interviewees emphasised the audit committee’s authority in mediating the relationship between the management and the auditors. It seems that the interviewees were discussing their general principles in approaching this issue. For them, it did matter whose opinion was valid. The management were expected to respect the audit committee’s authority and follow its ruling. Interviewee 10 spelt out that the audit committee’s authority was conferred and supported by the board, whereas interviewee 20 did not refer to any real example, but discussed the general expectation on the management to obey the audit committees’ decisions.

Interview responses quoted from participants 04 and 05 are of particular interest to this research. Both interviewees were experienced audit committee members and chartered accountants. They demonstrated a higher level of confidence in dealing with the external auditors. They seemed confident to challenge the competence or validity of the auditors’ stance. On one hand, this may be interpreted as a competent audit committee member acting
aggressively against the auditor to promote an outcome which he/she believes is for the best quality of auditing or financial reporting. On the other hand, in both cases, the audit committee members can be so influential in either making the auditor compromise or ‘teaching’ the auditors, it may actually undermine their independent position to oversee the audit function. Both incidents were perceived as important by the participants and they regarded their behaviours and opinions as justified.

The audit committees’ mediation between the management and the internal auditors will be discussed in the next section.

(3) Mediating between the internal auditors and management

Evidence from this research suggests that many listed companies in New Zealand had not formed any formal internal audit function by the time the interviews took place. In contrast to the dominant theme in mediating between the external auditors and the management, where the majority of the participants perceived that it was important to respect the external auditors’ stance, many interviewees suggested that it was ‘impossible’ to follow all the recommendations made by the internal auditors. Interview responses are summarised in Table 6-9.

There are several important findings, which can be discussed.

Among the eight interviewees who suggested there was no formal internal auditing in their organisations, three perceived the internal auditing as ‘unnecessary’ due to the scale of the business. The other five interviewees who suggested that there was no internal auditing function in their organisation, seemed fully aware that internal auditing as a best practice had been promoted by the authorities. So they continued to describe how their audit committees were directly involved in risk management practices and overseeing the management’s internal control practices. It is noteworthy that these five interviewees emphasised that when the internal audit function was absent, all the recommendations given by the audit committees were carried out by the management.

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40 Node No.3.3 in Table 5-1.
## Table 6-9: Mediating the relationship between the internal auditors and the management

<table>
<thead>
<tr>
<th>Have the recommendations by the internal auditors been followed by the management?</th>
<th>No. of interviews</th>
<th>Examples</th>
</tr>
</thead>
</table>
| The internal auditors recommendations are not 100 percent followed, compromises are needed from both the management and the internal auditors | 10 | Interviewee 04:  
“No, (not always). The reason is simple. Internal auditors in the companies where we have internal auditors, they are coming from a very pure perspective. They are saying, “If you follow this, this should happen. This person should sign this. Then this should happen.” Okay? And they recommend on that basis. Sometimes the management said, “if we do this, we will never get anything done.” It takes far too long and it is a far too convoluted process. We do this instead, we think it is sufficient. And the internal auditors usually accept that.” |
| No formal internal auditing function, but the audit committee directly oversees the internal control and risk management | 5 | Interviewee 08:  
“Well… it’s not… when I talk about internal audit, there are some exercises undertaken that an internal audit might otherwise do as a part of the check and balance system. But now they (the CEO and staff) are doing it themselves. It is not those external party came in with recommendations that need to be followed. I am not aware of anything that has been found that hasn’t been actioned.”  
Interviewee 11:  
“At this stage it doesn’t have a specific internal audit function. But the chief financial officer is charged with… I suppose… some of things that normally an internal auditor will do, but generally those were merged with his general duties. I mean that… any recommendations that the CFO made, the audit committee endorsed them at the meetings. There would be a very high expectation that the management would follow those.”  
Interviewee 16:  
“We don’t have internal audit, but we have something like a high level of risk assessment of the business. Huh… I wouldn’t call it a process. That’s being a little bit generous… We put a lot of work into that. We spelt that out with quite some detail… in our prospectus. Then we have an action on our CFO to update on that. But at year end, we actually reviewed all of that as well. So that seems fine.” |
<table>
<thead>
<tr>
<th>Have the recommendations by the internal auditors been followed by the management?</th>
<th>No. of interviews</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>No formal internal auditing function, and it does not seem necessary</td>
<td>3</td>
<td>Interviewee 10: “No, we don’t have internal audit. It’s only a small company. Hum… we are probably close enough… well… yeah… close enough to know the accounting and control very well…”</td>
</tr>
<tr>
<td>The company is in the process of setting up an internal audit function as a result of the efforts of the audit committee</td>
<td>1</td>
<td>Interviewee 06: “There’s been a long drawn-out battle to put in place a formal internal audit structure, and we are just getting there. Agreements in principle have been reached, and it is waiting for the final acceptance by the management and implementation. And that will be happening pretty soon.”</td>
</tr>
<tr>
<td>Yes, but I have to make sure that the issues are serious enough to be raised at audit committee level</td>
<td>1</td>
<td>Interviewee 15: “Sometimes, particularly for internal auditors, big things can drift on. So part of my responsibility would be to make sure that things are serious enough to raise an issue. The job of the internal auditors, since they have no power within the company… they rely on the audit committee… they rely on us to make sure that the management team own the problem. Okay so that’s part of the role you have.”</td>
</tr>
<tr>
<td>Yes, but the internal auditors’ work is unsatisfactory</td>
<td>1</td>
<td>Interviewee 12: “Yes. Hahaha… (shaking his head and laughing loudly, then long pause and thinking) The recommendations as agreed by the audit committee are implemented. (long pause) I think it is the internal auditor’s crap! Well… I can prove it! The internal auditors have done limited scope of work. Hum… therefore whatever recommendations that have come through, have been …you know… have been agreed and followed through, but we could have done a whole lot more in the internal audit.”</td>
</tr>
</tbody>
</table>

In contrast, the 10 interviewees who had experience in working with their internal audit departments all suggested that both the internal auditors and the management had to compromise to reach an agreement, because it was not possible to follow the internal auditors’ recommendations ‘100 per cent’. This evidence is particularly interesting when compared to the situation when the internal auditing function is absent in the organisation. It seemed that when there is an internal audit function in the firm, the audit committee’s role is perceived as an ‘arbitrator’ and its function is mediating between internal auditors and the management. Especially as quoted from interviewee 15, the audit committee chairperson tended to assess the validity of the internal auditors’ recommendations first. But when there is no internal audit
function, the audit committee’s role is perceived as an ‘authority’ and its function is ‘supervising’ the management.

Interviewee 12 was the audit committee chairman of a failed financial company. During the interview, he became sarcastic and angry when talking about the internal auditing in his company. Rather than trying to blame the poor internal auditing on the difficulties faced by his company, he referred to the lack of experience of all of the audit committee members. His disappointment in the audit committee itself, the management, and the internal auditors was apparent. He continued: ‘Internal audit for us is actually a hard one, in my point of view. You know… we are a small company. Having a single person assigned in that area is a cost that the company really cannot afford to bear. So we also had a lot of debate over that area. We’ve been debating having another part time person or something. But, (emphasising) remember this is only a company of fifteen people!’ This evidence is also interesting when compared to the quote from interviewee 10 in Table 6-9. Logically, whether to establish a formal internal auditing function is subject to the cost-benefit constraints of a company. However, being a ‘small’ company may not be a strong argument from interviewee 12’s point of view, when considering the ‘closeness’ emphasised by interviewee 10. When the audit committee members are close to the operation of the company, they seemed comfortable having a hands-on approach rather than put reliance on the internal auditing function. In contrast, in the case of interviewee 12, who was an independent director, a chartered accountant, and was not intensively involved in the company’s operation, his insight into the company could be very limited. He seemed to be putting a certain reliance on the internal auditors to provide the assurance on management conduct. However, the resource constraint faced by his internal auditors, coupled with his own lack of confidence in judgement due to lack of audit committee experience, was a source of regret to him.

In summary, audit committee members assumed their delegated responsibilities from the board of directors, and they reported to the board as a conclusion to their delegated responsibilities. The reporting process was perceived to be formal and important. All the recommendations from the audit committees to the board of directors were expected to be accepted without any exception. Otherwise the audit committee members would not accept the responsibility. In mediating external auditor and management relationships, the audit committee members demonstrated a high level of authority to the management. In certain circumstances, audit committee members with a high level of financial or accounting competence may
deliberately influence the external auditors’ practices, contravening the expectation on their independent status. In mediating internal auditor and management relationships, the perceived roles of audit committees were different, depending on whether or not there was an internal auditing function. The special case reported for a failed finance company indicates that the distance between the independent directors and the daily operations of the company may decide the level of reliance the audit committee members place on the internal audit function.

6.2.4 Perceptions of the audit committee environment

Topic four of the interview questionnaire is titled ‘perceptions of the audit committee environment’. This topic investigates the audit committee members’ perceptions of events or changes associated with audit committees, but not necessarily the committee duties per se.

(1) The relationship between audit committee members and the management

Question 4.1, is: ‘has your relationship with other executives changed since you were nominated as an audit committee member? Please give an example. What do you think might be the reason?’ Interviewees were requested to comment on their relationships with the management prior to and after they served on the audit committee. If any changes in the relationships were identified, the interviewees were invited to relate an account of how they sensed that the relationships had changed and explain the reasons that they believed triggered such changes. Furthermore, the expected findings from this interview question are not the change in relationship per se, but how the participants perceived it, and how they explained such changes.

Only two interviewees claimed that they sensed substantial changes in their relationship with the management since they served on the audit committee, or became audit committee chairperson.

Interviewee 03 said: ‘my general comment would be that there isn’t usually a change in the relationship with the executive, where a director is nominated or joins the audit committee. But there is a noticeable change (smiling) experienced when someone was appointed as the chairman of the audit committee. The relationship, my experience, anyway tends to formalise a little bit more and perhaps, it is seen that the audit committee chairman was perceived perhaps a

41 Node No.4.1 in Table 5-1.
Interviewee 03 described the change in relationship as a process of formalisation. He explained it as the management gradually regarded audit committee members as on the opposite side. What is noteworthy is the process of formalisation. The audit committee as an overseeing mechanism was not regarded as ‘outsiders’ straightaway, but there had been incidents or events that gradually changed management’s perception. In the case of interviewee 03, he had to stand strongly against the management proposal on a provision during the NZ IFRS transition. As a result of this incident, the relationship between the executive and the interviewee changed. This idea is shared by interviewee 16, who said: “I think what has changed though was the other directors are getting… slowly… a better understanding of why we have an audit committee. It is a change in the relationship, because now they would defer to me as the chairman of the audit committee on issues. But a year ago, they wouldn’t.” It is noteworthy that interviewee 16 was an audit committee chairman of a start-up company, which had been listed on the stock exchange only one year when the interview was conducted.

The other nineteen interviewees all indicated that their relationships with the management had not changed since they served on the audit committee. Using the response from interviewee 02 as an example: ‘The main relationships with the executives of the company are with the managing director, the deputy managing director, the chief financial officer, and the internal auditor, and I was already the board chairman before the internal auditor and chief financial officer were appointed, so our relationship has always been identical. It’s been the same. It wasn’t affected by my appointment [to the audit committee].”

The researcher posits that the relationship between the management and audit committee members may be determined by individual organisations’ contexts. Individual incidents or the environment, for instance, a different view on issues to be resolved, or publicly raising funds, may change the relationship.

(2) Assessing the level of remuneration

Interviewees were given an opportunity to evaluate the reasonableness of their remuneration. When the interviewees explained their evaluation, an account of their perception

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42 In this case, most of whom are executive directors.
43 Node No.4.2 in Table 5-1.
of the magnitude of their audit committee duties and the achievement of audit committee objectives are also expected to be revealed. Thirteen interviewees claimed that they believed their remuneration was reasonable, while eight interviewees claimed that they were not remunerated reasonably. As designed, the interview question brought up the question of how interviewees assess, that is the benchmark they adopted to measure their remuneration. The interview data revealed several different ways of assessing the level of remuneration. Some interviewees adopted two or more benchmarks in discussing the level of remuneration. The classification and examples are displayed in Table 6-10.

Table 6-10: Assessing the level of audit committee remuneration

<table>
<thead>
<tr>
<th>Theme (benchmark)</th>
<th>No. of interviewees</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>The remuneration should reflect the workload</td>
<td>6</td>
<td>Interviewee 01:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“The remuneration should be a complement to the job, not the person. In other words, it should be related to the amount of duty involved and so on.”</td>
</tr>
<tr>
<td>There should be additional compensation for serving on the audit committee</td>
<td>3</td>
<td>Interviewee 11:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“It is reasonable in terms of the remuneration you receive as a director. I think the ratio between the extra you get for the audit committee… if you proportion it to what you get for being the director… that ratio was fine.”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Interviewee 16:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“Ha! (long unhappy pause) We don’t pay extra for sitting on the committees. We don’t pay extra.”</td>
</tr>
<tr>
<td>There should be additional compensation for chairing the audit committee</td>
<td>5</td>
<td>Interviewee 19:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“It is determined that the audit committee chairman should, in addition to that sum… get ten thousand dollars more a year. Because the audit committee chairman does do a lot of extra work.”</td>
</tr>
<tr>
<td>Theme (benchmark)</td>
<td>No. of interviewees</td>
<td>Examples</td>
</tr>
<tr>
<td>-------------------</td>
<td>---------------------</td>
<td>----------</td>
</tr>
</tbody>
</table>
| Comparing to overseas companies’ directors fees | 2 | Interviewee 05:  
“Yeah, workload is time… Hum… I think directors’ fees are low in this country. If they were higher, and if the role of directors was more remunerated, directors will do more.” |
| The remuneration should reflect the value brought into the audit committee by a particular audit committee member | 2 | Interviewee 15:  
“Well… I think… Let me put it in this way, as far as I am aware, I am the highest paid audit committee chairman in New Zealand. I think! I don’t know for sure, but I think. If I am not the highest, I am the second highest. (laugh) It’s okay, you get what you are paying for. But you do get different schemes in the game, you know what I mean.” |
| It is not a matter of high or low. It is about the responsibility of being a director | 2 | Interview 09:  
“My answer will be “yes, (my remuneration is reasonable)” for all of them (the companies he serves on), although all of them are actually different. Hum… I guess I don’t necessarily do what I do for the remuneration. Once I am a director of the company, I assume that I have a responsibility in that company. And I do not think about the level (emphasising) of the remuneration.” |
| The audit committee remuneration is only a portion of an overall package | 2 | Interview 02:  
“I get remunerated partly through my investment in the company, and partly, to a lesser extent, by my directors’ fees. I look at it all as a big package. I give and I assist. And I am contributing and I get some remuneration back. But I don’t assign it to the audit committee, the board or investor whatever.” |

The above interview data can be linked to the theory in several ways. According to Adams & Ferreira (2008), audit committee members with higher fees attend board meetings more frequently. In other words, remuneration may have motivated audit committee members...
to work harder to spend more time on audit committee related issues. As quoted in Table 6-10, audit committee members tended to justify their remuneration against their perceived level of work load they take on, either as a member or as a chairman. Proponents of equity theory (Miller, 1995) also argued that remuneration receivers tended to compare the level of their inputs (the work load) to their outputs (how much the remuneration was) and then compared that proportion to a referent, for example, in this research, the directors’ pay in another country. The equity theory predicts that if the remuneration receivers perceive their remuneration as ‘unfair’ in comparison to the referent, they would adjust their efforts to re-establish the ‘fairness’. However, as indicated by interviewees 09 and 02, they were not concerned about the level of remuneration in relation to the audit committee’s role as such.

It also revealed that a ‘labour market’ of available audit committee members may have formed as a result of increased expectations on forming corporate audit committees. Gomez-Mejia and Wiseman (1997) suggested that directors’ pay was explained in terms of the supply and demand of the labour market. There are interviewees who justify their remuneration by referring to their expertise or reputation (see the quotation from interviewee 15). It is noteworthy that none of the interviewees related the level of remuneration to the effectiveness or performance of their audit committees.

(3) Assessing the regulatory environment of audit committees

Interview question 4.3 is: ‘how have the increasing regulations and guidelines governing audit committees affected your work on the audit committee? Please give an example.’ In answering this question, interviewees were given an opportunity to discuss the impact of the regulations on the performance of their audit committee duties. Although the interview question per se does not specifically refer to any particular regulation or guidance, the interviewees tended to comment on the transition from NZ GAAP to the IFRS, and the compliance requirements. The stances held by the interviewees varied greatly from strongly against the increasing regulations to praising the guidelines for being specific and helpful. The interview data are summarised in Table 6-11.

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44 Node No.4.3 in Table 5-1.
Table 6-11: Assessing the regulatory environment of audit committees

<table>
<thead>
<tr>
<th>Stance</th>
<th>Subject area</th>
<th>No. of interviewees</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Frustrated by the imposition</td>
<td>IFRS transition</td>
<td>6</td>
<td>Interviewee 15: “We had the IFRS, which is absolutely… well… you know… I just don’t think IFRS is all that cranked up as it should be. There are too many problems… the real issue with IFRS is it is continuously changing… even in some fundamentals. Every single standard is up to a continuous review… so you will have to keep on top of them.”</td>
</tr>
<tr>
<td></td>
<td>Compliace-related</td>
<td></td>
<td>Interviewee 04: “Sarbanes-Oxley comes in. In my view, it is as a pendulum swing, right oh?? What happened was we were doing too little before, but we are now doing far too much. Eventually it will come back to a sensible position in the middle. Under the new IFRS, we are producing a lot of information in a set of statutory accounts that is of no value to anybody.”</td>
</tr>
<tr>
<td></td>
<td>requirements</td>
<td></td>
<td>Interviewee 01: “So the requirements are actually pulling people out of the audit rather than make the audit better. I think that can actually happen. I just worry about you scaring people off rather than bringing out the changes you are trying to achieve. But I might be wrong. Just my opinion.”</td>
</tr>
<tr>
<td></td>
<td>Compliance-related</td>
<td></td>
<td>Interviewee 11: “I mean my life as director or even sitting on board as an executive started probably 25 or 30 years ago at what stage the complexity of the requirements was a lot simpler, and I think… although at times it did mean that people could sidestep. I think for the genuine hard working director, they aimed more to focus on the nucleus of the business, rather than on the compliance issues which related to ticking the boxes and all the rest of that.”</td>
</tr>
<tr>
<td>Negative: being distracted from ordinary operations</td>
<td>Compliance-related</td>
<td>2</td>
<td>Interviewee 05: “The problem was the increased regulations and guidelines… (pause) don’t make allowances for small, medium or large companies. I talked about compliance here. It’s very different for compliance when you’ve got a firm that is just a bit bigger but it’s got branch offices. Huh… for a large firm very, very different. It’s much easier to keep an eye on what’s going on if it is just a small firm.”</td>
</tr>
<tr>
<td>Stance</td>
<td>Subject area</td>
<td>No. of interviewees</td>
<td>Example</td>
</tr>
<tr>
<td>--------</td>
<td>--------------</td>
<td>---------------------</td>
<td>---------</td>
</tr>
<tr>
<td>Negative: additional workload and compliance costs</td>
<td>Compliance-related requirements</td>
<td>4</td>
<td>Interviewee 19: “We are actually adding enormous complexity which implies a lot of cost in the areas where my perception would be… that the risk in that area where you apply a lot of money and effort to is minus or even non-existent. So in other words, we have slavishly taken on US implied standards because... all the major firms are there. And this is probably time consuming and unnecessary. And from time to time, I think of people doing that when there would be more potentially productive areas that they could have been working on.”</td>
</tr>
<tr>
<td>Positive: being helpful</td>
<td>Compliance-related requirements</td>
<td>3</td>
<td>Interviewee 16: “You know... helpful, I mean... huh... in some respects, the more guidelines there are around the audit committee and how it should operate imposed from the outside, the easier it is to actually establish it internally. So for me... it is certainly not a negative. No... it is as much... it created a lot of work, but it is helpful at the same time largely.”</td>
</tr>
<tr>
<td>Neutral: the company has adopted the best practice so has had a minimum impact from regulation</td>
<td>Compliance-related requirements</td>
<td>2</td>
<td>Interviewee 07: “Certainly there are a lot more in terms of... (pause) I am just thinking... the finance companies in through the stock exchange, the securities commission, they are requiring a lot more by way of regulation, and what is required in terms of reporting and so on. So that’s added work. But it doesn’t raise any issues that were not there before. We would be... same sort of things they now want us to report on ourselves anyway. So to that extent, it hasn’t changed.”</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Interviewee 02: “The stock exchange reporting requirements have changed it a bit. So each time there is a change, we have to review and make sure we are on top of the changes. But overall, in terms of substance, it hasn’t changed it that much, because we are not minimal disclosers. We try to be informative. So we have just about got it covered before the regulations come in.”</td>
</tr>
</tbody>
</table>
Although not expected at the time of designing the questionnaire, the results provided three particular insights. Firstly, the increasing compliance regulations have had an impact on audit committee composition and conduct. As quoted in Table 6-11, several interviewees suggested that although ‘well-intended’ and ‘understandable’, the incremental compliance based regulations distracted them from dealing with issues of the ordinary operation of the business. The regulatory requirements were perceived as stringent with a lack of flexibility. The audit committee members had to take on additional workload, as a result of which, the firm’s compliance costs increased. However, there were also three interviewees who argued that the increased regulations and guidelines were ‘helpful’. For example, interviewee 16, who chaired an audit committee of a newly-listed company, stated that as the guidelines were of sufficient detail, he benefited from following the guidelines to establish and arrange the audit committee-related matters. Two interviewees specifically emphasised that the regulatory requirements made it difficult to appoint suitable auditors and competent fellow audit committee members.

Secondly, the impact of adopting IFRS in New Zealand on the duties of audit committees was perceived as negative by the interviewees. This theme is reflecting some of the difficulties they had encountered identified by the interviewees. It is noteworthy that all except one criticism of the IFRS were from the experienced and CA qualified audit committee members. This can be interpreted that on the one hand the regulatory requirements increase the complexity of the audit committee’s tasks, on the other hand, although the members posted a negative stance, they did not suggest that the IFRS transition was indeed beyond their capacity. Four out of five interviewees also used examples to represent the complex technical accounting issues caused by the IFRS transition, including financial instrument disclosure for forward energy provision contracts and accounting issues for heritage assets and the agricultural industry.

Thirdly, several interviewees discussed the importance of achieving a balance between the compliance and performance aspects of corporate governance. As quoted in Table 6-11, interviewees believed that in substance, the increased regulations and requirements did not substantially change what a director was expected to do. Meanwhile, they suggested that compliance is not the nucleus of a business entity. This may be interpreted as meaning that whether they carried out their duties as an audit committee member or as a corporate director, they were concerned about the balance between compliance and the performance of the business.
(4) Recapitulation of motivation for serving on the audit committee

The last interview question is: ‘if you are nominated to serve on the audit committee again, will you accept it? Why or why not?’. This question is designed to encourage interviewees to reflect on the first interview question in the questionnaire, which asks what motivated them to become audit committee members. In closing the interview process, interviewees are provided with an opportunity to re-examine their experience of serving on an audit committee. Except for interviewee 06, who indicated firmly that he was going to retire from all directorships, all the other interviewees did not object to the idea of serving on the audit committee again, but their justifications are different. See Table 6-12.

Table 6-12: Recapitulation of the motivation for serving on the audit committee

<table>
<thead>
<tr>
<th>If nominated again, will you accept to serve on the audit committee? And why?</th>
<th>No. of interviewees</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes, definitely, because this is where my expertise lies</td>
<td>6</td>
<td>Interviewee 10: “Yep! Because I almost think this is my obligation to do so because of the background I’ve got. And I quite enjoy it.”</td>
</tr>
<tr>
<td>Yes, because it is the request from the board</td>
<td>6</td>
<td>Interviewee 13: “I would probably accept, because the chairman would think that is the best decision for the company. If the chairman asked me to do something, I would almost always do it, because he is responsible for leading the board, and I am just a member of the board. Having made the decision to go on the board, I think it creates an obligation to follow the leadership of the chairman.”</td>
</tr>
<tr>
<td>Not seeking this role, but will do it as it is the board’s request</td>
<td>5</td>
<td>Interviewee 20: “Well, I wouldn’t necessarily prefer to be on it, to be honest. But if I am required, I will accept it and do it, because as a director you’ve got to do the job. It wouldn’t be necessarily my first choice, actually. If you have an accounting rather than a legal background you might be better suited to chair an audit committee.”</td>
</tr>
</tbody>
</table>

45 Node No. 4.4 in Table 5-1.
If nominated again, will you accept to serve on the audit committee? And why?

<table>
<thead>
<tr>
<th>Yes, it is a chance to learn more</th>
<th>1</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interviewee 12:</td>
<td></td>
<td>“It’s probably interesting to… you know… this is my personal point of view… is to see another more developed audit committee functioning. It’s back to the initial comment I made of … you know… I don’t know whether we are an efficient audit committee or not, because I don’t have the visibility of another one.”</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Yes, as I have committed to this company</th>
<th>1</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interviewee 02:</td>
<td></td>
<td>“In this company, I guess I will just stay here until someone more suitable is available. (smiling) Or we have a bit of a shift-around in jobs and responsibilities. So I would accept it if I thought I was the best person for the job and available to do it.”</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Yes, I would rather do it myself</th>
<th>1</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interviewee 01:</td>
<td></td>
<td>“Yes. I’d rather see what is happening, rather than wondering. Actually you are responsible for what is happening all the time. If you take it seriously, it is not an extra job. You also get a certain amount of money for doing it. That’s all. I don’t think many people treat it like that anyway.”</td>
</tr>
</tbody>
</table>

As quoted in Table 6-12, the audit participants tended to serve on the audit committee for various reasons. Six interviewees suggested that they were the most suitable personnel for the audit committee, thus they almost took it for granted that they would serve on the audit committee again. The majority of interviewees (11 out of 21) believed that audit committee membership was not a choice or option, but a task they would perform as long as they were requested; irrespective of whether they would personally prefer it or not. There were also three interviewees who would take on the position for more personal reasons. Interviewee 12 tended to learn more from serving on a more developed audit committee. Interviewee 02 had a long tenure with and had a deep tie with his company, so he would stay in the position until he was replaced. Interviewee 01 seemed not able to trust the other directors to perform the audit committee’s role. It is also noteworthy that interviewee 14, although he indicated that he would
take on the position as long it was requested by the board, also indicated that he would be selective and only be willing to serve on more ‘organised’ audit committees.

6.2.5 Summary

The interviewee data have revealed a diverse range of qualitative information of how the interviewees perceive the effectiveness of audit committees.

Firstly, some interviewees related the existence of the audit committee and their contribution to it through compliance with the requirements for, or a fulfilment of public expectations of, formal audit committee settings. These interviewees explained the way in which they perceived the audit committee objectives through: (1) presenting their independent status and financial expertise as required by rules and regulations regarding audit committee composition; (2) the recognition of their independent status and financial expertise by their organisations; and (3) emphasising the development and disclosure of audit committee charters. In contrast to this, some interviewees tended to justify the duties of audit committees as a part of performing their directorship duties. This research has documented a diverse range of activities identified by audit committee members as comprising their daily lives in audit committees. By classifying these activities into board-delegated tasks and committee formalities, it can be asked whether an audit committee can exist in substance without the committee formalities. The board-delegated tasks are duties of the board, with or without an audit committee. The committee formalities merely formalise the performance of the delegated tasks, or make the performance of the delegated tasks more visible, by documenting them in an audit committee meeting agenda and/or minutes. This view reflected interviewees’ accounts in situations when the boundary between the audit committee and the board of directors was blurred. It was noticeable that some interviewees deliberately blurred such boundaries, in order to justify their belief that substantive audit committee activities were within the scope of, rather than in addition to, their perceived general directorship roles. Interviewees also provided evidence that ‘experience’ helped them the most in performing their audit committee roles.

Secondly, Turley and Zaman (2007) suggest that audit committee members emphasise the informal processes outside formal audit committee meetings, in order to avoid ‘surprises’ in the audit committee meetings. On the one hand, this research found that the hours worked by interviewees in addition to attending the audit committee meetings, far outweighed the hours of attending the meetings, especially for audit committee chairpersons. On the other hand,
interviewees recognised that the meeting formalities, such as the agenda and minutes, were essential to document and formalise the processes and conclusions. Audit committee meetings are possible contributors to its effectiveness through the consensus of decision making, and publicly manifest its influence on the management.

Thirdly, the relationship between the audit committee members and other parties who work with audit committees are perceived differently by the interviewees. Audit committees are perceived to conclude their performance of their duties by reporting or recommending to the board of directors. It is perceived that the board of directors usually accepts the audit committee’s recommendations. Audit committees were expected to mediate the relationship between the management and external auditors. However, the relationship between the management and external auditors was perceived to be straightforward. Although most interviewees suggested that they met with auditors privately, there were few incidents identified as requiring resolution. However, the relationship between the management and internal auditors was regarded by the interviewees as requiring more supervision as, for most of the time, compromise between the two parties was required.

Finally, the data analysis provided evidence that interviewees did not tend to evaluate their performance against the remuneration they received nor the compliance requirement specified by regulations or guidelines. Interviewees had wide-ranging views about the increased corporate governance regulations and guidelines. Some interviewees commented specifically on the increased workload that this had created and questioned whether the increased regulations and guidelines had in fact changed the nature of a director’s role. If audit committee members were motivated through the fear of litigation, it would be logical for members to evaluate their performance according to the requirements of corporate governance regulations. The interview data obtained in this research do not, however, support this argument. The evaluation of their audit committee performance by members is of a qualitative nature, with interviewees tending to explain the extent to which they believed they had accomplished their roles from a personal perspective. Most of the interviewees would agree to serve on the audit committee again for various reasons, but a majority of them would do so if required by the board.

In the next section, the second round of coding will be completed using reflective analysis.
6.3 The second round of coding – reflective analysis

This section focuses primarily on the analysis of the explanatory accounts provided by the participants. The relevant descriptive accounts will be referred to as supporting evidence in the discussion of the explanatory accounts.

6.3.1 Believing

As described in Chapter Five, ‘believing’ accounts represent ‘what the others have communicated to us’, i.e. the believing accounts come from a source. It may be argued that such believing may have formed a foundation for the interviewees on which to perceive the effectiveness of their audit committees. Figure 6-1 shows the screen cuts from NVivo 9 for the structure and nodes of the explanatory accounts.

Figure 6-1: The structure and nodes of explanatory accounts
Table 6-13 categorises the believing accounts captured and analysed in the order of frequency. It is noteworthy that the believing accounts sometimes overlap between different sub-categories.

**Table 6-13: Believing accounts**

<table>
<thead>
<tr>
<th>Sub-nodes of ‘believing’ accounts</th>
<th>No. of interviewees</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>According to the audit committee charter or other documents</td>
<td>18</td>
<td>Interviewee 03: “I thought of a particular responsibility that I was assigned. So I will talk about that. But just before I do that, in general terms, both of most companies’ [audit committees] have a charter. So it is usually in terms of your responsibilities, you know, it's responsibilities you assume as a result of agreeing to the charter, and agreeing to the company or to the audit committee.”</td>
</tr>
<tr>
<td>Referring to perceived public expectations</td>
<td>17</td>
<td>Interviewee 05: “Huh… I mean an audit committee… if you define it, it is ‘auditing’… I mean it is auditing… risk… it is auditing compliance… compliance with the IFRS, if you like… that is a reasonable expectation from the shareholder…”</td>
</tr>
<tr>
<td>Referring to the regulatory requirements</td>
<td>17</td>
<td>Interviewee 04: “That’s all about the learning and understand the law, then be able to challenge the management around it. It’s getting more and more complicated. The thing is (pause) this is the problem. A lot of regulations apply to the non-listed companies as well. So you get smaller companies with all of this rate of regulation and you still haven’t understood it all.”</td>
</tr>
<tr>
<td>Referring to the director’s duties to justify the audit committee’s responsibilities</td>
<td>13</td>
<td>Interviewee 11: “I think the function of the board… the directors… the totality is three things. One is to hire and fire the chief executive. Two is to guide the company’s strategy… And three is to look after the compliance of the business. To me I would argue that in terms of a successful business, all three are equal. And certainly going back 25 to 30 years, I believe they were treated equally.”</td>
</tr>
<tr>
<td>Sub-nodes of ‘believing’ accounts</td>
<td>No. of interviewees</td>
<td>Examples</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>---------------------</td>
<td>----------</td>
</tr>
</tbody>
</table>
| Referring to personal background or experience | 12 | Interviewee 10:  
“So what motivated me? I didn’t actually put my hand up, I got conscripted because of my accounting background. That always happened. As soon as, someone says, “oh, good! You are a finance person, and you are on the audit committee.”” |
| Referring to the power or authority of audit committees | 7 | Interviewee 19:  
“… recommendations from the external auditors. Huh… I think it is a wrong question. I don’t think it is the management’s decision. It is not theirs… they don’t have the authority to decide if they will follow a recommendation from the external auditor, it is the audit committee’s decision.” |
| Comparing to other organisations | 7 | Interviewee 02:  
“But I am aware of some other boards I’ve been in. They have been required to pay the directors; rather than a flat fee, they pay for the hours they work. And it works for some people. To get certain people on board, you just do have to do that. If you want that type of person, you must pay for it and then it’s a good thing for the company. Otherwise you wouldn’t have them.” |
| Consulting an external organisation or expert | 3 | Interviewee 06:  
“Now if I find that I am having a problem on an issue. I can always fall back and give a paper to the audit committee, and to the board, you know, based on what the Securities Commission, or the ASX, or the New Zealand Exchange expects - drawn from their best practice guideline which is all available publicly, or from my experiences at the IOD (Institute of Directors) or Society of Accountants’ continuing education courses.” |

As mentioned previously, ‘believing’ accounts are communicated to the participants from a source and can be regarded as the foundation upon which the interviewees perceive the effectiveness of their audit committees. The eight sources revealed from the interviews can be further classified as in Table 6-14.
In those cases where the believing accounts had a perceptual component, they were often supported by perceptual accounts. For example, interviewee 03 said: ‘I thought of a particular responsibility that I was assigned. So I will talk about that. But just before I do that, in general terms, both of most companies [audit committees] have a charter (coded as ‘referring to the audit committee charter or other documents’). So it is usually in terms of your responsibilities, you know, it’s responsibilities you assume as a result of agreeing to the charter and agreeing to the company or to the audit committee’ (coded as perceptual account ‘perceiving’).

### Table 6-14: Classification of believing accounts

| Referring to an authoritative doctrine | • According to the audit committee charter or other documents  
| | • Referring to the regulatory requirements  
| | • Referring to the power or authority of audit committees  
| Referring to a set of well accepted principles | • Referring to perceived public expectations  
| | • According to the director’s duties  
| Benchmarking | • Referring to personal background or experience  
| | • Comparing to other organisations  
| | • Consulting an external organisation or expert  

As perceptual accounts reflect one’s indirect experiences; they may or may not be factual encounters of the participants. The participants intentionally justify how they believe an effective audit committee should or should not do by referring to a source rather than what they have personally experienced as true. In other words, there are doctrines, principles, or benchmarks that are believed to be true by the participants, and they have described these doctrines, principles, or benchmarks in making sense of their experience in audit committees, without always identifying any significant direct experience to support what they believed really took place. Turley and Zaman (2004) and Spira (1998; 2005) suggested that the audit committee formation was an institutionalised phenomenon in the significant securities market of the world. The current research provided further evidence to support such a claim. The practice of having an audit committee, what it should do and what it is expected to achieve, has been institutionalised by the audit committee members in reality.

A question which can be asked at this point is: ‘why do some interviewees intentionally conform to doctrines or principles, whereas others benchmark against other organisations?’ In
section 6.4, the third round of coding, the analysis of these differences between interviewees will be discussed further.

6.3.2 Valuing

This research argues that cognition is value laden. ‘Valuing’ something to be either right or wrong is relatively closer to a deduction from past experience. Valuing accounts have two components - the value - ranging from positive, to neutral, and then to negative, and the objects that are being valued, i.e. the experience. Table 6-15 below categorises the valuing accounts captured and analysed in this research.

Table 6-15: Valuing accounts

<table>
<thead>
<tr>
<th>Sub-nodes of ‘Valuing’ accounts</th>
<th>No. of interviewees</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive valuing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Satisfaction</td>
<td>21</td>
<td>Interviewee 13: “Most people regard this as way over the top. Hum… there is no other more comprehensive… charter that I’ve ever seen in New Zealand. But another reality is everyone is using it as a model. And the auditors themselves will… I know because they told me… when their clients are asking… when they are pointing at a good charter. That is the one (from our company).”</td>
</tr>
<tr>
<td>Neutral valuing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reliance</td>
<td>16</td>
<td>Interviewee 01: “They (the accountant and the bookkeeper) actually dealt with them (the auditors) most of the time. So it is important, as I don’t have to do much. I just met with them a couple of times and then did the reviews. I think the biggest thing is that it is really quite relaxed, not a stressful process.”</td>
</tr>
<tr>
<td>Sub-nodes of ‘Valuing’ accounts</td>
<td>No. of interviewees</td>
<td>Examples</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>---------------------</td>
<td>----------</td>
</tr>
</tbody>
</table>
| Neutral valuing Importance      | 21                  | Interviewee 04:  
“When Sarbanes-Oxley came with all the new requirements… all that sort of thing, they became very clear very quickly. (So) that the auditors and the audit committee members would need to come to speed what those requirements were. That meant a lot of personal time studying and understanding and learning what they mean. Then you can ask the right question to management.” |
| Neutral valuing Fairness         | 7                   | Interviewee 19:  
“Well… I’m not complaining about it. We don’t pay huge fees, and for the audit committee… for the standard committee fees is a thousand dollars a half day. I’d probably get two thousand dollars if I went to the meetings from Wellington and back. Those locals are getting one thousand dollars.” |
| Negative valuing Disappointment  | 16                  | Interviewee 17:  
“He (the internal auditor) made a comment about it during the meeting, but that caused an eruption because he hadn’t discussed it with the executive but brought it straight to the audit committee. You know… I had several phone calls after the meeting… I am the chairman of that one. Well I’m not sure how much time I spent just to find out and to follow up about where it got to. Well, they (the management) got offended because he didn’t consult their opinion first.” |
| Negative valuing Opposition      | 17                  | Interviewee 21:  
“Huh… I mean an audit committee… if you define it, it is for auditing. I mean it is auditing risk… it is auditing compliance… compliance with the IFRS, if you like… that is a reasonable expectation from the shareholder. So they are audited honestly. But… but… you know… some audit committees start taking on the role of God! They think they are the company, I think that’s wrong. So I think there needs to be a balance…” |
|                                 |                     | Interviewee 18:  
“Look, I’m not at all comfortable with this. But in that company, they asked the audit committee to have a look at the year end result, and make a recommendation on what the dividend should be. And twice now, the board has rejected our recommendations on dividend, which is quite important you know. We just had to… huh… it is a little bit frustrating for me when that happens, because if that is the case, they really shouldn’t ask us to recommend.” |
In contrast to the believing accounts discussed in the previous section, which were commonly supported by indirect experiences, the valuing accounts were usually supported by remembering accounts (i.e. the real encounters of the interviewees, or something that factually took place in their audit committees). In other words, believing accounts revealed that the interviewees intentionally justified their audit committee effectiveness through what they believed acceptable, whereas valuing accounts represented their own acceptance or rejection of what they had personally experienced. This is particularly noticeable when some of the anecdotal accounts by interviewees are considered in terms of their ‘value’. This is illustrated in Table 6-16.

**Table 6-16: Anecdotes**

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>Anecdote</th>
<th>‘Valuing’ interpretation</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Not being able to find an auditor after the corporate governance and auditing regulations tightened.</td>
<td>The regulations are not being helpful, but scared the auditors away, which was frustrating to him.</td>
</tr>
<tr>
<td>02</td>
<td>Implementing an advanced retail store’s internal control and audit mechanism greatly improved the company’s performance.</td>
<td>The audit committee had made a positive and significant improvement to his organisation.</td>
</tr>
<tr>
<td>03</td>
<td>During the IFRS transition, the management and the audit committee, who were supported by the auditors, had a stand-off about some accounting treatments. It was resolved by the management reluctantly following the audit committee’s ruling.</td>
<td>It is important to be distant and persistent when dealing with the management.</td>
</tr>
<tr>
<td>04</td>
<td>A fellow director sold shares under conditions prohibited by the insider trading regulations. The audit committee resolved the situation with the authority and the company avoided sanction.</td>
<td>The audit committee played an important role in mitigating litigious risks for the company.</td>
</tr>
<tr>
<td>05</td>
<td>The company operated in a unique industry. The auditors’ high turnover made the audit committee members become the ‘trainers’ of new audit staff.</td>
<td>The financial accounting expertise is important to his audit committee for a ‘frustrating’ reason.</td>
</tr>
<tr>
<td>06</td>
<td>He, as an audit committee chairperson, successfully persuaded his managing director to establish a formal internal audit function.</td>
<td>The audit committee member’s (or chairperson’s) persistence had improved the company’s operation.</td>
</tr>
<tr>
<td>Interviewee</td>
<td>Anecdote</td>
<td>‘Valuing’ interpretation</td>
</tr>
<tr>
<td>------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>09</td>
<td>The CFO’s capability affected her workload as an audit committee chairperson. She was relied on (‘an awful lot’) in terms of arranging internal auditing related matters.</td>
<td>Financial accounting expertise is important to his audit committee for a ‘frustrating’ reason.</td>
</tr>
<tr>
<td>13</td>
<td>The newly implemented IFRS created difficulties in his judgement. He had to ‘pioneer’ an approach for accounting disclosures which he believed to be true and fair. The auditors only reluctantly accepted this treatment.</td>
<td>Financial accounting expertise is important to his audit committee in a ‘pioneer’ fashion.</td>
</tr>
<tr>
<td>18</td>
<td>The board of directors did not accept but revised the audit committee’s proposal on the level of dividends that should be distributed.</td>
<td>Recommending dividends should not be regarded as a duty of audit committees if the board is not prepared to accept the level of dividends proposed by the audit committee.</td>
</tr>
</tbody>
</table>

The anecdotal accounts displayed in Table 6-16 were not documented in the existing audit committee literature. On the one hand, these extend the body of knowledge of what was actually carried out in audit committees. Furthermore, these types of activities could not be resolved only with audit committee meetings. On the other hand, most of these anecdotes to some extent interfered with the operation of the organisations, although they are supposed to remain independent and do not have executive power. In contrast to Turley and Zaman (2007), who suggested that audit committees were substantially influenced through the power bargaining between the management and the auditors, this research provided further evidence on the influence of audit committees.

However, this research argues that instead of the management or the auditors utilising the audit committees to exercise influence, it is the other way around – with audit committee members actively promoting a certain outcome. It was the auditors or the management who were intentionally utilised by audit committee members to execute plans or as a supporting partner for their influence.

In the next section, ‘willing’ accounts will be discussed to explain how interviewees transfer their beliefs and values into future actions. Willing to do or not to do something can be regarded as an intended realisation of ‘believing’ and ‘valuing’ in the future.
6.3.3 Willing

The ‘willing’ accounts obtained from this research are all related to the interview question: ‘if you are nominated to serve on the audit committee again, will you accept it?’ This subject is a real issue for every interviewee, except for interviewee 06 who was retiring from his entire directorship portfolio. Table 6-17 categorises the willing accounts captured and analysed in this research.

<table>
<thead>
<tr>
<th>Sub-nodes of ‘Valuing’ accounts</th>
<th>No. of interviewees</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Interviewee 10:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“Yep! Because I almost think this is my obligation to do so because of the background I’ve got. And I quite enjoy it.”</td>
</tr>
<tr>
<td>Active</td>
<td>11</td>
<td>Interviewee 12:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“It probably gives you a bit more insight into the company than you get just purely as a director. The insight comes from the audit side and the internal audit side as well… It’s probably interesting to… you know… this is my personal point of view… is to see another more developed audit committee functioning.”</td>
</tr>
<tr>
<td>Passive</td>
<td>9</td>
<td>Interviewee 08:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“I think… I guess I see it as a… if you like a responsibility… I don’t want to use the word “responsibility” in a high and mighty way, but I guess I see it as a responsibility, if it is the right mix to the board that I am on…alright…because of the background. So the answer is “yes”. But it is not necessarily that I would seek it.”</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Interviewee 14:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>“I did not want to be a member. No… It is not very exciting. (both laughing) So why did I agree? Hum… it is a very important role. And I think I can add value and a sense of responsibility that I should agree. You all sit on the board; there are a number of board committees. And you need to go on one or more.”</td>
</tr>
</tbody>
</table>
The willing accounts are comparatively straightforward. It is noteworthy that except for interviewee 06 who said that he would not serve on the audit committee again due to his retirement, all of the other twenty interviewees said that they would accept nomination to serve on the audit committee again. It is almost a tie between actively and passively accepting the nomination.

6.3.4 Summary

The second round of coding and the reflective analysis investigated the intentive processes whereby audit committee members justify the effectiveness of audit committees. Based on a framework adapted from Embree’s (2007) reflective analysis, the research findings suggest that firstly, audit committee members refer to an authoritative doctrine or a set of well accepted principles or benchmarking with other organisations to justify what they believe an effective audit committee should have and should do. However, such beliefs were commonly supported by indirect experience rather than by personal encounters. Secondly, various values were placed by the interviewees on their personal encounters, ranging from strong opposition to satisfaction. These valuations were commonly supported by vivid and detailed descriptions of direct experiences, including anecdotes. Thirdly, although all except one interviewee will agree to serve on the audit committee again, their attitudes of such acceptance were equally divided between passive and active. A question can be asked: why is there such a diverse range of perceptions and justifications? The third round of coding, based on the researcher’s reflection is discussed in section 6.4, which attempts to address these problems.

6.4 The third round of coding - the researcher’s reflection

The first round of coding and data analysis documented the interviewees’ responses to the interview questions, i.e. it revealed ‘what they said’. The second round of coding and data analysis discussed the interviewees’ intentive justification of their responses, i.e. it explained ‘why they said what they said’. The third round of coding and data analysis focuses on the researcher’s reflection on the differences between interviewees, i.e. it discusses the intentionality of the interviewees from an outsider’s perspective.

The interviewees revealed that they performed their audit committee duties through two intentional orientations, which are summarised in Table 6-18; some interviewees performed their role according to their assessment of what good directorship comprises, classified as ‘conventional directors’, whereas others tended to perform their role to conform to public
expectations of audit committees, classified as ‘professional audit committee members’. In some cases, the two orientations were not mutually-exclusive, but overlapped.

Table 6-18 illustrates these two intentional orientations.

### Table 6-18: The intentional orientations of the interviewees

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>AC chairperson</th>
<th>Chartered accountant</th>
<th>Multi AC membership</th>
<th>Long tenure with the company</th>
<th>Orientation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>2</td>
<td>Yes</td>
<td>Yes (not practising)</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>3</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (3)</td>
<td>No</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>4</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (6)</td>
<td>No</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>5</td>
<td>Yes</td>
<td>Yes (not practising)</td>
<td>Yes (3)</td>
<td>No</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>6</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>7</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>8</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (3)</td>
<td>No</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>9</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (4 or 5)</td>
<td>No</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>10</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Not sure</td>
<td>Conventional director</td>
</tr>
<tr>
<td>11</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>12</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>13</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>14</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (3)</td>
<td>Yes</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>15</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (3)</td>
<td>Yes</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>16</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (3)</td>
<td>No</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>17</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>Yes</td>
<td>Professional AC member</td>
</tr>
<tr>
<td>18</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>19</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>20</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
<tr>
<td>21</td>
<td>Yes</td>
<td>Yes (not practising)</td>
<td>No</td>
<td>Yes</td>
<td>Conventional director</td>
</tr>
</tbody>
</table>

### 6.4.1 The intentional orientation as a ‘conventional’ corporate director

This intentional orientation was found in the interview accounts provided by audit committee members who had usually had years of experience as corporate directors, or had been involved in their organisations for a long period of time. Those directors, however, were not chartered accountants. Their experience in business operations, strategic management, and dealing with resistance to change by management contributed to their performance of the audit committee’s role. It was also common for those interviewees, in describing their audit committee duties, to blur the boundaries between those and their other directors’ duties. It was
also seen in the interview accounts that these directors took a sceptical view of the increased emphasis in recent years on audit committees in improving the integrity of corporate governance. On the one hand, they perceived that what had been promoted as the audit committee’s responsibility, i.e. enhancing the financial reporting quality and the independent audit function, was not a new development, but a traditional part of the duties of directors. On the other hand, they criticised the increased corporate governance regulations for resulting in extra time and effort required to comply with those regulations, which was, in fact, perceived by them as being outside the scope of a directorship. In one case, an audit committee member expressly criticised the trend towards overemphasising the compliance side of corporate governance, at the cost of ignoring its performance side. In performing their audit committee duties, these directors tended to act in a style of ‘seeking the truth, not compliance’. For example, one interviewee emphasised that openness between the audit committee and the management was more important than committee members being critical towards and distrustful of management. When evaluating their performance in the audit committees, these committee members tended to justify it through the changes and influences their efforts produced through concrete outcomes, such as, having a better internal audit function within the organisation. For these directors, it could be argued that those outcomes still fell within their perceived scope of general directorship.

6.4.2 The intentional orientation as a ‘professional’ audit committee member

The second intentional orientation was most often found in the interview accounts provided by ‘specialist’ audit committee members, who were usually chartered accountants and also the chairperson of one or more audit committees. One interviewee chaired six audit committees. During the exploratory investigation of New Zealand listed companies’ disclosures in order to identify potential interviewees, it was found one that one particular director was or had been on, seventeen audit committees in New Zealand listed companies.

These directors typically started serving on audit committees after the Cadbury Committee (1992) recommendations, which emphasised the audit committee in listed companies, became commonly accepted by the public. Therefore, the directors were ‘new’ to the organisations, having been elected on to the board of directors and often chairing the audit committee, in compliance with corporate governance best practice. They were equipped with years of experience of acting as accountants in different industries, having been in an accounting profession that had come under increasing public scrutiny in recent years, due to lost confidence
in financial reporting. They had endured the pressure of changing public expectations regarding the role of audit committees in enhancing the integrity of financial reporting. In describing their audit committee’s role, those directors tended to portray themselves as strong ‘believers’ of the concept of an audit committee, usually justifying such belief in relation to public expectations to enhance financial reporting quality and to mediate between the audit/management relationship. In performing their audit committee responsibilities, these directors emphasised formalities, i.e. the audit committee charter, audit committee meetings, the agenda, minutes, and other supporting documents. They perceived such formalities as vitally important, not only to document the activities of the audit committee, but also to formalise and visualise the process whereby important conclusions were reached and unanimously agreed to by all meeting participants.

In evaluating the performance of their audit committee duties, they tended to justify their performance through the changes they brought to the audit committees that they served on, for example, setting up audit committee formalities for firms which did not have them, spending significant time outside audit committee meetings to prepare for the meetings, working intensively with management and auditors, seeking significant information to support the meeting agenda items and, during meetings, insisting that management accept the auditor’s recommendation(s). This intentional orientation reflected deliberate conformity with the public expectations of the role of an audit committee.

**6.4.3 Further discussion**

The difference between these two intentional orientations also reflected the interviewees’ perceptions about their future role in audit committees. The first group of directors stated that if they were requested to serve on the audit committee again, they would accept the nomination, as this was a part of their directorship, but they would not voluntarily seek this role. The second group, the so-called ‘professional’ audit committee members, usually stated that they would accept the role without any reluctance, justifying this perception by saying that it is on audit committees where they ‘can contribute’ and where ‘their expertise lies’.

Multi-directorship, i.e. serving on two or more audit committees of listed companies, is common for the second group of interviewees, namely, the ‘professional’ audit committee members. Being ‘independent’ is critical for this category of audit committee members, because these directors usually present themselves as candidates for the position of chairperson or for
being the required accounting expert for the audit committees of listed companies. According to
the NZX listing rules (2003), the majority of listed issuers’ audit committee members should be
independent. One of the attributes of the NZX’s definition of an independent director is that he
or she shall not derive a substantial portion (i.e. 10 percent) of his or her annual revenue from a
particular listed issuer on which he or she serves as a director. This partially explains
‘professional’ audit committee members tending not to evaluate their remuneration for serving
on the audit committee in relation to their workload, even if it was perceived as important and
sometimes ‘onerous’. It could, in any event, be argued that, serving on from six to seventeen
audit committees, plus practising in consulting- or accounting-related work as a chartered
accountant, would presumably enable the audit committee member to derive sufficient revenue
annually. By contrast, the other group of interviewees, who did not have an accounting
background, but had worked for the company before becoming audit committee members,
tended to describe their remuneration for being on the committee as unsatisfactory in relation to
the workload.

The practices of listed companies in New Zealand have been affected by the global trend
towards increased scrutiny of corporate governance and the increased efforts of regulators to re-
establish public confidence in the financial reporting of organisations with public accountability.
Having an independent and accounting-competent audit committee in each listed company
became commonly accepted and preferred practice in New Zealand after the issue of the New
This research provides evidence that, in New Zealand, listed companies’ audit committees have
been formed to comply with the applicable principles and guidelines. This inevitably changed
the composition of companies’ boards of directors, particularly in respect of their expected
independence and proven financial accounting expertise. It also substantially divided the
intentional orientations of directors serving on audit committees into two distinctive groups.

The first group comprises directors who are not chartered accountants, but either have a
long relationship with the company, or have intensive business management experience. This
group of audit committee members did not completely believe in the mechanism of an audit
committee per se. They regard the integrity of financial reporting and the compliance aspects of
corporate governance as falling within the traditional roles of directors, with no difference
whether or not there is an audit committee. They therefore tended to justify their performance of
the audit committee’s role as a part of their directorship. Sometimes, this would mean that the
audit committee would need to make sure that the board was not preoccupied with overwhelming compliance and formality issues, whilst ignoring the performance aspects of corporate governance. This could be the reason why, when describing their responsibilities, or the objectives of serving on audit committees, they sometimes blurred the perceived boundary between acting as a director and acting as an audit committee member. This group of directors also questioned the increased emphasis on the role of audit committees. In their opinion, audit committee requirements impose a compliance burden and require extra paperwork, but add no value to good directorship. Furthermore, the extra workload is also not justifiable from a remuneration perspective. They accept the audit committee’s existence as a matter of compliance, but their primary motivation for being an audit committee member is to further the wellbeing of their particular firms. In their opinions, this is the only way in which the audit committee could be perceived as ‘effective’.

The audit committee members comprising the second group have been developing their careers since the audit committee mechanism became publicly accepted in New Zealand in the 1980s (Bradbury, 1990). They are chartered accountants, presenting themselves as ‘independent’ ‘audit committee experts’, who profess to be strong believers of the audit committee mechanism *per se*. They perform the audit committee’s role to conform to a public expectation based on an authoritative doctrine or a set of principles. The formal audit committee settings, meetings, and documentation are of great value to them. They tend to justify their role in audit committees as being to maintain those settings, meeting processes, and documentation. Performing the audit committee mechanism - in both a formal and highly visible manner – fulfils the public’s expectation of audit committees. This is how an audit committee is evaluated as ‘effective’ by them.

6.4.4 Summary

This study argues that these two groups of directors/audit committees may form an intentional, but friendly, rivalry in the board rooms of New Zealand listed companies. The first group of directors performs its corporate governance duties, which includes serving on the audit committee. The second group of directors establishes and maintains a professional audit committee, which is visible to the public, in order to avoid attracting negative attention. These two groups of directors may not necessarily agree with each other’s intentional orientations, but they recognise each other’s value. It is also noteworthy that neither group tends to accept extra
accountability for serving on the audit committee; rather, they both believe that it is the board of directors as a whole which should be held accountable for the firm. The findings from the three rounds of coding will be used to answer the research questions of the study in Chapter 7. The two groups of audit committee members are illustrated in Figure 6-2.

Figure 6-2: The intentional orientations of audit committee members

6.5 Summary

This study, through the analysis of the qualitative data obtained in the interviews, identifies at least two intentional orientations for justifying audit committee members’ perceptions of their daily lives. Some interviewees tend to perform their roles according to their assessment of what good directorship comprises, whereas others tend to perform their role to conform to public expectations of audit committees. In some cases, these two orientations are not mutually-exclusive, but overlap. These different intentional orientations may provide a possible explanation as to why the actual performance of audit committees has not conformed to the theoretical framework on which earlier qualitative hypotheses are based. In the next chapter, the conclusions, limitations, and future research possibilities will be discussed.
Chapter Seven: Conclusions, Limitations, and Future Research Opportunities

7.1 Introduction

This chapter is organised into three sections: conclusions of the research, i.e. answering the research questions; contributions of the study; limitations and future research opportunities.

7.2 Conclusions - answering the research questions

7.2.1 Research question one: what do audit committee members perceive the desired objectives of an audit committee to be?

When analysing the qualitative data obtained from the interview questions relating to this research question, it was found that audit committee members perceive the desired objectives of an audit committee by referring to the delegation by the board of directors. The interviewees perceived their existence in their audit committees by implying a fulfilment of the ‘expectations’ placed on audit committee members. This is justified by referring to a doctrine (for example, the regulatory requirements), a set of principles (for example, corporate governance best practice), or benchmarking with other organisations. It is noteworthy that the institutionalisation of the audit committee mechanism is the very result of professional institutions lobbying with government bodies in various jurisdictions in order to avoid rigid, harsh legislation (Spira, 1998; 2005). This may provide an explanation as to why some of the interviewees intentionally strived to present themselves as being a fulfilment of, or in compliance with, those best practice guidelines.

Several interviewees described the objectives of an audit committee in terms of the specific tasks that they had been performing. When describing these tasks, it was evident that some interviewees blurred the boundaries between acting as an audit committee member and acting as the only financial or accounting expert on the board. For example, developing the business strategy model, or recruiting and supervising the CFO, which were not typically regarded as the duties of the audit committee (DeZoort et al, 2002). Furthermore, carrying out these tasks could undermine the objectivity of audit committee members, who were being held accountable for these tasks and for overseeing the financial reporting simultaneously.
7.2.2 Research question two: what do the members bring to an audit committee in order to achieve its desired objectives?

When the interviewees were asked to describe what had helped them the most in achieving the desired audit committee objectives, a common theme emerged. Nineteen of the twenty-one interviewees stated that either their background, or their experience, helped them the most. ‘Experience’ was perceived in several different ways – professional and educational background, serving on a number of audit committees, or being an executive of the firm before serving on the audit committee. Furthermore, it was perceived as important for members to have experience which fitted into the organisation’s context. This justification was also typical for interviewees who were not chartered accountants, including an experienced, senior lawyer and two other company directors who were not accounting experts, but who had worked for the same company for a long time and claimed that they had a very good understanding of their firms and their industries. Furthermore, three particular interviewees attributed their determination, analytical mind-set, and ability to read disclosure documents as if they were investors, to their experience. Their experience in business operations helped audit committee members to remain confident.

According to Turley and Zaman (2007), an audit committee may have a pervasive influence on governance-related issues and conflicts. The interview data obtained in this study provide evidence that such an influence does indeed exist. However, instead of being utilised by the management or the auditors, as suggested by Turley and Zaman (2007), this research indicates that audit committee members rather utilised the executive power of the management, supported by the auditors to exercise their influence.

Furthermore, this research strongly questions the stance taken by much of the qualitative research that audit committee members must be independent to be effective. In their real lives, audit committee members’ ‘independent’ status was of no concern to the interviewees; in fact, quite the opposite; in sustaining their roles as being authoritative, confident, and dependable, audit committee members developed leadership skills that could assist them to intentionally influence the behaviour of the management towards an intended outcome. This raises the question of whether the independence measures identified in the qualitative audit committee studies reveal independence in substance, or merely in form; are these supposedly independent directors genuinely concerned about their independent status, or do they wish to be deliberately and pervasively influential - through the management - on their firms’ operational issues? This
may also have consequences for the oversight objective of audit committees, as effective oversight may be hampered by a lack of independence.

When valuing their personal experience in audit committees, the interviewees’ attitudes were diverse, ranging from strong opposition to satisfaction, supported by vivid descriptions of anecdotes and encounters.

7.2.3 Research question three: how do members help attain the desired audit committee objectives?

This research question was included in the survey to enable interviewees to describe a typical audit committee event or ordinary occurrence that was important to them (Rubin & Rubin, 2005), as well as to cover many aspects of daily audit committee life.

Turley and Zaman (2007) suggest that audit committee members emphasise the informal processes outside formal audit committee meetings to avoid ‘surprises’ in audit committee meetings. Interviewees in the current study also suggested that the hours they worked in addition to attending audit committee meetings outweighed the hours of attending meetings.

Several of the interview questions were designed to investigate how audit committee members managed their relationship with management and especially to determine if there were any changes in this relationship after the interviewee became an audit committee member. In answering these interview questions, the interviewees revealed two different types of relationship with management: either an unchanged relationship, if the interviewee joined the firm as an audit committee member, or an evolved relationship, if the interviewee joined the firm as an executive or a director, before serving on the audit committee.

When describing audit committee meetings, there were several themes identified in the interview data: firstly, well established meeting procedures and documentation provide comfort to the audit committee members. However, interviewee 01 was from an organisation where the setting of the audit committee was vague and informal, which he also felt was comfortable and appropriate given the scale of the business. Secondly, a number of interviewees strongly rejected a show-of-hands (voting) approach to resolving issues during audit committee meetings. Obtaining unanimous agreement on specific issues was of great importance to interviewees. If there was disagreement, the only acceptable solution was to seek more information and to keep the issue on the committee meeting agenda, until a consensus-based agreement could be reached.
Furthermore, because the meeting agenda and minutes are circulated amongst several parties, such formalities became an important means by which the committee members communicate the seriousness of the audit committee issues to all of the meeting participants. Most of the interviewees were therefore able to vividly describe audit committee meeting processes. It is debatable, however, whether such a sense of gravity, or ‘heaviness’, of itself, leads to a higher level of effectiveness by audit committee meeting participants.

7.2.4 Research question four: how do members assess the extent to which the audit committee objectives have been achieved?

Audit committee qualitative research studies tend to measure the impact of audit committees through companies’ disclosed information, typically in annual reports (Turpin & DeZoort, 1998). Audit committee performance has commonly been measured in terms of their success in constraining earnings management and earnings misstatements. This study argues that these measurements reflect public expectations of an audit committee and can only provide a limited vision of the conduct and diligence of an audit committee. The interviewees revealed a diverse range of audit committee activities and described the various changes that they had observed in their firms. When identifying these changes, several different approaches were revealed and discussed by the interviewees as to how they assessed the extent to which the audit committee had achieved its duties.

This study contends that the evaluation of an audit committee’s contribution to an organisation should be related to the organisation’s specific historical context. In addition to its expected or presumed oversight function, an audit committee, through its members, brings knowledge of best corporate governance practice and advanced financial accounting into the organisation. The ‘professional and experienced’ audit committee members discussed in the previous section joined their firms bearing an expectation by the shareholders of compliance with corporate governance practice guidelines. In attempting to meet this expectation, such ‘professional and experienced’ audit committee members emphasised the establishment and maintenance of formal committee procedures and documentation. The previously discussed ‘replication’ of the audit committee process by an experienced audit committee chairman in different organisations is an example of this.

Bédard and Gendron (2010) reviewed 85 archival studies that used 24 different criteria to measure audit committee performance. These criteria were grouped into four dimensions namely, financial reporting, external auditing, internal control, and investors’ perceptions.
Having previously documented and discussed audit committee members’ views on the pervasive influence of audit committees, this study argues that an effective audit committee is influential, rather than independent. Many interviewees described concrete improvements in their organisations that they believed their audit committee played a part in achieving. It was through these improvements that the interviewees tended to assess the effectiveness of their audit committees.

According to Cohen and Holder-Webb (2006), corporate directors are motivated through remuneration (the ‘carrot’) and litigation (the ‘stick’). The interview data obtained in this research study do not support this claim.

Firstly, if audit committee members were motivated by their remuneration, they would evaluate their performance from an approach of ‘value for money’. Interview question 2.3 specifically asked the interviewees to comment on the reasonableness of their remuneration.47 Interviewees revealed quite different opinions about the compensation they received for serving on their audit committees. Some interviewees stated that they did not rely solely on the remuneration paid by specific audit committees and that, compared with their total annual income, the amount received for serving on a specific audit committee was not regarded as significant.

There was also an interview question that invited interviewees to discuss the impact of the increased corporate governance regulations on their audit committee duties. Interviewees had wide-ranging views about the increased corporate governance regulations and guidelines. Some interviewees criticised the increased corporate governance regulations as being neither flexible nor practical. Although interviewees did not evaluate their performance against the regulatory requirements or guidelines for audit committees, at least two of them said that the guidelines were helpful, but did not give any specific examples of how the guidelines assisted them in any particular situation. The regulations and guidelines became part of the contents of their work in terms of ‘compliance’ and also increased their workload, but did not change the nature of their directors’ duty. Although the formal, or ceremonial, side of audit committee performance may

47 According to the exploratory studies conducted on New Zealand listed companies’ annual reports for the 2006 and 2007 financial years, the average remuneration for AC members, including their director’s fee, was around NZD 45,000 per annum and the remuneration for AC chairpersons was around NZD 67,000 per annum. In some cases, there was no difference between the remuneration for an ordinary committee member and a committee chairperson.
have made audit committees more visible to the public, it has not had a substantial impact on directorship as a whole. Audit committee members did not tend to change their performance to conform to corporate governance guidelines and regulations, but their ‘compliance’ – whether in substance, or in appearance only - was disclosed to the public. The evaluation of their performance by AC members was of a more qualitative nature, with interviewees tending to explain the extent to which they believed they had accomplished their roles from a personal perspective.

7.3 Contribution of the study

The contributions of this research study can be assessed from two perspectives – empirical and methodological. The empirical contribution provides an understanding of what gives rise to an effective audit committee, seen through the lenses of actual audit committee members in New Zealand, extending the literature, as this domain has not previously been examined. The methodological contribution enriches the qualitative paradigm of audit committee research studies, which are largely dominated by quantitative research methods.

7.3.1 The empirical contribution

There is disagreement in the corporate governance literature about the extent to which an audit committee is associated with the integrity of corporate financial reporting. Since the Cadbury Committee Report (1992), establishing an audit committee in an organisation with public accountability has become globally accepted practice. Both rules-based and principles-based corporate governance regimes in the world’s major securities markets either prescribe or promote the establishment of independent and financially competent audit committees in publicly listed companies, for example, the OECD Principles of Corporate Governance (2004) and the Sarbanes-Oxley Act (2002). The audit committee quantitative literature, however, has failed to conclude that the presence of an independent, competent, and diligent audit committee is correlated with a better quality of corporate financial reporting and audit function (Turley & Zaman, 2004). This research study has provided qualitative evidence about why the actual performance of audit committees has not conformed to the theoretical framework on which the preceding empirical hypotheses were based.

Firstly, according to the evidence provided by the interviewees in the study, when performing the audit committee role, the independent status required by most of the corporate governance rules or principles, is not of concern to individual members. On the one hand, such
independent status is superficial in nature, as firms with public accountability usually disclose the independent status by satisfying a ‘relationship test’. For example, according to the NZX listing rules, one of the attributes of an independent director is that he/she must not hold more than five percent of the voting securities of the issuer. This study argues that independence in appearance does not automatically – or necessarily - lead to objectivity as a state of mind for an audit committee member.

On the contrary, as shown from the interview data, when evaluating the performance of audit committees, members tended to justify the effectiveness of an audit committee by identifying concrete changes in their firms as a result of the efforts of the audit committee. Since audit committees are delegated an overseeing, rather than an executive, responsibility, the outcome of an audit committee’s work is attested to by an assurance opinion. The study demonstrated that audit committee members conclude their accomplishment of the board’s delegation by reporting or recommending to the board the acceptance of the financial statements and the audit report. It is noteworthy that the audit committees’ assurance opinions (the recommendations to accept the reports) were never questioned or turned down by the board. Before this reporting process, however, numerous significant changes, initiated or influenced by the audit committee, may already have been accepted and implemented by the management. Although in some cases, interviewees justify these changes as being contrary to management’s wishes and therefore reaffirming the ‘independent’ status of the audit committee, this level of influence nevertheless extends beyond the overseeing and assurance scope of audit committees. Furthermore, in some cases, audit committee members/chairpersons may also be involved in selecting and mentoring executives. It is arguable whether such a substantial influence by the audit committee is of benefit to the overall integrity of a firm’s financial reporting, which relies on the individual audit committee member’s judgement and integrity. Nevertheless, it is evident that independent status, as one of the public expectations of an audit committee, may well stop at disclosure, as it is not evident in audit committee members’ accounts.

Secondly, if audit committees are expected to oversee the process of financial reporting and auditing, it is expected that audit committee members will be competent in financial reporting-related issues. As discussed in Chapter Two, the evidence provided by qualitative research studies on audit committees has not confirmed such expectations conclusively. In 2003, the New Zealand Securities Commission implemented the revised Corporate Governance Principles and Guidelines. In the same year, the NZX amended the listing rules, requiring all
listed issuers to include a chartered accountant in their audit committee. This research study revealed that corporate directors with a chartered accountant’s qualification and an independent status, formed a group of ‘professional audit committee members’ compared to the conventional corporate directors, who seemed more concerned with the general direction of firms. As discussed previously, the ‘professional audit committee members’ tended to justify their existence in firms in terms of conforming to public expectations by establishing and operating a formal audit committee. By contrast, the other group of corporate directors serving on the audit committee, who were usually not chartered accountants, tended to be sceptical about the increased emphasis on the contribution of audit committees. These audit committee members justify their performance according to their interpretation of ‘good directorship’.

The two groups of audit committee members rely on each other for financial accounting expertise and firm-specific experience. Furthermore, ‘professional audit committee members’, although they usually acted as chairpersons, did not express any willingness to accept additional accountability, except for the collective accountability of the board as whole. That is the reason why almost all of the interviewees concluded that their duties were a fulfilment of the board’s delegations. This study argues that these ‘professional audit committee members’ do not represent audit committees as a whole, as there is another group of directors who serve on the committee. This is a possible reason why qualitative research on audit committees cannot conclusively prove that audit committee financial expertise is associated with the integrity of financial reporting and the auditing function.

Finally, audit committee qualitative research studies have attempted to establish the association between the frequency of audit committee meetings and the effectiveness of audit committees in terms of better quality financial reporting. In addition to the criticism against adopting meeting frequency as the only measure of audit committee diligence (DeZoort et al 2002), the qualitative research results are inconsistent and inconclusive. Several qualitative research studies have provided evidence that audit committee members work on audit committee-related issues outside formal audit committee meetings (Gédron & Bédard, 2005; Turley & Zaman, 2007). Some of the findings of this research suggest that when describing audit committee responsibilities and activities, several interviewees blurred the boundary between their audit committee responsibilities and other board responsibilities. This raises the question of whether, without audit committee meeting formalities and documentation, an audit committee can indeed exist or be separated from the board of directors’ general activities. The audit
committee meeting formalities and documentation made audit committees visible and created a sense of serious purpose when financial reporting and auditing issues were discussed by directors. However, it is arguable whether such a sense of seriousness could, by itself, increase the accountability of audit committee members.

Spira (1998; 2002) suggested that the audit committee is engaged in a private performance for a public audience. This research study provides evidence that this private performance is carried out by two categories of audit committee members, each of which, in its own way, is striving to fulfil a public expectation. The two distinguishable styles or approaches that audit committee members use to carry out their daily work provide a further possible explanation for the inconsistent testing results of previous qualitative audit committee studies.

This research study concludes that recent years’ emphasis on audit committees in organisations with public accountability may have enhanced the formal settings of audit committees and created a new category of directors who are specialists in arranging formal audit committee structures. Meanwhile, other directors, who have a more conventional perspective, also played an important role in performing their audit committee’s responsibilities. It is uncertain whether the abovementioned intentionally in conforming to the public’s expectations, or either of the perspectives by itself, gives rise to an effective audit committee.

These research results and conclusions should be of value to corporate governance stakeholders. Clearly, the integrity of the financial reporting of an organisation cannot be assumed. This study recommends that the evaluation of an audit committee should be based on an assessment of the individual audit committee members within the context of their particular firms. Furthermore, it is evident that an open, qualitative, and transparent explanation and justification of audit committee actions and intentions by an audit committee member has the potential to be of more value for corporate governance stakeholders than stringent, rules-based disclosures.

### 7.3.2 The methodological contribution

The methodological contribution of this study will be discussed firstly by considering the issue of research reflectivity and secondly by comparing the study to previous audit committee qualitative research. Reflectivity is usually discussed from two perspectives: the researcher’s personal reflectivity, and methodological reflectivity. ‘Personal reflectivity’ involves reflecting
upon the ways in which the values, experiences, interests, and identity of the researcher have shaped the interpretation of the research results. Personal reflectivity will be discussed first, with ‘methodological reflectivity’ discussed in the next section, when identifying limitations of the research design.

Researchers have long expressed concern with the limited vision provided by the existing measures for audit committee effectiveness, such as independence, financial expertise, and meeting frequency (DeZoort et al, 2002; Gendron & Bédard, 2005). This research study addresses the need for a qualitative research study to broaden the understanding of audit committees - not by measuring them through disclosed data, but rather by investigating what happens in real-life situations.

The study analysed and interpreted interview data from 21 audit committee members of New Zealand listed companies. The conclusions revealed two clearly distinguishable intentional orientations of audit committee members when performing and justifying their roles in their audit committees. Furthermore, the results and conclusions provide possible explanations for the inconsistent testing results of existing audit committee qualitative research studies. This research study is one of only four qualitative studies which have been constructed using a sociological theoretical framework. It has developed a new avenue, namely, to investigate the intentional processes of individual audit committee members, rather than to focus on interpreting the interactions within the group of people who attend audit committee meetings (Spira, 1998; 2005; Gendron & Bédard, 2005; Turley & Zaman, 2007). As it is the intentional orientation that ultimately explains and justifies behaviours, it is to be hoped that future research will develop this approach further, to investigate and interpret the intentional factors of other corporate governance stakeholders.

In a study of this nature, it can be argued that the researcher’s values, beliefs, experiences, and characteristics may affect the interpretation of the research results. In this respect, the following two aspects, in particular, may result in a misunderstanding or misinterpretation of the interview data.

Firstly, it could be asked: ‘would the research results have been different if the researcher or the interviewer was a different person?’ This was addressed in the study, during the process of analysing and interpreting the interview data, by constantly asking: ‘whose voice is this – the interviewee’s or mine?’ For example, one interviewee stated that she would accept a nomination
to serve on the audit committee again, because that was where her expertise lay and that was where she could contribute. Quoting the text of the interview transcript is an illustration of speaking in the interviewee’s voice. The researcher interpreted this statement as a representation by a ‘professional’ audit committee member, who believes in audit committees, and conforms to public expectations. Such interpretation represents the researcher speaking in her voice. In summing up the research results and conclusions, the researcher put considerable effort into distinguishing between the voices of the interviewees and the voice of the researcher.

Secondly, during the process of interpreting the interview data, the researcher maintained a critical stance towards the ‘genuine’ nature and legitimacy of the interviewees’ responses. In other words, the interviewer was alert to the possibility of the interviewees saying what they thought should be said. Although there may well be subjectivity and bias embedded in the interview data, deliberately rejecting the interviewee’s perceived subjectivity and bias could result in the injection of the researcher’s own bias. For example, several interviewees expressed satisfaction with their level of remuneration for serving on the audit committee, although the level of their remuneration did not reflect the actual workload. The researcher did not interpret these interviewees’ motivation for serving on the audit committee as being because of a passion or conscientiousness, but rather linked the discussion towards the interviewees’ serving on two or more audit committees, enabling them to generate sufficient annual income.

From the above examples, it is evident that if the interviewer or the researcher were a different person, the research results and conclusions could have been different. This fact should not, however, be used to undermine the validity of the research, but should rather be regarded as a limitation of the research findings.

7.4 Limitations and future research opportunities

The limitations of the study will be assessed by answering the following questions: (1) how have the research questions defined and limited what could be found? (2) how could the research questions have been investigated differently? and, (3) to what extent would the answers to these questions have given rise to a different understanding of the phenomena under investigation (Willig, 2001)?

7.4.1 How have the research questions defined and limited what could be found?

As stated previously, the motivation for this research was to answer the general research
problem: “What gives rise to an effective audit committee?” The study is an exploratory one that aims to identify the qualitative factors that contribute to audit committee effectiveness. The general research problem is investigated by answering four interrelated specific research questions, namely: (1) what do audit committee members perceive the desired objectives of an audit committee to be? (2) what do the members bring to an audit committee in order to achieve its desired objectives? (3) how do members help attain the desired audit committee objectives? and, (4) how do members assess the extent to which the audit committee objectives have been achieved? This research study concluded that two distinctive intentional orientations were demonstrated by the interviewees to explain and justify the performance of their audit committee responsibilities.

The factors which initially contributed to the formation of these intentional orientations, however, require further investigation. It was noticeable that during the interview process, several interviewees described incidents that occurred long before they served on their current audit committees; this included events that took place at a very early stage of their careers. Because the research questions focus on audit committees per se, those events that took place outside audit committees were not included in the data analysis and interpretation. It is to be hoped that future research will incorporate this by investigating the factors that contribute to audit committee members developing one particular intentional orientation, rather than another one.

7.4.2 How could the research questions have been investigated differently?

As this study was constructed using a qualitative exploratory approach, it was not immune from the inherent limitations of this type of research design. The findings, using a small sample (21 interviewees) selected from one particular country - New Zealand - are not generalisable findings that can be verified through quantitative evidence. Furthermore, as discussed previously, personal reflectivity may have impacted on the analysis and interpretation of the interview data.

This research study stops at having identified two intentional orientations. It is unknown whether, or to what extent, these two intentional orientations are shared by other audit committee members, or whether there could have been more intentional orientations. Future research may be constructed based on the findings that there are two, or possibly more, intentional orientations explaining the performance of audit committee members. Grounded theory may be used to
interview more audit committee members, possibly including directors who have chosen not to serve on the audit committee, to profile other possible intentional orientations of directors. This could ultimately facilitate the development of measurable models of audit committee effectiveness.

7.4.3 To what extent would the answers to these questions have given rise to a different understanding of the phenomena under investigation?

This research paradigm aimed to provide an insight into audit committee members’ activities, rather than to measure them from disclosed information. Spira (1998; 2002), who first researched audit committees using a qualitative approach, suggested that firms, in order to avoid the legal imposition of more stringent corporate governance rules, establish audit committees to demonstrate to the public that there is an emphasis on financial reporting integrity and accountability. Gendron and Bédard (2005) interpreted the effectiveness of audit committees through the interactions between the audit committee meeting participants. They established that effectiveness is internally constructed during the committee meetings and is blended with emotional factors. Turley and Zaman (2007) also investigated the interactions between audit committee members and the parties who worked with them. They argued that audit committees have a pervasive influence in corporate governance, which is carried out either through formal meetings, or informal activities, outside audit committee meetings. The preceding three qualitative audit committee studies, as well as numerous qualitative research studies, formed the foundation upon which the current research was constructed.

The current research study differentiates itself from the aforementioned three audit committee qualitative studies in the following respects: firstly, this study focuses on individual audit committee members, rather than on particular audit committees. This focus is embedded in the basic assumption that social phenomena are intended by the people who live through them. Therefore, it is the intentions and sense-making processes of audit committee members that are of importance in explaining and justifying their daily lives. Secondly, in addition to revealing further insights into audit committee activities, the research also provides a possible reason why qualitative research studies cannot consistently prove that an audit committee’s existence and attributes are associated with the quality of financial reporting, namely, that there are at least two intentional orientations governing the performance of audit committee responsibilities.

Finally, this research study contributes to the general research problem: ‘what gives rise to
an effective audit committee?’ by providing several insights and explanations. In doing so, the research also poses the fundamental question: ‘can an audit committee exist without formalities?’ It is still uncertain whether audit committees do in fact provide oversight of, and assurance on, the financial reporting and auditing functions, or whether they simply conform to a public expectation. The integrity and accountability of financial reporting is a substantial research agenda, with which some progress has been made over the past decades. The audit committee is one of the central participants, but not the only stakeholder, within this agenda. It is to be hoped that this study will encourage further and broader investigation into the many stakeholders, including an effective audit committee, which contribute to improved corporate governance for companies.


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KPMG (1999). *Shaping the Audit Committee Agenda*. New Jersey: KPMG LLP.


Appendix A – Cover Letter

(CONFIDENTIAL

(Name of Participant)
(Title / “Director”)
(Name of Organisation)
(Address 1)
(Address 2)

Date

Dear (Mr/Ms):

Subject: Invitation for Participation

This letter is an invitation to participate in PhD research being conducted on audit committee effectiveness of New Zealand listed companies.

The audit committee, as one of the most important elements of corporate governance, has been the subject of much discussion by practitioners, scholars and policy makers in recent times. Little research, however, has examined the perceptions of audit committee members about audit committees. By interviewing audit committee members, this study aims to understand the qualitative factors that give rise to an effective audit committee.

Participation in this project will involve an interview that will last for a maximum of sixty (60) minutes in a venue that is convenient for you. All information that you provide will be considered to be completely confidential. For further information about the research and the procedures taken for ensuring confidentiality, the following documents are attached:

- Research Information
- Interview Questionnaire
- Consent Form
It is hoped that the results of this study will be of benefit to audit and assurance practitioners, audit committee members, regulators and other stakeholders, all of whom are concerned with corporate governance and accountability, as well as to the broader research community.

If you agree to participate, I would appreciate it if you could fill out and sign the attached consent form and return it to me before (Date) August 2007 by using the stamped and addressed envelope provided. I will contact you to arrange an interview time and venue shortly after receiving your consent form.

Should you have any questions regarding this study, or would like additional information before deciding whether or not to participate, please contact Julia Wu at (03) 325-3838 ext. 8518 or by email at wuy9@lincoln.ac.nz.

I look forward to hearing from you and thank you in advance for your support in this project.

Yours sincerely,

Julia YH Wu  
PhD Student  
Commerce Division  
Lincoln University

Associate Professor Sidney Weil  
Supervisor of Julia YH Wu  
Centre of Accounting Education and Research  
Commerce Division  
Lincoln University
Appendix B – Interview Questionnaire

INTERVIEW QUESTIONNAIRE

Topic 1: Perceptions of responsibilities of the audit committee

1.1 What motivated you to become an audit committee member?

1.2 Are you assigned any specific responsibility by the audit committee of (Company Name)? Why are you assigned with this responsibility?

1.3 What do you think helps you most in achieving your assigned responsibility? Please describe how this helped you in a specific situation. Was this typical?

1.4 Have you encountered any difficulties or conflicts in achieving your assigned responsibility? If so, please specify.

1.5 On a scale of 1 to 10, with 10 being the best, how well do you believe you achieved your assigned responsibility? Please explain why you chose this score.

Topic 2: Operation of the audit committee

2.1 Please describe the process for discussing and resolving issues in your audit committee.

2.2 Are you able to achieve your assigned responsibility during the scheduled audit committee meetings?

2.3 Do you need to do additional work by yourself in addition to attending the scheduled audit committee meetings in order to achieve your assigned responsibility?
2.3.1 Please give one or more examples of any additional work you have done by yourself.

2.3.2 Approximately how many hours per annum do you need to work by yourself in addition to attending the audit committee meetings?

2.4 In addition to attending scheduled audit committee meetings do you also need to work with other people in order to achieve your assigned responsibility?

2.4.1 Please give one or more examples of any additional work you have done with other people.

2.4.2 Approximately how many hours per annum do you need to work with other people in addition to attending audit committee meetings?

2.5 Please describe an audit committee meeting in addition to the regular scheduled meetings during the last financial year. What was the meeting about? Please describe what happened during that meeting.

OR

Please describe the most recent audit committee meeting that you attended, the reason it was called, what took place and any subsequent follow-ups.

Topic 3: Relationships with audit committee stakeholders

3.1 Are the recommendations given by the internal auditors followed by the management? If not, how did the audit committee resolve the conflict? Please give an example. How typical is this?

3.2 Are the recommendations given by the external auditors followed by the management? If not, how did the audit committee resolve the conflict? Please give an example. How typical is this?
3.3 Was (were) any recommendation(s) made by the audit committee during the last financial year accepted by the board? If not, please explain why you think the board turned down the recommendation(s).

**Topic 4: Perceptions of the environment around the audit committee**

4.1 Has your relationship with other executives changed since you were nominated as an audit committee member? Please give an example. What do you think might be the reason?

4.2 Do you believe your remuneration for serving on the audit committee is reasonable?

4.3 How have the increasing regulations and guidelines governing audit committees affected your work on the audit committee? Please give an example.

4.4 If you are nominated to serve on the audit committee again, will you accept? Why (or why not?)
Appendix C – Research Information Sheet

Lincoln University

Division: Commerce

Research Information Sheet

You are invited to participate as a subject in a PhD project entitled *Audit Committee Effectiveness – from the Perspective of Audit Committee Members in New Zealand Listed Companies.*

The aim of the research project is to enhance understanding of the qualitative factors that give rise to an effective audit committee. Examining audit committees is important because market participants view them as providing effective oversight of the financial reporting of public listed companies. The research argues that the effectiveness of an audit committee ultimately lies in the efforts and attributes of its committee members.

Audit committee development in New Zealand reflects recent overseas trends. Investigation of the functioning of audit committees in New Zealand companies, however, is very rare. This research into audit committee effectiveness in companies listed on NZX markets will address the following questions:

1. What do audit committee members perceive the desired objectives of an audit committee to be?
2. What do the members bring to an audit committee in order to achieve its desired objectives?
3. How do members help attain the desired audit committee objectives?
4. How do members assess the extent to which the audit committee objectives have been achieved?
The data will be collected by interviewing selected audit committee members.

Your participation in this project will involve an interview based on the attached questionnaire. As a follow-up, you will be asked to review the transcript of the interview.

All data gathered in this investigation are strictly confidential. All participants are assured of complete anonymity in any publication of the research results. The identity of the participants will not under any circumstances be made public or revealed to any parties other than the researcher and her supervisors. To ensure confidentiality, the following detailed procedures will be followed:

- The interview will be taped and transcribed.
- Pseudonyms will be assigned to you and your organisation(s) in the interview transcripts and in any text content quoted or discussed in any publication format.
- The interview transcript will be reviewed and edited by the interviewee. Shortly after each interview has been completed, you will receive a copy of the transcript to confirm the accuracy of the conversation and to add to or clarify any points.
- You may decline to answer any of the interview questions. Furthermore, you may withdraw at any time by advising the researcher telephonically or in writing.
- The researcher and her supervisors will be the only persons having access to the tapes (or other storage devices) recorded during the interviews. The tapes (or other storage devices) and the transcripts will be kept for six (6) years from 2007. After six years, the tapes (or other storage devices) and the transcripts will be destroyed under the supervision of the researcher, or any person authorised by the researcher, or her supervisors.

The project is being carried out by:

Julia Yonghua Wu
Lincoln University
Commerce Department
P O Box 84
Lincoln 7647
Tel: +64 3 325 3838 ext. 8518
Email: wuy9@lincoln.ac.nz

She will be pleased to discuss any concerns you have about participation in the project.

Names of Supervisors:

Associate Professor Sidney Weil
Dr. Ahsan Habib

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Appendix D – Consent Form

Consent Form

Name of Project:

Audit Committee Effectiveness – from the Perspective of Audit Committee Members in New Zealand Listed Companies

I have read and understood the description of the above-mentioned project. On the basis described in the Research Information Sheet, I agree to participate in the project and I consent to publication of the results of the project, on the understanding that anonymity will be preserved. I understand that I may withdraw from the project at any time, and may also withdraw any information that I have provided.

Name: ____________________________

Email: ____________________________

Telephone number: ____________________

Signed: ____________________________

Date: ____________________________