AUDIT COMMITTEE: SOME EVIDENCE FROM MALAYSIA

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Abstract

This study aimed to investigate the perceptions of senior managers of Malaysian publicly listed companies on issues relating to audit committee authority and effectiveness. Questionnaire survey technique was employed to seek the respondents perceptions on five issues, namely audit committee appoints the auditor, audit committee determines and reviews audit fees, audit committee determines and reviews the auditor's scope and duties, and audit committee's reports and meetings. The majority of respondents agreed that auditor would be more effective and independent if audit committee assumed the responsibility to appoint the auditor, determine and review the audit fees, and determine and review the external auditor's scope and duties. It is also found that disclosure of audit committee report and quarterly meeting would enhance the perceptions of users of financial statement concerning the effectiveness of the committee.

Keywords: Audit Committee, Authority, Effectiveness, Meeting, Auditor

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1. Introduction

The increasing importance of financial markets, as the pre-eminent source for capital worldwide, has been the catalyst for an unprecedented degree of public attention to corporate governance. Corporate governance is recognised as indispensable for effective market discipline. Discussions on financial reporting failures in developed and developing markets inevitably focus on the lack of corporate governance. Investor trust and confidence in capital markets depend on the credibility of the financial information they receive and analyse. The investing public's trust and confidence lay in receiving high quality financial information prepared by management, audited by external auditors and verified by an independent audit committee of the Board of Directors.

Though Table 1 shows that the listing requirements and Business Act required the formation of audit committee in the USA and Canada respectively in the 1970s, there is documentation that audit committee was formed before 1870 in the USA (McKee, 1979) and in early 1870s in England (Tricker, 1978). The importance of the audit committee and the need for publicly owned firms to form the committee is well documented in many reports, for example, Report of the National Commission on Fraudulent Financial Reporting by the Treadway Commission in USA, Draft Report of the Committee on the Financial Aspects of Corporate Governance by the Cadbury Committee in the UK, Report of the Commission to Study the Public's Expectations of Audits by Macdonald Commission in Canada, Audit Committees by South African Institute of Chartered Accountants, and Corporate Practices and Conduct by the Bosch Working Group in Australia.

To effectively deliver their duties, audit committees should have adequate and appropriate authority. The committee gains their authority from codes, rules and regulations. These sources of authority spell out the responsibilities, roles and perhaps the power to influence the financial reporting process. However, the Asian Financial Crisis in Malaysia in 1997/1998 has shown that many audit committees of publicly listed companies do not function as effective oversight mechanisms (A-Kadir, 2002a, b).

Table 1. Requirement of Establishment of the Audit Committee in Selected Countries

Country	Formation of Audit Committee (Year)	Events/Comments
Canada	1971	Enacted in Ontario Business Corporation Act 1970 w.e.f. 01.01.1971
USA	1978	Listing Requirements by the NYSE w.e.f. 30.06.1978
Singapore	1989	Enacted in Companies (Amendment) Act 1989
Malaysia	1993	Listing Requirements by the KLSE w.e.f. 01.08.1994
Thailand	1999	Listing Requirements by the Stock Exchange of Thailand w.e.f. First Quarter of 1999

Table 2. Recommendation of Formation of the Audit Committee in Selected Countries

Country	Year	Details
Australia	1991	Bosch Working Party – Report on Corporate Practices and Conduct
South Africa	1991	Audit Committees-South African Institute of Chartered Accountants
New Zealand	1992	Draft Code of Practice for Boards of Directors
United Kingdom	1992	Cadbury Committee – Committee on the Financial Aspects of Corporate Governance

The objective of this study is to investigate the perceptions of senior managers of Malaysian publicly listed companies concerning the relationship of audit committee authority and effectiveness. Five issues on audit committee authority were presented to the respondents, such as audit committee appoints the auditor, audit committee determines and reviews audit fees, audit committee determines and reviews the auditor's scope and duties, and audit committee's reports, meetings, charter and roles.

The paper is organised into seven sections. The following section provides an overview of audit committee development in selected countries. Section three provides literature review on audit committee authority. Section four provides the data collection and research methodology. The fifth sections present the research findings. The sixth section provides discussion on the results and the final section provides conclusions of the study.

2. The Development of Audit Committees in Selected Countries

The Development of Audit Committees in the USA

In the USA, the development of audit committees was strongly recommended following the case of Mc Kesson-Robbins in the late 1930s, a wholesale drug company listed on NYSE.

In the late 1960s, a number of audit committees were established following several legal decisions like Escott v BarChris Construction Corporation. However, the idea of an AC was not popular until 1967 when the American Institute of Certified Public Accountants issued a statement recommending that "publicly-owned corporations appoint audit committees composed of independent directors" as part of the corporate governance process to protect public interest and preserve the integrity of the nation's capital and financial markets.

During the 1970s, the New York Stock Exchange (NYSE) actively encouraged the establishment of audit committees by listed companies. In 1973, NYSE recommended that each listed company form an audit committee comprising three to five independent directors.

Since 1970s politicians in the US have hotly debated the issue of audit committee, and the Moss Committee (a Congressional Sub-committee)(1976) and the Metcalf Committee (a Senate Sub-committee)(1977) recommended that the audit committee be made a listing requirement. The case of SEC v Killearn Properties Inc. (May 1977) had a direct effect on the recognition of the audit committee as a tool to prevent fraud and improve corporate governance, in line with the SEC directives relating to the audit committee as a part of a consent judgement.

In 1977, this recommendation became a listing requirement effective on 30th June 1978. In the same year (1977), the AICPA's Board of Directors reaffirmed this position, urging AICPA members to encourage corporate clients and employers to establish audit committees. In 1978, the AICPA's Special Committee on Audit Committees concluded that audit committees were necessary for both corporate directors and independent auditors to fulfil their respective responsibilities. Further, it endorsed the efforts of the stock exchanges, the National Association of Securities Dealers (NASD), and other bodies to require audit committees.

The movement towards a regulatory requirement for public companies to establish audit committees gained momentum from the National Commission on

Fraudulent Financial Reporting (the Treadway Commission). This Commission was formed with the aim of identifying the conditions that may lead to fraudulent financial reporting and the necessary steps to reduce the frequency of occurrence. In its report (1987), the Commission recommended that "all public companies should be required by the SEC rule to establish audit committees composed solely of independent directors" so as to reduce the possibility of fraudulent financial reporting.

In 1994, the POB Advisory Panel on Auditor Independence (the Kirk Panel) issued its findings, "Strengthening the Professionalism of the Independent Auditor", which identified the need for a strong relationship between audit committees and the independent auditor in order to improve the overall financial reporting process.

Finally in 1999, The NYSE, the NASD and the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (established in September 1998 by the NYSE and the NASD) released its report announcing far-reaching recommendations to improve the quality of corporate financial reporting.

The Development of Audit Committees in Canada

In Canada, the motivation to establish the audit committee was a result of the seizure of Atlantic Acceptance Corporation Ltd in 1965. The Lawrence Committee (1967) and Adams Report (1978) also supported the development of the audit committee. As a result, the requirement for the establishment of an audit committee was enacted in the Ontario Business Corporation Act 1970, which is the first legislation requiring the establishment of an audit committee.

From 1st January 1971, all public companies incorporated in Ontario were required to form an audit committee; this was followed by the territories of British Columbia (1973), Manitoba (1976) and Saskatchewan (1977).

The Development of Audit Committees in the United Kingdom

Tricker (1978) provides evidence that the audit committee was is in operation in England in the early 1870s. The development of audit committees in the UK was slower than in other countries. It was only in 1987, after evidence of increasing failures and incidents of corporate fraud in Britain, that the Bank of England and an organisation called PRO-NED (objective of the formation of the organisation was to promote the appointment of non-executives to Boards of Directors) urged public companies to adopt audit committees.

In 1992, the Cadbury Report gave a boost to the idea of the audit committee. The report made recommendations on the Financial Aspects of Corporate Governance, with emphasis on the importance of properly constituted audit committees in raising standards of corporate governance. It recommended that all public listed companies in UK establish audit committees within the two years following May 1992.

The Development of Audit Committees in Australia

The move towards the establishment of audit committees in Australia was driven by the high frequency of corporate failures in the 1970s and 1980s. Chandler (1982) noted that, "In Australia, well publicised failures such as Cambridge Credit and the Latee and Gollin Holdings have served to strengthen the call for increased director accountability and audit committees. The Securities Institute of Australia recommended in December 1978 that positive efforts be made by The Institute, professional bodies, the Stock Exchange and The Australian Institute of Management to encourage listed companies to appoint audit committees and publicise their existence and membership".

The idea of the audit committee received further momentum in 1991 when the Bosch Working Party recommended that all public companies be required to establish audit committees comprising a majority of non-executive directors.

The Development of Audit Committees in Malaysia

In Malaysia, the central bank (Bank Negara Malaysia) prescribed the setting up of the audit committee for financial institutions in 1985 but the development of audit committees began in 1991. Prior to this, the Malaysian Institute of Accountants prepared a proposal on fraud prevention called "Fraud Prevention Measures" suggesting that the government require all public companies to establish the an audit committee.

In 1991, the Malaysian Institute of Accountants jointly with the Malaysian Association of Certified Public Accountants and the Institute of Internal Auditors submitted a memorandum to the Registrar of Companies, the Capital Issues Commission (CIC) and the Kuala Lumpur Stock Exchange (KLSE)[3] recommending that the audit committee be made mandatory for companies seeking listing on the KLSE since 1 August 1994, it become mandatory for all listed firms on the KLSE to establish an audit committee. The role of audit committee was further strengthened when the government undertakes corporate governance reform in the post Asian Financial Crisis 1997/1998. The establishment of the high level of Finance Committee on Corporate Governance and the release of the Malaysian Code on

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[3] The Kuala Lumpur Stock Exchange (KLSE) is now known as the Bursa Malaysia Berhad (BMB)

Corporate Governance further improved audit committee practices in Malaysia.

3. Literature Review

Audit committees serve as a bridge in the communication network between internal and external auditors and the board of directors, and their activities include review of nominated auditors, overall scope of the audit, results of the audit, internal financial controls and financial information for publication (FCCG, 1999). Indeed, the existence of an audit committee in a company would provide a critical oversight of the company's financial reporting and auditing processes (FCCG, 1999; Walker, 2004).

Audit committee could also enhance auditor independence. Knapp (1987) discovered that an audit committee is more likely to support the auditor rather than management in audit disputes and the level of support is consistent across members of the committee, regardless of whether the member is in a full-time or part-time position, such as corporate managers, academicians and retired partners of CPA firms.

In addition, audit committees could play a role in selecting auditors, determining their remuneration and in the dismissal/retention of auditors. Goldman and Barlev (1974) pointed out that audit committees could observe the financial reporting process and provide recommendations in the selection of auditors, negotiation of fees and termination of external auditors, which would ultimately diminish management's power over the auditor. An audit committee is anticipated to ensure that a business organisation has sufficient internal controls, proper accounting policies, and independent external auditors that will prevent the incidence of fraud and promote high quality and timely financial statements.

Furthermore, the existence of an audit committee was found to have an association with the tendency to switch from less credible to more credible auditors (Kunitake, 1983; Eicheneher and Shields, 1985). Kunitake (1981) believed that independent directors of audit committees might have exposure to larger and better-known CPA firms rather than to local or regional firms, through their involvement as officers or directors of other public corporations. In addition, Kunitake (1983) found that there was less frequent auditor switching in companies that had audit committees than companies that did not have audit committees. These results indicate that the audit committee acts as a catalyst to enhance good financial reporting and support the role of auditors.

In addition, the formation of an audit committee would improve the credibility and reliability of financial statements through providing an assurance of the objectivity of financial statements to shareholders (Auerbach, 1973; FCCG, 1999). However, in Malaysia, the Finance Committee on Corporate Governance (FCCG) (1999) is concerned about the effectiveness of audit committees, and has noted, "We have very real experience in Malaysia in the form of audit committees, where companies merely comply in form by setting up such committees without giving heed to the spirit of the requirement by ensuring, for example, the quality of the people within the committee" (p. 64). In this respect, Mohamad *et al*. (2001) found that a large majority of companies listed on the KLSE tend to comply with all regulations imposed on them, such as the requirement to disclose audit committee reports, without concern for the quality of these reports.

An active audit committee would enhance their role to pursue the terms of reference and objectives (FCCG, 1999; Treadway Commission, 1987). The frequency of audit committee meetings would indicate whether the committee was active or not. Although the presence of non-executive directors was linked with audit committee effectiveness, it is not guaranteed. Menon and Williams (1994) pointed out that audit committee independence did not guarantee effectiveness unless the committee was active. In addition, Kalbers and Forgarty (1993) supported this argument and indicated that audit committee effectiveness would only materialise if the members were committed to pursue their roles and duties. The KLSE listing requirements (2001), BRC (1999) and the Treadway Commission (1987) suggested that audit committees should meet at least four times a year.

In a review of the literature, DeZoort *et al*. (2002) concluded that: (i) audit committee responsibilities are diverse and seem to be intensifying; (ii) the main areas of audit committee oversight include oversight of financial reporting, auditing and controls; (iii) audit committee authority is associated with written authority and management support. However, they pointed out several limitations of prior studies: (i) none of the prior studies focus on the ultimate source of the audit committee's authority (i.e. board of directors) or aspects linked with variations in such authority; (ii) there is a lack or absence of empirical research that addresses the relationship between audit committee effectiveness and audit committee authority.

4. Methodology

Based on the aim of the study and review of the literature, the study attempted to answer the following research question:

> *What are the perceptions and current practices of corporate management concerning issues of audit committee authority (e.g., responsibility, influence) that contribute to the audit committee's effectiveness?*

Therefore, postal questionnaire survey is the most appropriate research tool to answer the above question. It is an effective tool to seek opinions, attitudes and descriptions about audit committee effectiveness issues. On the other hand, the development of the questionnaire for this study has taken into account the unique nature of the Malaysian corporate environment and culture, which are different from those of developed and other developing markets.

In order to enhance the quality of the questionnaire and to ensure its applicability to the practices in Malaysian corporations, it was pilot-tested. In this study, senior managers of publicly listed companies were selected as the population. The group was selected because they are the key players in Malaysian corporations and corporate governance (FCCG, 1999). Their perceptions on audit committee effectiveness are valuable to this study because they are directly involved in audit committee monitoring activities.

A listing of Malaysian listed companies is available from the KLSE web page and as of 31 December 2004, a total of 900 companies were listed on it (i.e. 622 companies listed on the main board and 278 companies on the second board). It was decided to distribute the questionnaire to 150 companies (i.e. 75 questionnaires each to the main and second boards). Therefore, companies were selected on the basis of every sixth company on the list, one company being selected to make up the sample list to 150 companies.

The response rate of the questionnaire survey was 23%, where only 35 out of 150 questionnaires were received back after four weeks in circulation (i.e. from 1st July to 31st July 2005). The literature documents that responses to mail questionnaires are generally poor, and it is a common phenomenon to see return percentages as low as 15% to 20% (Saunders *et al*., 1997, p. 131). Therefore, it is important to undertake an examination of non-response bias in order to identify the reliability and validity of the data.

Based on the received date recorded on each questionnaire, the first 10 questionnaires received from respondents were classified as 'early' and the last 10 questionnaires as 'late'. The early and late responses were matched with the aim of examining whether significant differences between the two groups exist. The Mann-Whitney test was used as a statistical tool to examine the differences. No significant differences were detected between the 10 early and 10 late responses. Thus, the results provide an indication that the respondents who failed to return the questionnaires would have the same perceptions as those who responded.

5. Research Findings

5.1 Respondents' Background

An analysis of the distribution of respondents across companies listed on the KLSE was carried out based on two criteria, namely board listing and industry. Following on from this, more specific criteria were used to analyse respondents' profiles, such as age, education level and professional qualifications.

A large majority of the responses (i.e. 91%) came from senior managers of main board companies, and only 9% of the respondents were attached to companies on the second board of the KLSE, as shown in Panel A of Table 3. As shown in Panel B of Table 3, the majority of respondents were concentrated in five industries, namely trading/services (26%), plantation (17%), consumer products (14%), technology (11%) and finance (11%). Only small numbers of responses were received from senior managers of companies in the area of industrial products (3%), properties (6%), construction (6%), infrastructure projects (3%) and hotels (3%). Although this study recorded a relatively low response rate, i.e. 23% (as reported in the section 4.0), the respondents represented a wide range of industries that cover the majority of the Malaysian economy.

Table 3. Classification of Respondents Based on Board Listing and Type of Industry

Panel A: Board Listing		
Board	Frequency	Per cent
Main	32	91
Second	3	9
Total	35	100
Panel B: Type of Industry		
Industry Type	Frequency	Per cent
Industrial Products	1	3
Properties	2	6
Construction	2	6
Infrastructure Project	1	3
Technology	4	11
Consumer products	5	14
Trading/Services	9	26
Finance	4	11
Plantation	6	17
Hotel	1	3
Total	35	100

Since the questionnaires were directed to senior managers of publicly listed companies, all of the respondents were more than 30 years old. As shown in Panel A of Table 4, 57% of the respondents fell in the age range between 30 to 40 years old, 37% came from the age range between 41 to 50 years old, and only 6% were more than 50 years old.

In terms of educational level, Panel B of Table 4 indicates that all of the respondents have a minimum of professional qualifications (34%) or degree with (29%) or without (37%) professional qualifications. This might indicate that the respondents that participated in this study might have adequate or reasonable knowledge of Malaysian corporate governance in general and audit committees in particular. The wide distribution of respondents that have a high education level (degree and professional qualifications) and mature age might provide richer insights into the issues investigated in this study.

Table 4. Respondents' Background Information

Panel A: Respondents' Age		
Range	Frequency	Percentage
<30	0	0
30-40	20	57
41-50	13	37
>50	2	6
Total	35	100
Panel B: Respondents' Education Level		
Education/Professional Qualification	Frequency	Percentage
Degree with Professional Qualification	10	29
Degree without Professional Qualification	13	37
Professional Qualification (No degree)	12	34
Total	35	100

In the following section, results relating to five questions on audit committee authority will be reported.

5.2 Audit Committee Appoints Auditor

As shown in Figure 1, 60% of the respondents indicated that auditor effectiveness and independence would be greatly enhanced if the audit committee assumes responsibility for appointing the external auditor, rather than the board of directors. Only 23% of the respondents indicated that it would not affect auditor effectiveness and independence, and 17% agreed that an audit committee assuming the role of appointing the auditor would partly enhance the auditor's effectiveness and independence.

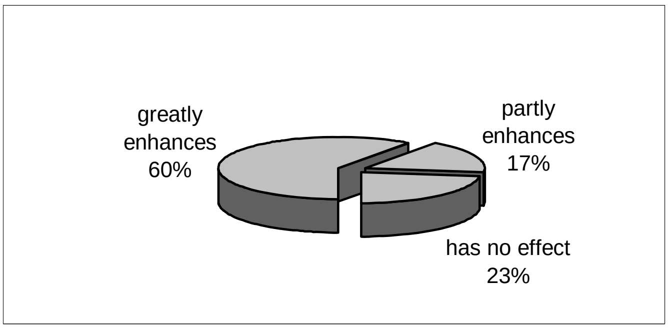

Figure 1. Audit Committee Appoints Auditor

It may be that an audit committee that comprises a majority of non-executive directors would support the auditor in delivering their duties, especially in situations of conflict. If the audit committee assumes the responsibility to appoint the auditors, the management should not be able to influence the auditor or threaten to terminate the auditor should the auditor not adhere to their choice of accounting policy. Thus, the auditor would be more effective if the audit committee were responsible for their appointment.

5.3 Audit Committee Determines and Reviews Audit Fees

When the respondents were asked about the impact of an audit committee assuming the responsibility to determine and review audit fees as effect to cost and audit, 60% of them agreed that it would result in a more cost-effective and thorough audit (refer to Figure 2). A small percentage (i.e. 11%) of the respondents indicated that it would result in a less cost-effective audit, but that the audit would be conducted more thoroughly. On the other hand, 29% of the respondents indicated that there would be no effect to cost and audit when the audit committee assumed the responsibility to determine and review audit fees.

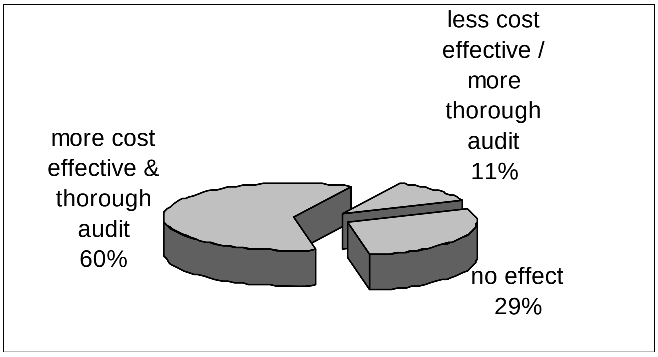

Figure 2. Audit Committee Determines and Reviews Audit Fees

Although the total audit fees might increase due to a thorough audit exercise performed by the auditors, the benefits derived from such an exercise could be more than the cost because a thorough audit could avoid misstatement in financial reporting, which consequently provides greater benefits to safeguard shareholders' interests. The respondents might have believed that in the presence of a thorough audit, the possibility of mismanagement or financial fraud would be minimised. As a result, the respondents might have come to the conclusion that the audit would be more cost effective and thorough if the audit committee determines and reviews audit fees.

5.4 Audit Committee Determines and Reviews Auditor's Scope and Duties

With regard to the statement on the audit committee assuming responsibility to determine and review the external auditor's scope and duties, 66% of the respondents agreed that this would result in a more cost-effective and thorough audit, as shown in Figure 3. In contrast, only 11% were of the opinion that this would lead to a less cost-effective but more thorough audit. On the other hand, as many as 23% of the senior managers of publicly listed companies indicated that this role would not have an effect on the cost effectiveness and thoroughness of the audit.

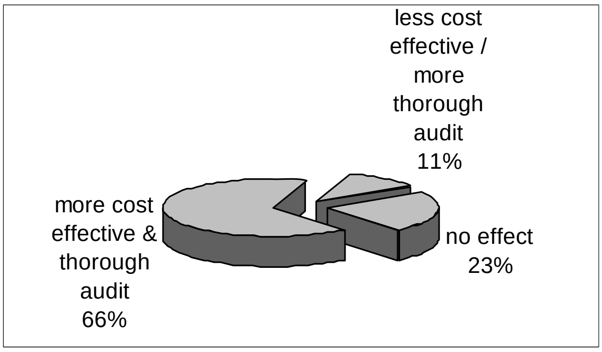

Figure 3. Audit Committee Determines and Reviews Auditor's Scope and Duties

Indeed, an audit committee could enhance the auditor's objectivity and independence if they reviewed the auditor's scope and duties. In addition, an audit committee would determine specific areas or duties that need attention based on risk assessment results and the audit would be more thorough if it took into consideration the risk areas. This would minimise the chances of misstatement in financial reporting that could lead to shareholders' losses. More cost effectiveness could be seen in terms of the benefit that shareholders could gain from the thoroughness of the auditors' scope of duties. The result is consistent with the findings concerning the audit committee determining and reviewing audit fees, as reported in Section 4.3, where there is a positive relationship between the cost effectiveness and thoroughness of the audit.

5.5 The Effect of the Audit Committee Report on User's Perception

Following the amendments to the KLSE listing, all Malaysian listed companies are required to disclose audit committee reports in annual reports. Respondents were asked about the impact of audit committee reports on the perceptions of users of financial statements concerning the committee's effectiveness and role. Half (i.e. 50%) of the respondents agreed that this would greatly enhance the perceived effectiveness and role of the committee, while 38% of them indicated that it would partly enhance the perception of users of financial statements concerning the committee's effectiveness and role. Only 12% of the respondents believed that the publication of audit committee reports would not effect the perception of financial statement users.

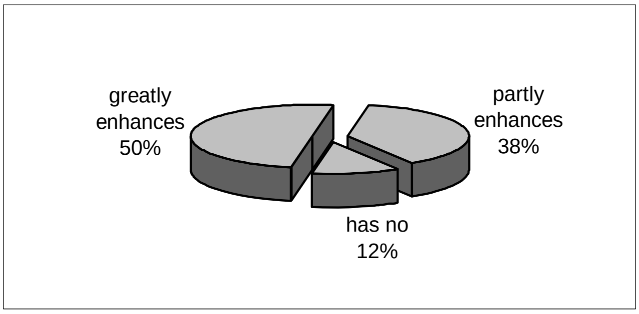

Figure 4. The Effect of the Audit Committee Report on User's Perception

The result might indicate the respondents' support for the disclosure of the audit committee report, where this report would outline activities undertaken during the year. Perhaps, as all documents relating to audit committee meetings and activities are treated as 'private and confidential', the disclosure of the audit committee report in the annual report would provide information on efforts undertaken to ensure shareholders and stakeholders' interests are protected. Thus, the perceptions of users of financial statements on the role and effectiveness of the audit committee would be enhanced.

5.6 Audit Committee Meetings

When the respondents were asked about the frequency of audit committee meetings in a calendar year, Figure 5 reveals that a large majority (85%) of the respondents indicated that the audit committee should meet quarterly. Only 9% and 6% of the respondents indicated that the audit committee should meet monthly and twice a year respectively.

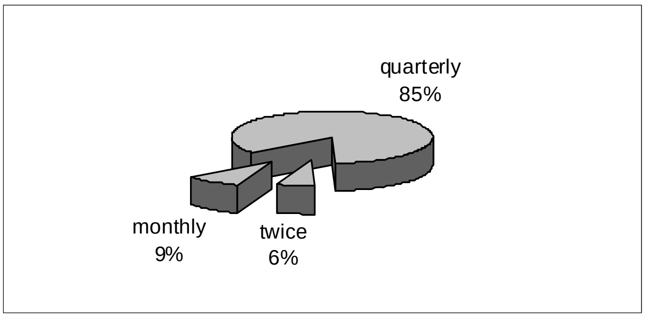

Figure 5. Audit Committee Meetings

This result indicates that the respondents are in agreement with the KLSE listing requirements that stipulate that an audit committee should meet at least on a quarterly basis. If an audit committee were to meet on a quarterly basis, they might discuss the results reported in quarterly financial statements and perhaps would be able to evaluate internal control systems and any issues arising from previous meetings. Indeed, the frequency of meeting indicates how active the committees are in pursuing good corporate governance objectives.

6. Discussion

The authority of an audit committee is drawn from the board of directors, the rules and regulations, and the KLSE's listing requirements. Five issues concerning authority, namely whether the audit committee appoints the auditor, whether the audit committee determines and reviews the audit fees, whether the audit committee determines and reviews the auditor's scope and duties, and audit committee reports and meetings, were examined in this study and will be discussed in the following paragraphs.

In this study, the majority of respondents indicated that audit committee effectiveness and independence would be greatly enhanced if the audit committee were to appoint the external auditors. This result might indicate the respondents' concern about the potential drawbacks of the current practice, where the management through the mandate from the shareholders appoints the external auditor. Although shareholders are responsible for appointing the external auditors under the Malaysian Companies Law 1967, effectively this role is mandated to the management, and in addition the management sends the audit engagement letter to the auditor. This practice would either directly or indirectly influence auditor behaviour because the auditor is seen to be responsible to the management. In order to avoid this misconception or the unnecessary mandate to appoint the auditor from the shareholders to the management, it would be more appropriate if the audit committee were to assume responsibility for appointing the auditor, rather than the management. As a result, the auditor could then easily resist management pressure and report directly to the audit committee on significant issues or irregularities without any fear of termination or pressure from management. Goldman and Barlev (1974) believed that through this approach, management power over auditors would diminish. However, this argument was rejected by a manager, who pointed out, "This is subjective. If the audit committee still refers to the management on the appointment of external auditor, even though audit committee appoint, then the effectiveness is low". Furthermore, another manager believed that the suggestion would not solve the financial reporting problem and noted, "There will be no different because audit committee report to the Board of Directors. It will only make difference if the committee has a say in the audit fees or scope of work."

Auditor independence is important to the credibility and reliability of the financial information of companies. The behaviour of the auditor could have a direct link with how their fees are determined and reviewed because the auditor's economic benefit would determine their survival. The majority of respondents were of the opinion that if the audit committee assumes the responsibility of determining and reviewing audit fees, a more cost-effective and thorough audit would be obtained. This result might be a sign of the respondents' belief in the importance of changing the current practice of fee determination, where the system should be passed to the audit committee instead of leaving it to the board of directors, who received a mandate from the shareholders. An audit committee that consists of a majority of non-executive directors and is not involved in day-to-day business activities could fairly determine and review audit fees and subsequently closely monitor the business operations and management behaviour. The careful design of the fee determination and review system could perhaps result in better governance and financial reporting, where auditors would be able to freely express their views on any irregularities or fraud without any fear or favour. However, a senior manager that responded disagreed that there would be a more cost-effective and thorough audit, and pointed out, "This is irrelevant if audit committee decision can be overruled by the board".

With regard to the question of the audit committee determining and reviewing the auditor's scope and duties, the majority of respondents indicated that this would result in a more cost-effective and thorough audit. Although a thorough audit is seen to cost more to the companies, the respondents might see the increase in cost effectiveness when a thorough audit is conducted, in terms of the benefit that the shareholders gain through good and reliable financial reporting. It might be the case that the respondents viewed the cost effectiveness that the company might gain with a long-term perspective. Bowling and Burke (2005) argued that the first year of compliance to the Sarbanes Oxley Act for US listed corporations involved a huge amount of "wasted time, unnecessary expenditure and needless frustration". However, a news report from Reuters (2005) argued, "three years after the corporate governance guidelines set under the Sarbanes Oxley Act were unveiled, financial managers are increasingly acknowledging its benefits for investors". It further stated that a study done by a business software company, Approva Corporation, found that 44% of finance executives perceived the Act as offering net gains to investors.

The KLSE listing requirements necessitate audit committees to provide their report in the company's annual report. The majority of respondents were of the opinion that this could greatly or partly enhance the perception of the users of financial statements concerning the effectiveness and role of the audit committee. This result might indicate the confidence of respondents in the benefits that such a report might bring to users of financial statements because these groups of stakeholders do not have all the inside information required for the purpose of economic decision–making. In this context, Mohamad *et al.* (2001) found that many of the documents and records are classified as ‘private and confidential’. Indeed, the publication of the audit committee report could show the appearance of audit committee independence and their efforts to ensure good corporate governance and financial reporting. However, in order to avoid a ‘paper exercise’, clear guidelines should be in place to ensure that this monitoring agent provides an informational report. A manager that responded argued, “currently, most of the companies listed on the KLSE only complied with the requirement without giving great attention on the quality of the report”. Concern about the content of the audit committee report was expressed by another manager, who argued that the audit committee reports of many listed companies use very similar wording and might not reflect the business reality of the company, and he noted, “audit committee report would only effective if its report major findings and action taken”. This move would also surely involve cost to the company and shareholders.

Another aspect of audit committee authority is the frequency of audit committee meetings. The majority of respondents agreed that audit committees should meet quarterly, as required by the KLSE listing requirements. The number of meetings could signal the amount of effort undertaken by the committee to ensure good governance and financial reporting. An active audit committee is a sign of their effort to review financial reports and transactions and to make sure that proper internal control is in place. Although they agreed with the listing requirements, a number of managers that responded were flexible on the frequency of meetings, where they believed that the type of industry and business play an important role. One of them further noted, “Frequency should be dependent on the complexity of the organisation’s business”. In addition, if the meeting frequency were to be reported in the annual report, users of financial statements could evaluate the amount of credibility and reliability that they could put on the reports. In addition, an active audit committee could reflect the number of safeguards of good financial reporting and governance provided by the committee to shareholders and stakeholders.

7. Conclusion

The majority of respondents agreed that the auditor would be more effective and independent if the audit committee assumed the responsibility to appoint the auditor. This result implies that the auditor could be threatened or pressured by the parties that appointed them. If an audit committee that comprised a majority of non-executive directors appointed them, such risk could be avoided because the committee members would not be involved in the day-to-day operations and could thus provide an independent view and input to the auditor.

In light of the above issue, the auditor’s roles would be more effective and efficient if the audit committee were also to determine and review the audit fees. The auditor would be able freely to issue their opinion without fearing any threat to their economic benefits. Thus, the audit would be more cost-effective and conducted more thoroughly. Perhaps cost effectiveness from the thorough audit could be seen in the long term when good financial reporting and corporate governance have been put in place, which consequently increase the stakeholders’ and shareholders’ confidence. A consistent result was found on the issue of the audit committee assuming responsibility to determine and review the external auditor’s scope and duties. The majority of the respondents believed that this would be more cost-effective and that the auditor would conduct a more thorough audit. These results might reflect the respondents’ concern about the current system of auditor appointment and determination of the fee and the scope and duties of the auditor.

The audit committee report is one way that the committee communicates their efforts to instil good financial reporting undertaken during the year. The majority of respondents agreed that this approach would enhance the perceptions of users of financial statement concerning the effectiveness and role of the committee. Indeed, users of financial statements lack information relating to the company except that disclosed in the annual report and other statutory announcements, because most of the documents and records are classified as ‘private and confidential’.

The majority of the respondents indicated that the audit committee should meet at least quarterly, which is consistent with the recommendations of the KLSE listing requirements. Meeting frequency would perhaps indicate the amount of effort undertaken by the committee to monitor the reporting process and internal control.

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