

NON-EXECUTIVE DIRECTORS AND AUDIT COMMITTEE: A STUDY ON THEIR AUTHORITY AND EFFECTIVENESS

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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 seven 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, meetings, charter and roles. 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, quarterly meeting and disclosure charter in annual report would enhance the perceptions of users of financial statement concerning the effectiveness of the committee.

Keywords: Authority, Effectiveness, Perceptions, Malaysia, Survey.

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1. Introduction

One mechanism that has been widely used in worldwide corporate organisations to monitor the financial reporting process and corporate governance is the establishment of an audit committee comprising a majority of independent directors. The existence of an audit committee could improve the monitoring of corporate financial reporting and internal control. This could be done by bridging the communication gap between the auditors and corporate management and through strengthening the role of the internal auditors. Although audit committees have been in existence for decades, there are criticisms of the practices of audit committees and a large amount of research have been undertaken to identify an ideal audit committee that

would act in the interest of shareholders (Abbott and Parker, 2000; Krishnan, 2005).

To effectively deliver their duties, audit committees should have adequate and appropriate authority. The committee gains their authority from rules and regulations, the board of directors and the Bursa Malaysia Berhad (BMB) listing requirement (i.e. Part C, Chapter 15). 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).

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. Seven 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 six sections. The following section provides literature review on audit committee authority. Section three provides the data collection and research methodology. The fourth sections present the research findings. The fifth section provides discussion on the results and the final section provides conclusions of the study.

2. 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 BMB 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 BMB listing requirements (2001), BRC (1999) and the Treadway Commission (1987) suggested that audit committees should meet at least four times a year.

To effectively pursue their objective, audit committees need unambiguous, practical and flexible terms of reference, sometimes referred to as the charter (Mohamad and Sori, 2001). This charter should be deliberated on and accepted by the board of directors that govern the firm's operations. The charter should be re-evaluated periodically, sufficiently flexible to incorporate a changing business environment and clearly spell out the responsibilities of the audit committee. Preferably, the charter should be disclosed in the financial statements to help shareholders assess the performance of the committee in relaying their responsibilities.

Prior studies have documented the various roles of audit committees. Vanasco (1994) contended, "there seems to be a consensus among researchers in the field and the various national and international organizations that audit committees provide significant benefits to the corporation, public, investors and regulatory agencies" (p.38). He further provided the most cited functions of audit committees,

as follows: “strengthening the internal and external audit functions”, “co-ordinating the work of the external and internal auditors”, “strengthening the position of non-executive directors”, and “assisting the board of directors to fulfil their legal responsibilities” (p. 38). Furthermore, audit committees are also expected to regularly assess a company’s risk and management’s responses to significant financial and non-financial risks facing the organisation. Duncan (1991) argued that audit committees must take into account the following audit risk assessment: (i) the major risks facing the organisation; (ii) the auditor examines the company’s efforts to control these risks through contingency plans, security measures and other means; (iii) the auditor compares the risks and company responses to determine adequacies; (iv) the auditor recommends improvements in company activities in the identification, control and financing of critical risks. Cowan (2004) argued that risk management is crucial to corporate governance and it has become the main component of ‘effective modern management’. He further pointed out that the complexity of today’s business environment necessitates the committee and the entire organisation to understand the importance of risk management. Mohamad and Sori (2001) summarised an audit committee’s responsibilities to include ensuring quality accounting policies, internal controls, and the independent and effective role of outside auditors to deter fraud, anticipate financial risks and promote accurate, high quality and timely disclosure of financial and other material information to the board, to the public markets, and to shareholders. 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.

3. 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 Bursa Malaysia Berhad 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.

4. Research Findings

4.1 Respondents’ Background

An analysis of the distribution of respondents across companies listed on the Bursa Malaysia Berhad

(BMB) 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 BMB, as shown in Panel A of Table 1. As shown in Panel B of Table 1, 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 3.0), the respondents represented a wide range of industries that cover the majority of the Malaysian economy.

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 2, 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 2 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.

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 seven questions on audit committee authority will be reported.

4.2 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.

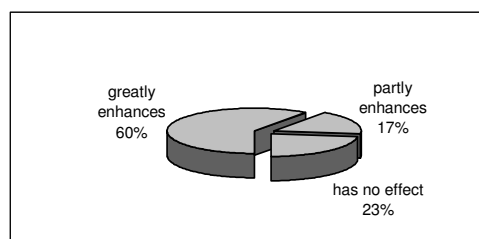


Figure 1. Audit Committee Appoints Auditor

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.

4.3 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.

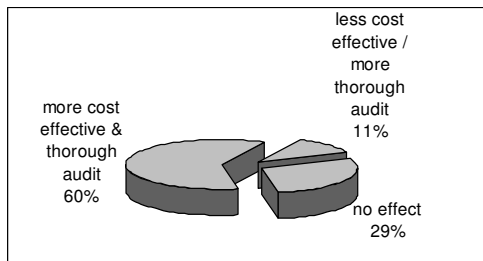


Figure 2. Audit Committee Determines and

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.

4.4 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.

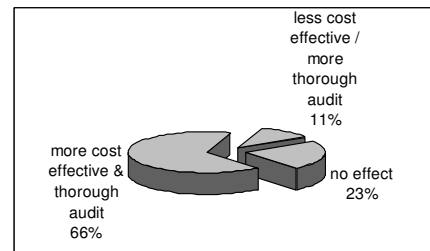


Figure 3. Audit Committee Determines and Reviews Auditor's Scope and Duties

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.

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

Following the amendments to the BMB 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.

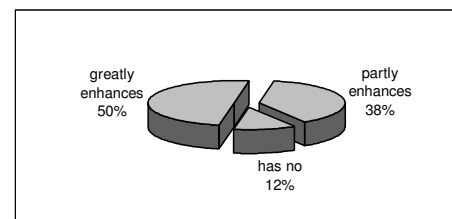


Figure 4. The Effect of the Audit Committee Report on User's Perception

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.

4.6 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.

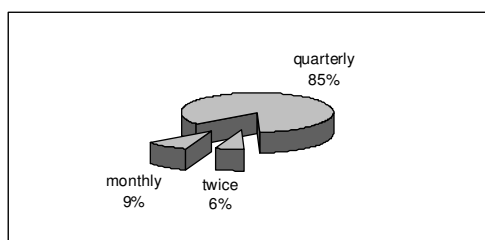


Figure 5. Audit Committee Meetings

This result indicates that the respondents are in agreement with the BMB 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 committee is in pursuing good corporate governance objectives.

4.7 The Effect of the Charter on Perceived Effectiveness and Role

It is a common practice for Malaysian listed companies to provide the audit committee's terms of reference or charter in the annual report. Respondents were asked about the impact of disclosure of the audit committee's charter on the perception of users of financial statements concerning the committee's effectiveness and role. As shown in Figure 6, a sizeable percentage of the respondents indicated that it would greatly (37%) or partly (43%) enhance the perception of users of financial statements concerning the committee's effectiveness and role. On the other hand, only 20% of the respondents indicated that it

would have no effect on the perceived effectiveness and role of the audit committee.

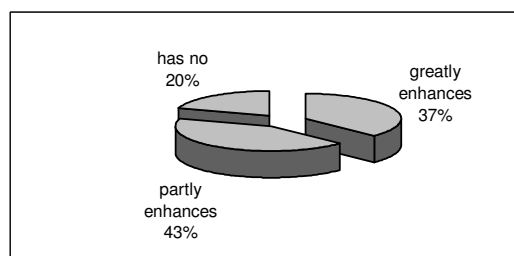


Figure 6. The Effect of Charter on Perceived Effectiveness and Role

The disclosure of the audit committee charter would provide users of financial statements with information relating to the roles and responsibilities of the audit committee. Indeed, the charter would serve as the responsibilities for the members of the audit committee to perform during the financial year. Thus, users of financial statements would be aware of these responsibilities and could ask questions during the annual general meeting concerning what has been done during the year to meet them, and this would increase the perceptions of users of financial statements concerning the committee's effectiveness and role.

4.8 Audit Committee Roles in Monitoring Financial Reporting

Respondents were provided with a list of nine roles of the audit committee in monitoring financial reporting and were asked to rank them accordingly, where point 1 as the most important and point 9 is the least important (refer to Table 3). From the ranks provided by the respondents, the means of the distributions were calculated and subsequently the roles were ranked based on the means to show their importance from the perspective of senior managers of the publicly listed companies that participated in this study.

As shown in Table 3, the majority of the respondents indicated that the audit committee's role to review the internal audit programme, processes and the results of the internal audit report (mean=3.2), to review and monitor the effectiveness of the company's risk assessment procedures (mean=3.3), and the review and analysis of the adequacy and effectiveness of the internal accounting and financial controls of the company (mean=3.3) were the top 3 most important roles. In addition, the audit committee's role to review the external audit programme, processes, and the results of the external audit report (mean = 3.9), to review and monitor action plans linked to audit recommendation (mean = 3.9), to review and monitor special investigation project e.g. potential fraud (mean = 4.4) and to review the annual financial statements and interim reports

(mean = 4.9) were also considered important. On the other hand, the majority of the respondents indicated that the review and analysis of significant changes in accounting policies and year end adjustments (mean = 6.2) and the review and analysis of accounting estimates and judgement (mean = 6.0) were the least important of the audit committee's roles. The respondents' perceptions on audit committee roles in monitoring financial reporting indicates that the role relating to internal control and risk assessments is at the top of the list of importance. This might explain why the role of the audit committee was seen primarily as examining the adequacy of the internal control of the company, which is important to ensure appropriate measures are in place to prevent financial irregularities or mismanagement from occurring. In addition, risk assessment was considered important, probably because this role would enable the committee to highlight the areas that need more attention and the mechanisms that are needed to mitigate the risk. As a result, the committee, internal auditor and external auditor would place more attention on that particular area. This effort could enhance the company's financial viability and shareholder and stakeholder confidence in company performance and internal control.

5. Discussion

The authority of an audit committee is drawn from the board of directors, the rules and regulations, and the BMB's listing requirements. As mentioned earlier in Section 4.1, seven 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, meetings, charter and roles, 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.

Table 3. Audit Committee Roles in Monitoring Financial Reporting

Roles	Rank										Mean	Rank
	1	2	3	4	5	6	7	8	9	Total		
Review and analysis of significant changes in accounting policies and year end adjustments	9	0	11	14	3	6	9	29	20	100	6.2	9
Review and analysis of accounting estimates and judgement	3	6	20	3	3	3	31	17	14	100	6.0	8
Review of the annual financial statements and interim reports	17	9	11	6	3	26	6	11	11	100	4.9	7
Review and analysis of the adequacy and effectiveness of the internal accounting and financial controls of the company	29	23	9	9	9	6	17	0	0	100	3.3	2
Review internal audit programme, processes, and the results of the internal audit report	31	14	6	14	26	6	0	3	0	100	3.2	1
Review external audit programme, processes, and the results of the external audit report	11	9	20	29	23	0	0	6	3	100	3.9	4
Review and monitor special investigation project (e.g. potential fraud)	29	0	17	6	9	17	6	3	14	100	4.4	6
Review and monitor the effectiveness of the company's risk assessment procedures	9	29	20	29	6	3	0	6	0	100	3.3	2
Review and monitor action plans linked to audit recommendation	9	23	31	6	6	9	6	0	11	100	3.9	4

Note: The above figures on rank are stated in percentages.

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 BMB 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 BMB 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 BMB 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.

An audit committee charter or terms of reference outline the committee's duties and responsibilities,

which they are expected to achieve or pursue. The majority of respondents were of the opinion that the disclosure of the charter in the annual report would greatly or partly enhance the perceptions of users of financial statements concerning the effectiveness and role of the committee. Indeed, the charter would signal the seriousness of the committee's intent to undertake appropriate measures to ensure shareholders' and stakeholders' interests are protected, and would also indicate that they are pursuing good corporate governance consistent with international best practice. However, some of the respondents are concerned about the practice of using similar wording in the audit committee's charter in many of the publicly listed companies, and a manager revealed, "The charter is a standard format. Most companies just copy the audit charter and adjust here and there to suit their operations". In addition, users of financial statements could evaluate and debate whether the scope of duties of the audit committee cover all material aspects and they could suggest further improvements to ensure adequate protection is in place.

With regard to audit committee roles, the majority of respondents indicated that the top 3 most important roles are: to review the internal audit programme, processes and the results of the internal audit report; to review and monitor the effectiveness of the company's risk assessment procedures; and the review and analysis of the adequacy and effectiveness of the internal accounting and financial controls of the company. In fact, the top 3 most important audit committee roles are associated with the internal control system of a company. This result is consistent with the literature, in that respondents in prior surveys frequently ranked internal control evaluation as the most important oversight area. This result might reflect the respondents' concern about the need to institute effective internal controls that would directly result in more effective financial reporting systems. The literature has documented that planned audit hours increase as the efficiency of the internal control system decreases (Kaplan, 1985). This finding might indicate that efficient internal control would directly influence the reduction in audit hours and fees, especially in a large and complex business organisation. As a result, higher quality financial reports would be produced with a minimum of or no financial misstatement. On the other hand, the least important of the roles of the audit committee are the review and analysis of significant changes in accounting policies and year-end adjustments; and the review and analysis of accounting estimates and judgement. These two roles are associated with the financial reporting process. It may be that the respondents believed that when internal controls are properly designed, the subsequent financial reporting process would produce more reliable results. Thus, it is fundamental to look at internal control systems that would have a greater impact and that cover the

financial reporting role of the bottom 2 audit committee roles.

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 BMB listing requirements. Meeting frequency would perhaps indicate the amount of effort undertaken by the committee to monitor the reporting process and internal control.

The majority of the respondents indicated the disclosure of audit committee charter in annual report would enhance the perceptions that users of financial statements have on the committee's effectiveness and role. Through this approach, the audit committee would appear to perform an extensive role in

safeguarding shareholders' and stakeholders' interests. In addition, it would create a responsibility of the committee, which they would be bound by law to perform. The three most important roles of an audit committee, as ranked by the majority of respondents, are to review the internal audit programme, processes and the result of the internal audit report, to review and monitor the effectiveness of the company's risk assessment procedures, and the review and analysis of the adequacy and effectiveness of the internal accounting and financial controls of the company. These roles are associated with internal control systems and risk assessment. It may be that internal control systems and risk assessment are fundamental to overall financial reporting. When the systems are properly in place, the other reporting processes would be organised accordingly. Thus, the majority of respondents believed that the review and analysis of significant changes in accounting policies and year-end adjustments, and the review and analysis of accounting estimates and judgement were the two least important audit committee roles.

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