

UNIVERSITY OF CAPE COAST

ROLE EFFECTIVENESS OF AUDIT COMMITTEES AND FINANCIAL  
REPORTING QUALITY IN SELECTED COMPANIES IN GHANA

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REPORTING QUALITY IN SELECTED COMPANIES IN GHANA

BY

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## DECLARATION

### Candidate's Declaration

I hereby declare that this dissertation is the result of my own original research and that no part of it has been presented for another degree in this university or elsewhere.

Candidate's Signature:..... Date:.....

Name: Anthony Agyeman Acquah

### Supervisor's Declaration

I hereby declare that the preparation and presentation of the dissertation were supervised in accordance with the guidelines on supervision of dissertation laid down by the University of Cape Coast.

Supervisor's Signature:..... Date:.....

Name: Dr Anokye Mohammed Adam

## ABSTRACT

The aim of this study was to examine the role effectiveness of Audit Committees and financial reporting quality in selected companies in Ghana. The study adopted the case study research design. A total of fifty-four respondents participated in the study. The convenience sampling method was used in selecting the respondents for the study. Data was collected using questionnaire. Spearman Rank Order ( $\rho$ ) correlation, frequencies and percentages, pie charts, and mean and standard deviation were employed in analysing the data gathered. The Statistical Packages for Social Sciences (SPSS) version 21.0 was the software that was used for the data analysis. The findings of the study revealed that the Audit Committees (ACs) in the companies studied were generally not effective in the performance of their duties. Additionally, the study found out that the effectiveness of ACs is affected principally by poor management support; low level of management interest in the activities of the audit committee; poor commitment of management toward the implementation of audit committee's findings; lack/inadequate resources for the audit committee to effectively perform its function, among others. Last but not least, the study found out that the quality of the companies' financial reporting did not have any significant relationship with Audit Committees' frequency of meetings, size, degree of independence, and financial expertise. Based on the findings of the study, it was recommended among other things that management of the companies should provide the needed support to the Audit Committee and should be more committed in implementing the recommendations by the committee.

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## DEDICATION

This work is dedicated to Irene, my lovely wife, Paul, Prerna and Praman, my  
dear children.

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## CHAPTER ONE

### INTRODUCTION

#### **Background to the Study**

The challenging economic environment has brought an increased risk of unethical behaviour and a great potential for fraud (Ernst & Young, 2007). Besides, financial reporting within corporate governance in contemporary times has become very technical and complex due to the emergence of new regulations and statutory requirements (Green & Gregory, 2005; Ernst & Young, 2007; Marx, 2008). This has consequently put the independence of external and internal auditors under constant threat (Bailey, 2007; Marx, 2008). Regardless of this, governing bodies of firms are expected to produce good results (Marx, 2008). This has resulted in company boards increasingly looking for better ways to help them function effectively.

According to Marx (2008), a small, highly skilled and independent committee will greatly assist the board of directors in discharging their various duties effectively. As emphasized by Klein (2002), one of such important independent committees that can assist board of directors in this regard is the audit committee. An audit committee is a subcommittee of the board of directors that consists of a number of independent non-executive directors tasked with an oversight role to assist the directors in meeting their financial reporting, risk management and control as well as other audit-related responsibilities (Marx, 2009). The committee acts as a liaison between the company's management, the board of directors, and the internal and external auditors.

According to Al-Lehaiden (2006), the search for mechanisms to enhance corporate governance and increase the quality of financial reports has mostly focused on the structure of audit committees. Again, studies have highlighted the role of the audit committee as an important mechanism in strengthening the overall corporate governance practices in companies (Turley & Zaman, 2007; Osma & Noguer, 2007; Chen, Duh & Shiue, 2008; Mallin, 2010; Bedard & Genron, 2010). An effective audit committee will be beneficial to the shareholders and stakeholders alike. According to Park (1998), companies with effective audit committees are less likely to have financial and auditing problems. Also, such companies tend to perform creditably on the various capital markets.

Ernst and Young (2006) posit that an effectively functioning audit committee will greatly assist the board of directors in their activities, particularly when it comes to the organization's financial reporting practices. In a like manner, KPMG (2005) asserts that an audit committee assists corporate board of directors in discharging its fiduciary responsibility. An audit committee that operates effectively is a key feature in a strong corporate governance culture, and can bring significant benefits to the company.

Audit committees are not a new concept. However, it is only in the last 10 to 15 years that audit committees have really come to the forefront (Brewer, 2011). Among the prominent factors that have given rise to renewed emphasis being placed on audit committees are major corporate collapses and business failures, and the issuing of various corporate governance codes and new or amended legislation (Payne, 2002; KPMG 2005; Agulhas, 2006; Ernst & Young, 2006; Terry, 2007; Marx, 2008). Ernst and Young (2007) opine that

the challenging economic environment which is associated with an increased risk of unethical behaviour and the potential for fraud have also resulted in company boards increasingly looking to their audit committees to provide them with assurance that these risks are adequately addressed.

The modern audit committee is usually faced with significant challenges, threats and limitations, which might negatively impact on its effectiveness. These include tasking the audit committee with responsibilities that fall outside its responsibility, unrealistic expectations of audit committees, the unavailability of suitable candidates to serve on audit committees and greater risk exposure, to name but a few (Casarino & Van Esch, 2005; Aghulhas, 2006; Marx, 2008). All these factors can greatly hinder the effectiveness of the audit committee.

Notwithstanding, it is essential for audit committees to be effective in their functioning and not merely be formed as window-dressing or to meet legislative or regulatory requirements. Carroll and Buchholtz (2006) have, however, warned of a possibility of an audit committee existing merely in appearance and not being effective in their governance oversight role. According to the authors, a number of audit committees in various organizations are gradually turning out to be toothless tigers, a situation which undermines the effectiveness of these audit committees.

Despite its increasing importance, very limited empirical studies have been conducted to examine the role effectiveness of audit committees in Ghana. This could probably be due to the fact that the concept is now gaining much prominence as revealed by Brewer (2011). This study therefore seeks to contribute to existing body of knowledge by investigating the roles

effectiveness of audit committees and financial reporting quality in selected companies in Ghana.

### **Statement of the Problem**

Ghana has so far witnessed a number of corporate failures as evidenced by the collapse of a number of major companies. Notable among them are Ghana Airways Limited, Juapong Textiles Limited, Bonte Gold Mines, Divine Sea Foods Limited, Ghana Cooperative Bank Limited, Aboso Glass Factory, Bonsa Tyres, and Bank for Housing & Construction Limited. A critical review of the circumstances that led to the collapse of these firms shows that most of these corporate failures could have been prevented if effective audit committees were in place to check on the activities of management, particularly when it comes financial reporting and other accounting practices. For instance, Yeboah (2009) in his study on the factors that led to the collapse of Ghana Airways indicated that government interference, lack of working capital, poor management practices, and poor accounting practices were the major factors that brought the corporation to its needs.

Audit committees help organizations to strengthen their internal audit and external audit functions, financial management, financial reporting, internal controls system, and overall governance (David, 2009). They help to mitigate corporate fraudulent or poor accounting practices and further enhance reliable, dependable, effective and efficient corporate governance (Owolabi & Dada, 2011).

According to Marx (2009), although audit committees are well established in companies across the world, they are not always effective as they should be in their governance oversight role. Marx (2009) further indicates that the ineffectiveness of most audit committees has, in part, contributed to corporate scandals and business failures, fraudulent financial reporting, audit failures, internal control breakdowns and other irregularities in organizations across the globe.

As reiterated by Quigley (2012), it is essential that the effectiveness of audit committees be evaluated from time to time so as to deal with any possible hindrances to their effectiveness. However, empirical research on the effectiveness of audit committees remains scant. According to Mohiuddin (2012), there is a general limited research on audit committee practices although the concept has been widely recognized as a very effective mechanism for ensuring good governance in corporate affairs.

Also, most of the few available studies on the subject were conducted in the context of developed countries such as the United States of America, the United Kingdom, Canada, and Australia, thus minimal research has been conducted in developing countries (Pomeranz, 1997; Tsamenyi, Enninful-Abu & Onumah, 2007; Bedard & Genron, 2010). This implies that the scenario of audit committee practices in emerging economies is still under-researched. In Ghana for instance, it is quite surprising to note that no attempts have so far been made by any researcher to find out the role effectiveness of audit committees in companies in Ghana. This might be due to the fact that the concept is new in the Ghanaian business setting.



Nonetheless, given the important roles that the audit committee plays in the governance structure of an organization, there is the need for empirical data that can be used to assess current audit committee responsibilities and effectiveness in order to provide a foundation for future recommendations. As reiterated by Marx (2009) as well as Unegbu and Kida (2011), an audit committee will be of value only if it functioning effectively and when its roles are clearly understood by all the parties concerned.

It is therefore against this backdrop that this study attempts to examine the role effectiveness of audit committees in companies from the Ghanaian perspective.

### **Purpose of Study**

The main purpose of this study was to examine the role effectiveness of audit committees in selected companies in Ghana.

Specifically, the study sought to:

1. examine the roles that audit committees perform in companies in Ghana.
2. assess the effectiveness of audit committees in the performance of their roles.
3. determine the factors that affect the effectiveness of audit committees.
4. examine the relationship between audit committees' frequency of meetings, size, independence, and financial expertise and companies' financial reporting quality.

### **Research Questions**

The study was guided by the following research questions:

1. What are the roles that audit committees perform in companies in Ghana?
2. How effective are audit committees in the performance of their roles?
3. What are the factors that affect the effectiveness of audit committees?
4. What is the relationship between audit committees' frequency of meetings, size, independence, and financial expertise and companies' financial reporting quality?

### **Significance of Study**

The findings of this research will be important to policy makers, stakeholders and the management of the various companies in a number of ways. First of all, the findings of this research will help the management of the various companies to formulate practical guidelines to enhance the corporate governance practices in their respective companies, particularly with respect to their audit committee. Additionally, the study will provide valuable information on audit committees' practices and their effectiveness in the selected companies. The findings of the study will also serve as guidelines for best practice standards for audit committees in the selected companies as well as other companies and institutions that may find the findings valuable. Moreover, this research will contribute to existing body of knowledge regarding the role effectiveness of audit committees and the impact of audit committees' characteristics on companies' financial reporting quality. Finally, the study will serve as a guide to future studies on audit committees.

### **Delimitations of the Study**

The study essentially focused on the role effectiveness of audit committees in selected companies in Ghana. It also touched on factors that affect the effectiveness of audit committees as well as the relationship between an audit committee's frequency of meetings, size, independence and financial expertise and financial reporting quality of a company. The study made use of only fifty-four companies drawn from the various regions in Ghana.

### **Limitations of the Study**

The primary constraint that was encountered in the course of this research was time. As a result, the research was confined to only fifty-four companies in Ghana. This, in addition the case study design that was adopted for the study, could decrease the generalizability of the findings. Also, the reliability of the findings hinges on how sincerely the respondents were in answering the various questions that were raised in the study. In order to overcome this, the respondents were educated on the main essence of the study. Also, they were encouraged to be as honest as possible in their responses.

### **Organization of the Study**

The study is organized into five chapters. The first chapter deals with the background to the study, statement of the problem, purpose of the study, research questions, significance of the study, delimitations of the study, limitations of the study, and ends with the organization of the study. The second chapter also discusses the relevant literature relating to the study. The

third chapter focuses on the methodology adopted in obtaining the necessary data for the study. It comprises the research design, population, study area, sample and sampling procedure, research instrument, data collection procedure, ethical consideration, and data analysis procedure. Chapter four covers the results of the data collected and their discussions. Chapter five touches on the summary, research findings, conclusions, and recommendations. It also offers a suggestion for further research.

## CHAPTER TWO

### REVIEW OF RELATED LITERATURE

#### **Introduction**

In this chapter, existing literature relating to the topic were reviewed under conceptual and empirical perspectives. The conceptual review entails the concept of auditing, and audit committees. The empirical review dwells on roles of audit committees, effectiveness of audit committees, factors that affect the effectiveness of audit committees and impact of audit committees' characteristics such as frequency of meeting, size, degree of independence, and financial expertise on companies' financial reporting quality. The chapter also presents the conceptual framework that guided the study.

#### **Conceptual Review**

##### **The Concept of Auditing**

Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. According to Clement (2012), auditing is a means of evaluating the effectiveness of a company's internal control, maintaining an effective system of internal control, preventing fraud and misappropriation of assets and minimizing a firm's cost of capital. According to the author, all these activities are geared towards obtaining reliable financial reporting on a firm's activities or operations.

Okezie (2008) also sees auditing as an independent examination of and expression of opinion on the financial statements of an enterprise by an appointed auditor in pursuance of that appointment and in compliance with

any relevant statutory obligation. It involves an independent evaluation of financial and operating information of systems and procedures with the view to providing useful recommendations for improvements, where necessary. It consists of a searching investigation of the accounting records and other evidence supporting the financial statement in order to provide a fair and reasonable picture of financial details of the company.

Auditing plays an important role in developing and enhancing the global economy and business firms (Ecaterral, 2007). It plays an essential role in serving public interest in order to strengthen accountability and reinforce trust and confidence in financial report. Uwota (2012) opines that auditing plays a vital role in accounting of a system's internal control; it seeks to provide a reasonable assurance that the financial statements are free from material misstatement and error.

According to the Institute of Internal Auditors (2002), effective auditing helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. Auditing ensures that all activities of an organization are carried out by employees according to laid down procedures. Auditing serves as a key factor in controlling every kind of organization, its financial and economic aspects. In other words, it serves as a sort of checks and balances in the financial and administrative procedure of any organizational setup.

According to Delathe (2012), the major reasons for auditing include evaluation and risk management, control and governance processes, and investigative and advisory services. Clement (2012) notes that audit system is

important for a company because it enables the company pursue and attain its various corporate objectives. It facilitates supervision and monitoring, prevents and detects irregular transaction, helps to measure on-going performance, maintains adequate business records and promotes productivity. Auditing helps to review the design of the internal control, propose improvement and document any material irregularities to enable further investigation by management if it is warranted under the circumstances.

Manguis (2011) observed that auditing helps top management to manage corporate affairs through the provision of guidance on various issues ranging from financial accuracy to internal control to regulatory compliance. It also helps department heads to identify tools and methodologies to improve operational activities, putting companies on a more sustainable path. According to Okezie (2008), auditing helps to attest to the truth and fairness of financial statement of companies.

### **The Concept of Audit Committees**

An Audit Committee is a committee of the board of directors responsible for oversight of the financial reporting process, selection of the independent auditor, and the receipt of audit results from both internal and external auditors. It is a standing committee established to enhance corporate accountability by working with the internal auditors and management to improve and strengthen the financial reporting practices of an entity and to also ensure proper conduct of corporate affairs in accordance with generally accepted ethical and legal standards (Ayinde, 2002). According to Marx (2009), an audit committee consists of independent non-executive directors

tasked with an oversight role to assist the board of directors in meeting their financial reporting, risk management and control and audit-related responsibilities. The audit committee is usually made up of an equal number of directors and shareholders. This enables the committee to be more effective in checking the powers of the executive directors, particularly in their accounting and financial reporting functions (Marx, 2009).

Audit Committees have been seen as a useful mechanism of corporate governance (Spira, 2002; US Securities and Exchange Commission, 2003; UK Financial Reporting Council, 2006). The committee assists the Board in fulfilling its corporate governance and oversight responsibilities in relation to an entity's financial reporting, internal control system, risk management system and internal and external audit functions. The Audit committee is recognized as the cornerstone of a successful and credible financial reporting system. According to the US Securities and Exchange Commission (2003), the role of the Audit Committee is to provide advice and recommendations to the board within the scope of its terms of reference/charter. The committee lends creditability to the integrity of the internal control and financial reporting system, and boost confidence in a company's financial reporting. It performs an oversight function over internal controls and risk management and provides an authoritative avenue for the resolution of divergence in views between the various parties.

According to the Canadian Institute of Chartered Accountants [CICA] (1992), the specific responsibility of an audit committee is to review the annual financial statements before submission to the board of directors. The American Institute of Certificate Public Accountants [AICPA](2009) posits



that an audit committee is responsible for oversight of the financial reporting process, selecting of independent auditor, and receiving and reviewing audit results.

According to Wong (2007), the Audit Committee has a lead oversight role in financial governance and financial reporting matters. It is actively involved in the monitoring of financial management compliance issues, particularly in the identification of risk areas and the monitoring of associated rectification plans. It also reviews the integrity of the financial reporting and internal control structures and oversees the financial performance of the entity.

According to Abbott, Parker & Peters (2003), the audit committee is a vital cog in a firm's control environment and corporate governance structure. Abbott et al. (2003) further state that the audit committee together with the internal auditing function helps to detect and prevent fraudulent financial reporting. As reiterated by Al-Lehaiden (2006), audit committees ensure reliable, high quality financial reporting and thus an effective audit committee is needed to enhance the integrity of companies' financial reports. Audit committee forms an integral part of the governance structures of a board of directors of a company (or other entities) and acts as the financial watchdog of the shareholders and all the stakeholders at large (Marx, 2009).

Audit committee internally audits the auditors and provides reports that are usually included in the financial statement of a publicly quoted company (Enofe, Aronmwan, & Abadua, 2013). Audit committees serve as a bridge in the communication network between internal and external auditors and the board of directors. Audit committee helps to check the activities of auditors

(both internal and external) and top management resulting to the bridging of the gap among users of financial statements.

According to Marx (2009), factors such as the various corporate collapses and business failures and fraudulent financial reporting practices are among the major reasons for the establishment of Audit Committees in recent times in companies. Similarly, Khamidullina (2012) opines that publicly traded companies across the world now maintain an Audit Committee. According to the author, the idea of having Audit Committees has largely arisen in recent years greatly due to the notorious corporate scandals in recent years that have hit big companies like Enron, WorldCom, Adelphia, and Tyco.

Audit committees are expected to enhance board of directors' oversight of management performance and financial reporting processes, thus providing additional protections to shareholders and public investors or creditors (DeZoort, Hermanson, Archambeault & Reed, 2002; Hemraj, 2003; Abbott et al., 2003; Pergola, 2005). The wide acceptance of audit committees underpins their importance as part of corporate accountability and transparency, thus audit committees are expected to serve as the overseer of stakeholder interests (Blue Ribbon Committee, 1999). Prior studies have demonstrated a positive relationship between audit committee formation and earnings quality (Wild, 1996; Baxter & Cotter, 2009). According to Ho and Wong (2001), firms with audit committee are less likely to manipulate earnings and are more likely to voluntarily disclose information.

The Canadian Institute of Chartered Accountants (2001) asserts that Audit Committees make it easier for auditors to retain their independence with clients. They also serve as an important communication link between the

auditor and the board of directors. In a similar note, Enofe et al. (2013) assert that an Audit Committee helps in preserving auditor independence by resolving contentions issues between the auditor and the company's management.

Audit committees are an essential element of corporate governance (Green, 1994). Audit committees serve as the “keystone” of corporate financial governance (Vanasco, 1994). Many audit committees have over the years been formed voluntarily, both in the private and public sector, with the view to utilizing the benefits they bring to an entity's control environment (‘tone at the top’) and its governance structures. According to McMullen (1996), one response to the main concern expressed by users of financial statements and the various governments over the incidence of fraudulent financial reporting is the establishment of audit committees. Similarly, Woolf (1997) mentioned that the appointment of an audit committee is an important development intended to enhance the communication between the board of directors and both internal and external auditors.

Dilworth (2000) argues that audit committees are one mechanism through which auditors are held accountable for the scope, nature and quality of their work. Audit committees can thus exert a powerful influence on auditors through their role in conducting a specific inquiry into the scope, nature and quality of the audit work done.

According to a Treadway Commission Report (1997), the reduction of illegal activities and prevention of fraudulent financial reporting are the primary roles of the audit committee. Similarly, a study conducted by Spangler and Braiotta (2000) revealed that the reduction of illegal activities

and the prevention of fraudulent financial reporting were the primary roles of audit committees. Further, Cobb (2003) investigated the purposes of the audit committee in the US during the 1990s. His investigation revealed four main objectives for the formation of audit committees viz: reduction of board liability, establishing links between the external auditor and the board, the reduction of illegal activity, and the prevention of fraudulent financial reporting.

Pomeranz (2001) argued that the popularity of audit committees is due not only to the fact that they protect shareholders' interests, but also because they help guide management and enhance corporate credibility. In addition, the author highlighted the important role of audit committees in the selection and protection of external auditors. According to the Institute of Directors (2002), the benefits of audit committees include improving the quality of entities' accounting and internal controls, strengthening the objectivity and credibility of their financial reporting, strengthening the independence of their internal and external auditors and creating a climate of discipline and control in entities which will reduce the opportunity for fraud. KPMG (2005, p.82) asserts that "corporate board of directors establishes an audit committee to assist in discharging its fiduciary responsibility. An audit committee that operates effectively is a key feature in a strong corporate governance culture, and can bring significant benefits to the company".

## **Roles of Audit Committees**

According to the Treadway Commission (1997), reduction of illegal activity and the prevention of fraudulent financial reporting are the primary roles of the audit committee. Marrian (1988) conducted a survey to investigate the reasons for the formation of audit committees in the UK. The results of his survey revealed that financial collapses was the most important reasons for such formation. In addition, Spangler and Braiotta (2000) in their study also found that the reduction of illegal activity and the prevention of fraudulent financial reporting were the primary roles of audit committees.

Collier (2002) conducted a more detailed survey to examine the incentives for the formation of the audit committee in UK firms. This study provided the following list of reasons for establishment of an audit committee ranked in order starting with the most frequent ones: good corporate practice; strengthen the role and effectiveness of non-executive directors; help directors in discharging their statutory responsibilities regarding the financial reporting; protect and enhance the independence of internal auditors; help the auditors in the reporting of any serious weaknesses in the control system or management; improve communications between the board and both internal and external auditors; increase the public confidence in the credibility and objectivity of the financial reports; assist management to discharge its responsibilities to prevent fraud and errors; increase the confidence of investment analysts in the credibility and objectivity of the financial reports; provide an opportunity for negotiation between management and auditors; and possibility of legislative pressure.

Another study conducted by Cobb (2003) to investigate the purposes of audit committees in the US identified four main objectives for the formation of such committees. These include reduction of board liability, establishing links between the external auditor and the board, the reduction of illegal activity and the prevention of fraudulent financial reporting.

The Blue Ribbon Committee [BRC] (2013) maintains that the audit committee, as a representative of the entire board, is charged with the responsibility for overseeing the financial reporting process of a company. DeZoort et al. (2002) opine that audit committee literature has experienced a rapid growth in the recent years as a result of the rising concerns about corporate governance and the emphasis on the importance of audit committees to enhance the quality of financial reporting.

According to the European Commission [EC] (2006), the primary duties and responsibilities of the audit committee in a company include monitoring of the financial reporting process; monitoring of the effectiveness of the company's internal control, internal audit where applicable, and risk management systems; monitoring of the statutory audit of the annual and consolidated accounts; reviewing and monitoring of the independence of the statutory auditor or audit firm, and in particular the provision of additional services to the audited entity; and proposing and recommending the statutory auditor to the board of directors.

Lin (2006) also states the roles and responsibilities of ACs include lifting the image of good corporate governance, enhancing communication between board of directors (BoD) and auditors, and mediating conflict between management and auditors. Pomeranz (2001) argues that the

popularity of audit committees is due not only to the fact that they protect shareholders' interests, but also because they help guide management and enhance corporate credibility. In today's business environment, Audit Committees are required to deal with diverse emerging issues in today's business environment though their traditional role has been the oversight of the financial reporting process with the aim of ensuring that accurate, credible and reliable financial reporting is provided to the shareholders (Marx, 2009).

According to Khamidullina (2012), one of the primary roles of AC as indicated by many international and national regulatory requirements is to monitor the integrity of the financial statements. The Audit Committee typically assists the board of directors with the oversight of the integrity of the entity's financial statements; the entity's compliance with legal and regulatory requirements; the independent auditors' qualifications and independence; the performance of the entity's internal audit function and that of the independent auditors; and compensation of company executives (in absence of a remuneration committee).

Many audit committees also have oversight of regulatory compliance and risk management activities. Audit Committees have the responsibilities of measuring performance of the internal audit function, appointment and dismissal of the heads of internal audit, recommending the appointment and dismissal of external auditors, support and promote the audit function within various organizations such as independence and objectivity (Davies, 2009).

The UK Financial Reporting Council (2006) presents a comprehensive roles of Audit Committees under the following sub-headings: role in oversight of financial reporting and accounting, role in oversight of internal control; role

in oversight of internal audit, role in oversight of the external auditor, role in oversight of regulatory compliance, role in oversight of risk management, and reporting responsibilities. The main roles under each of the aforementioned sub-headings are elaborated in the ensuing paragraphs:

Under role in oversight of financial reporting, the Audit Committee is expected to perform the following roles: review of annual financial statements and consider whether they are complete, consistent with information known to committee members, and reflect appropriate accounting principles; review with management and external auditors the results of the audit, including any difficulties encountered; review other sections of the annual report and related regulatory filings before they are released and consider the accuracy and completeness of the information; review with management and the external auditors all matters required to be communicated to the committee under generally accepted auditing standards; review how management develops interim financial information, and the nature and extent of internal and external auditor involvement; review interim financial reports with management and the external auditors before filing with regulators, and consider whether they are complete and consistent with the information known to committee members; monitor the choice of accounting policies and principles; review and recommend the financial statements prior to finalization and submission to the appropriate quarters; review significant accounting and reporting issues, including recent professional and regulatory pronouncements, and understand their impact on the financial statements; ensure accounting policies are consistently applied and any new accounting standards requirements that relate the company are appropriately adhered to; meet with



management and the external auditors to review the financial statements and the results of the audit; ensure that any significant adjustments, unadjusted differences, disagreements with management and critical accounting policies and practices have been discussed with the external auditor; and review all sections of the annual report before its release and consider whether the information is understandable and consistent with members' knowledge about the company and its operations.

Under role in oversight of internal control, the Audit Committee is expected to assess the effectiveness of the company's internal control system including information technology security risks and control; monitor the effectiveness of internal audit and risk management systems; monitor the internal control process; and review the findings of external audit on the internal control system.

Under role in oversight of internal audit, the Audit Committee is expected to review and approve the appointment and dismissal of the head of internal audit; review the co-operation between internal and external audit; ensure that the internal auditor has unrestricted access to the chair of the audit committee; review whether or not the internal auditor has unrestricted access to the chair of the board, review with management organizational structure of the internal audit function; review and approve the annual internal audit plan and all major changes to the plan; review the effectiveness of the internal audit function, including compliance with the appropriate regulatory standards; assess the health of relationship between external and internal audit teams; meet separately with the head of internal audit to discuss any matters that the committee or the internal auditor believe should be discussed privately; ensure

significant findings and recommendations made by the internal auditors are received, and discussed with a course of action agreed and implemented on a timely basis; review the proposed internal audit plan for the coming year, ensure that it covers key risks and that there is appropriate co-ordination with the external auditor; ensure any internal control recommendations made by the internal and external auditors, and approved by the Committee, have been implemented by management; and evaluate the process the entity has in place for assessing the effectiveness and efficiency of, and continuously improving internal controls, particularly those related to areas of significant risk such as fraud, code of ethics, etc.

Under role in oversight of the external auditor, the Audit Committee is expected to review the external auditors' proposed audit scope and approach, including coordination of audit effort with internal audit; oversee the hiring, performance and independence of the external auditors; review with management and the external auditors the results of the audit, including any difficulties encountered; on a regular basis, meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately; ensure significant findings and recommendations made by the external auditors are received and discussed on a timely basis; ensure that external auditors get unrestricted access to the audit committee; ensure management responds promptly to recommendations made by the external auditors; and discuss with the external auditor the quality of accounting policies applied in the company's financial reporting.

Under role in oversight of regulatory compliance, the audit committee is expected to review the effectiveness of the system for monitoring

compliance with laws and regulations and the results of management's investigation and follow-up(including disciplinary action) of any instances of noncompliance; review the findings of any examinations by regulatory agencies, and any auditor observations; review the process for communicating the code of conduct to the company's personnel, and for monitoring compliance therewith; and obtain regular updates from management and the company legal counsel regarding compliance matters.

Under role in oversight of risk management, the Audit Committee is expected to review the company's policy for the oversight and management of business risks; oversee management's overall risk management strategy and ensure the required actions are taken; discuss risk management policies and practices with management; oversee the establishment and implementation of the company's risk management system; review trends on the company's risk profile, reports on specific risks and the status of the risk management process; monitor performance of management in implementing risk management responses and internal control rectification activities; ensure that there are appropriate systems for identifying and monitoring risks in place and that these are operating as intended; review the current areas of greatest financial risk and how these are being managed in the company; assess whether management has appropriate controls in place for unusual types of transactions and/or any particular transactions that may carry more than an acceptable degree of risk; review the effective functioning of the risk management system; review the effectiveness of the risk management processes and procedures applied; review the findings of internal audit on risk management; and review the findings of external audit on risk management.

Under reporting responsibilities, the Audit Committee is expected to regularly report to the board of directors about committee's activities, issues, and related recommendations; provide an open avenue of communication between internal audit, the external auditors, and the board of directors; report annually to the shareholders, describing the committee's composition, responsibilities and how they were discharged, and any other information required by rule, including approval of non-audit services; and review any other reports the company issues that relate to committee responsibilities.

Other responsibilities expected of the Audit Committee include performing other activities related to the Audit Committee's charter as requested by the board of directors; instituting and overseeing special investigations; reviewing and assessing the adequacy of the committee charter annually, requesting board approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation; confirming on annual basis that all responsibilities outlined in this charter have been carried out; and evaluating the committee's and individual members' performance on a regular basis.

### **Factors that Affect the Effectiveness of Audit Committees**

The mere presence of the audit committee does not necessarily translate into an effective monitoring body. As a result, there is the need to find out the factors that affect the performance of audit committees in order to put in place appropriate measures to ensure their effective functioning.

According to Dittenhofer (2001), for an audit committee to be effective, its roles and objectives must be stated in clear terms and the means

for achieving such objectives should also be provided. The effectiveness of audit committees is found to be affected by a number of factors. These among others include audit committee independence (Carcello & Neal, 2000; Klein, 2002), audit committee diligence (Abbott, Parker & Peters, 2004; Raghunandan, Rama, & Scarbrough, 2007), and audit committee financial expertise (Krishnan, 2005; Zhang, Zhou, & Zhou, 2007).

According to Chan and Li (2008), audit committees may be established but not function properly for a number of reasons. First, the board of directors may not fully recognize the importance of an audit committee. Second, an audit committee may have difficulties in coordinating with related parties. Third, an audit committee may be comprised of members who are not fully qualified and independent.

Empirical evidence (Hooghiemstra, 2000; Klein, 2002; Xie, Davidson & DaDalt, 2003; Abbott et al., 2004; Croes, 2013) suggest that the presence of independent/outside directors serving on the audit committee is related to higher audit committee performance in monitoring the financial reporting and internal control processes. A study by Chan and Li (2008) found out that independence of the audit committee (i.e. the presence of at least 50 percent independent directors on the audit committee) has a positive effect on its effectiveness.

The number of audit committee meetings in a year is considered to be an important attribute for their monitoring effectiveness (Lin, Li & Yang, 2006). According to Xie et al. (2003), an audit committee that meets more frequently with the internal auditors is better informed about auditing and accounting issues. When an important auditing or accounting issue arises, the

audit committee can direct the proper level of internal audit function to address the problem promptly. Therefore, an audit committee that meets frequently can reduce the possibility of financial fraud and are more effective (Raghunandan, Read, & Rama, 2001; Abbott et al., 2004). Inactive audit committees with fewer numbers of meetings are unlikely to supervise management effectively (Menon & Williams, 1994). According to Beasley, Carcello, Hermanson, & Lapides (2000), fraudulent firms with earning misstatements have fewer audit committee meetings than non-fraud firms. An active audit committee with more meetings has more time to oversee the financial reporting process, identify management risk and monitor internal controls. As a result, firm performance increases with audit committee activity.

The size of the audit committee is another characteristic considered to be relevant to the effective discharge of its duties (Cadbury Committee, 2002). A minimum of three audit committee directors has been proposed by a number of corporate governance reports (BRC, 1999; New York Stock Exchange, 2002; Capital Market Authority [CMA], 2006). It is argued that a larger committee has greater organizational status and authority (Kalbers & Fogarty, 1993; Braiotta, 2000) and a wider knowledge base (Karamanou & Vafeas, 2005).

On the expertise of the audit committee members, empirical evidence (McDaniel, Martin, & Maines, 2002; Xie et al., 2003; Carcello, Hollingsworth, Klein, & Neal, 2006) suggest that the presence of financially literate (both accounting and non-accounting types) members on the committee is related to higher monitoring performance of the committee.

Additionally, studies conducted by DeZoort (1998) and DeZoort and Salterio (2001) suggest that greater financial expertise of audit committee members leads to a more effective audit committee. Audit committee members who are financially literate are more effective in monitoring the integrity of a firms' financial report (Carcello et al., 2006; Carcello, Hollingsworth, Klein, & Neal, 2006). A study conducted by Cohen, Krishnamoorthy, & Wrigh (2002) revealed that the lack of financial expertise of audit committee members negates the effectiveness of the committee. For example, one manager in that study stated (p.19) "Sometimes members of the audit committee might not be the most appropriate people to be on the audit committee because they lack experience on financial matters."

In a similar note, Song and Windram (2000) posit that the financial literacy of audit committee members helps to reduce fraud in corporate financial reporting. A high degree of financial literacy is necessary for an audit committee to effectively oversee a company's financial control and reporting. Wong (2007) opines that the role of an audit committee in overseeing accountability of the management covers a wide scope to include the overall process of corporate reporting. This therefore requires the audit committee to have accounting knowledge in order to acquire an in depth understanding of financial reporting and improve compliance with regulatory requirements.

According to DeZoort and Salterio (2001), audit committee members with accounting and financial knowledge are more likely to understand auditor judgment. A study conducted by Gendron, Bedard and Gosseline (2006) revealed that audit committee members' extensive financial and accounting

background was significant in making their respective audit committees effective. The study therefore concluded that audit committee financial expertise was a major determinant of audit committees' effectiveness in the three firms studied. Another study conducted by Chon and Zhou (2012) to examine the effectiveness of audit committees in selected government firms in China also revealed a statistically significant relationship between financial background of audit committee members and the effectiveness of the various audit committees.

According to Atu, Omimi-Ejoor, Atu, & Abusomwan (2013), audit committees require the assistance and support of other stakeholders such as management together with pertinent information and resources to be efficient and effective in the performance of their duties. Audit committees rely on others to provide the financial reports, internal control assurance and independent audit opinion (Wong, 2007). It is only when major stakeholders play their part that it can be assured that the oversight function of the audit committee is effectively achieved. Being a sub-committee of the Board, its main partners include management, internal audit and external audit. It is essential that management, internal and external auditors as well as audit committees themselves work with a common purpose of improving financial reporting and greater effectiveness in internal controls. An informed, diligent and probing audit committee can enhance confidence in the integrity of business process by which entities are directed and controlled (Atu et al., 2013).

According to Mihret and Yismaw (2007), support from management in the form of resources and commitment towards the implementation of audit



committee's recommendations is essential in attaining committee's effectiveness. Also, the organizational setting in which audit committee operates, that is, the organizational status of the office, its internal organization and the policies and procedures applying to auditing in the organization can affect the smooth operations of the audit committee. Further, the capability, attitude, and level of cooperation among the audit committee members and other parties in the organization such as internal auditors can have significant impact on the effectiveness of the audit committee. Mihret and Yismaw (2007) further posit that the introduction of new technologies such as the invention of new computerized audit system poses challenges to audit staff. Therefore, the update of their knowledge to meet with these challenges is desirable. More so, the requirement of new auditing standards underpins the need for audit staff to update their knowledge and adjust to the current practice.

Krishnamoorthy, Wright, and Cohen (2012) conducted a study to examine the effectiveness of audit committees and financial reporting quality among the Big-5 firms in the United States using a total of forty-two auditors. The study revealed that although the audit committees in the various firms had enough power to confront management on contentious issues, management were, however, not committed in helping to resolve financial reporting issues and disputes. Thus, lack of management support was identified as a key factor that hindered the nature, extent and quality of the audit committee functions.

According to the Institute of Internal Auditors (2003), the goals of audit committees and internal auditing are closely intertwined and the ability of the audit committee and internal auditing to work together significantly

impacts the effectiveness of the audit committee in fulfilling its responsibility effectively to the board of directors, shareholders, and outside parties.

According to MacRae, and van Gils (2014), factors that promote the effectiveness of audit committees include independence of the committee in the conduct of its activities in accordance with set standards without management interference; clear terms of reference; complete and unrestricted access essential records and other resources on timely basis; sufficient staffing; competent leadership, thus a professionally qualified leader who has sufficient knowledge of applicable audit standards; objective staff, thus staff who have impartial attitudes and avoid any conflict of interest; competent staff; and support from other stakeholders.

### **Effectiveness of Audit Committees**

Effective audit committees are not merely formalities to receive lip service. They can be of significant help to governing boards in effectively performing their fiduciary and oversight roles in ensuring reliable financial reporting, reducing risk, and maintaining donor and public confidence (e.g. avoiding legal problems and preventing the negative consequences that inevitably result from financial fraud or irregularities).

More researchers have recently focus their attention on audit committee as one of the component of corporate governance (Chen, Duh & Shiue, 2008; Davies, 2009; Barua, Rama & Sharma, 2010; Alkdai & Hanefah, 2012), because an effective audit committee plays an important role in reducing corporate inefficiency (Owolabi & Dada, 2011). Consideration therefore needs to be given, particularly toward encouraging the effectiveness

of audit committees so as to enhance corporate effectiveness as the committee has been found to be one of the powerful bodies that can be used to bring better changes in an organization setting (Owolabi & Dada, 2011).

The effectiveness of audit committees has recently been a subject of increasing interests due to increased concerns about the quality of corporate financial reporting process caused by recent accounting scandals (Soliman & Ragab, 2010). According to Alhaji & Yusoff (2012), the role of audit committees and audit quality in ensuring the quality of corporate financial reporting has come under considerable scrutiny due to recent high-profile earnings management case in the world.

Also, the role of auditing, especially in ensuring the quality of reported earnings has come under considerable scrutiny due to recent corporate accounting scandals (Balsam, Haw& Lilien, 2003). According to Mihret and Yismaw (2007), an audit committee is considered to be effective when it is able to meet the intended outcome that it is supposed to bring about. Similarly, Badara and Saiden (2013) posit that audit committee effectiveness is the ability of the audit committee to achieve established objective within the organization. Owolabi and Dada (2011) emphasize that effective audit committee will definitely enhance reliable, dependable, effective and efficient corporate governance. According the authors, the introduction of audit committees in the corporate governance has led to reduction of corporate ineffectiveness.

Previous researchers have sought to find out the effectiveness of Audit Committees in the performance of their various roles. However, their results have so far been inconsistent. To start with, a study conducted by Lin (2006)

among listed Chinese firms revealed that various audit committees effectively performed their ceremonial roles and responsibilities in terms of lifting the image of good corporate governance, enhancing communication between board of directors (BoD) and auditors, and mediating conflict between management and auditors. However, the audit committees were found to be ineffective in the performance of their oversight roles and responsibilities in relation to improving internal control, legal compliance, sound corporate financial reporting and auditing processes. The study again revealed that most audit committees in the Chinese listed companies held no or few meetings with a very short meeting during the year. Further, it was revealed that audit committees in the Chinese listed companies were rarely involved in the decisions of appointing auditors or determining audit fees, and kept little contact with internal and external auditors. Overall, the study concluded that even though a large portion of Chinese listed companies (62 percent of the responding companies) have set up audit committees, the majority of the audit committees did not function effectively as their actual operations were far behind the standards in the USA, the UK and other western countries.

Another study conducted by Bartov, Gul and Tsui (2000) to examine the determinants of audit committee effectiveness revealed that firms with independent and financial literate audit committee members had their audit committees to be more effective than those with less independent and financial literate members. Krishnamoorthy et al., (2012) also conducted a study to examine the effectiveness of audit committees and financial reporting quality among the Big-5 firms in the United States using a total of forty-two auditors. Their findings of their study indicated that the audit committees of the various

firms were more effective in their oversight roles of financial reporting, external audit and internal audit compared to other roles.

Marx (2009) conducted a study in Ethiopia to assess the effectiveness of audit committees. The results of his study indicated that the audit committees of the selected companies were performing their traditional responsibilities of overseeing external audit, internal audit, financial reporting, internal control and risk management reasonably well, while to a lesser extent dealing with emerging issues such as sustainability reporting and ethics compliance

Chon and Zhou (2012) also conducted a study to examine the effectiveness of audit committees in selected government firms in China. Their results of their study revealed that 56.4% of the firms investigated did not have effective audit committees.

### **Relationship Between Audit Committees' Frequency of Meetings, Size, Independence, and Financial Expertise and Companies' Financial Reporting Quality**

Audit committees are increasingly taking responsibility for the quality of corporate financial statements. This has consequently directed research to focus on the performance of audit committees by examining the relationship between audit committees' characteristics (e.g. audit committee's independence, financial expertise and frequency of meeting) and financial reporting quality of firms (Beasley et al., 2000).

The main elements that determines a company's financial reporting quality as indicated by existing literature are the extent of alleged fraud and

misstatements and/or restatements (Song & Windram, 2000; Farber, 2005; Abbott et al., 2004; Archambeault & Archambeault, 2008); and earnings quality, thus quality of the reported financial figures (Kent, Routledge, & Stewart, 2010; Baxter & Cotter, 2009; Vafeas, 2005). However, with regard to this study, financial reporting quality refers to the extent to which financial reports are truthful and reliable.

Audit committees enhance the quality of financial reporting through the choice of quality auditors (Abbott et al., 2004). According to Medawaki (2013), the search for a mechanism to ensure reliable and high quality financial reporting has largely focused on the structure of audit committees whose function is to oversee the financial reporting process and audit financial statements. Prior studies have demonstrated a positive relationship between the existence of an audit committee and an organization's earnings quality. For instance, a study conducted by Baxter and Cotter (2009) in Southern Queensland revealed that earnings quality increased after the year of audit committee formation in the selected firms. Dechow, Sloan, and Sweeney (2006) also posit that firms with audit committee are less likely to manipulate earnings and are more likely to voluntarily disclose information. Improved financial reporting quality has also been cited as one of the major benefits for companies' establishing audit committees (Blue Ribbon Committee, 1999; Ho & Wong, 2001)

Evidence from the earnings management literature shows that an audit committee degree of independence and financial expertise have positive relationship with a firm's financial reporting quality (Klein, 2002; Xie et al., 2003; Bedard, Chtourou, & Courteau, 2004; Vafeas, 2005; Yang & Krishnan,

2005; Davidson, Goodwin-Stewart & Kent, 2005; Krishnan & Visvanathan, 2008; Koh & Woo, 2010; Kent, Routledge & Stewart, 2010; Croes, 2013). Other studies also suggest a positive relationship between the financial knowledge of audit committee members and the quality of firms' financial reports (McMullan, 1996; Beasley et al., 2000; DeZoort & Salterio 2001; Abbott et al., 2004; DeChow et al., 2006).

Abbott et al. (2004) assert that a more active and independent audit committee is associated with a decreased incidence of financial statement fraud. Beasley et al. (2000) in their 10-year span study to evaluate documented incidents of financial fraud found that firms that were involved in frauds generally had audit committees that were typically inactive and less independent of management. As reiterated by Krishnamoorthy et al. (2012), for the financial reporting process to be more effective, auditors' independence must be vigorously monitored. Independence of an audit committee helps to ensure that management is transparent and will be held accountable to stakeholders (Treadway Commission, 1987; Blue Ribbon Committee, 1999; Cadbury Committee, 2002).

Empirical studies by Davidson, Godwin-Stewart, and Kent (2005); Yang and Krishnan (2005); and Abbott et al. (2004) found that independent audit committee members are more objective and less likely to overlook possible deficiencies in the manipulation of financial reports, hence improving the financial reporting quality of a firm. Beasley et al. (2000) also posit that financial reporting quality is significantly related with an audit committee's independence and that financial statement fraud is more likely to happen in firms with less audit committee independence. However, other studies have

indicated the contrary. For instance, Xie et al. (2003) found no evidence of a significant relationship between the level of discretionary accruals and the independence of an audit committee. Similarly, Lin, Li, and Yang (2006) reported an insignificant and weak positive relationship between audit committees' independence and earnings quality. Additionally, Park and Shin (2004) in their study did not find any significant relationship between financial reporting quality and audit committees' independence for Canadian firms. More so, Abdulrahman and Ali (2006) did not also find any significant association between audit committees' independence and financial reporting quality of Malaysian firms.

Another characteristic of audit committees that has been found to be associated with financial reporting quality is the level of financial knowledge of the audit committee members. Song and Windram (2000) suggest that high level of financial literacy is needed for audit committee to effectively perform its oversight function of monitoring. The role of an audit committee in overseeing accountability of the management covers a wide scope, which include the overall process of corporate reporting. This demands the audit committee to possess accounting knowledge in order understand the financial report and make positive contribution that will lead to improved financial report. Financial literacy of audit committee member will go a long way to help in reducing fraud in corporate financial reporting.

Also, DeZoort and Salterio (2001) assert that audit committee members with accounting know-how are more likely to make better professional judgments than those without. Similarly, Xie et al. (2003), Abbott et al. (2004) and Bédard et al. (2004) posit that audit committee financial



expertise reduces financial restatements or constrains the tendencies of manager manipulating financial report. In effect, all of these authors suggest that financially knowledgeable audit committee members are more likely to prevent and detect material misstatements.

A study conducted by Madawaki (2013) to examine whether audit committees were associated with improved financial reporting quality for a sample of 70 companies listed on the Nigerian Stock Exchange revealed that formation of audit committees was positively associated with improved financial reporting quality. The study also found out that audit committees having an independent chair and audit committee members' financial literacy had a positive relationship with financial reporting quality. Similarly, Carcello et al. (2006) studied the association between financial expertise and earnings management proxy by abnormal accruals and found that high accounting and financial knowledge of audit committees' members are consistently associated with less earnings management. Dhaliwal, Naiker, and Navissi (2010) in their study also found a positive relationship between accounting/financial expertise of an audit committee and a firm's financial reporting quality.

According to Krishnan (2005), an audit committee that has financial expertise has greater interaction with their internal auditors and is less likely to witness internal control problems. Such an audit committee is more likely to understand external auditors and support them in conflict situations with the management. Krishnamoorthy et al. (2012) conducted a study to examine the effectiveness of audit committees and financial reporting quality among the Big-5 firms in the United States using a total of forty-two auditors. Their findings revealed that financial literacy/expertise, independence, and a strong

commitment to perform the job effectively were identified by the respondents as important attributes played a greater role in ensuring financial reporting quality in the firms. Nonetheless, a study conducted by Yang and Krishnan (2005) and Lin et al. (2006) did not find any significant positive relationship between an audit committee's financial expertise and financial reporting quality measured as the level of earnings management. Also, Baxter and Cotter (2009) investigated the relationship between audit committee expertise and financial reporting quality in Austral and US. They both found negative relationship between the audit accounting expertise and financial reporting.

The number of audit committee meetings has also been found to be an indicator of audit committee effectiveness. According to Ghafran (2013), financial statement users perceive fewer meetings as an indicator of less commitment and insufficient time to oversee the financial reporting process. It is also argued that effective control is unlikely to occur if an audit committee holds a single yearly meeting, or none at all (Deli & Gillan, 2000; Klein & Garcia, 2007). Abbott et al. (2004) opine that an audit committee that is independent, meets at least four times a year, and includes at least one member with financial expertise is negatively associated with the occurrence of earnings management. The authors therefore recommend that that an effective Audit committee should meet at least four times annually

Bryan, Liv, and Tiras (2004) posited that audit committees that meet regularly improve the transparency and openness of reported earnings and therefore improve earnings quality. Audit committees' members who meet regularly are often able to monitor a firms' financial reporting processes effectively and vice versa. Zhang, Zhou and Zhou (2007) in their study that

sought to examine the relationship between the number of meetings of an audit committee within a year and financial reporting quality found a positive correlation between the two variables. Vafeas (2005) also found a positive relationship between the number of meetings of audit committees and earnings quality.

Another study conducted by Ghafran (2013) to examine the impact of audit committee characteristics on financial reporting quality in the context of a large sample of UK companies over the period 2007-2010 showed that audit committee meetings and financial expertise have a significant positive relationship with financial reporting quality. That is, audit committees that meet three or more times per year and fully independent had a significant positive with the quality of reported earnings.

A recent study conducted by Dabor (2015) to examine the relationship between audit committee characteristics, board characteristics and financial reporting quality in the Nigerian banking sector revealed positive relationship between audit committee meetings and financial reporting quality. However the study revealed no significant relationship between audit committees' size and expertise and financial reporting quality. Dabor (2015) concluded that more frequent the audit committee meets, the more opportunity it has to discuss current issues faced by the company. However, studies conducted by Bedard et al. (2004) and Lin et al. (2006) did not find any significant positive association between the frequency of audit committee meetings and financial reporting quality.

Moreover, the size of an audit committee has been found to be an effective mechanism for monitoring and controlling financial reporting. Jensen

(2001) asserts that having a small number of audit committee members improves the efficiency of audit committee monitoring and control. In a similar vein, Lipton and Lorsch (2002) argue that large audit committees gives room for rowdiness which in turn lowers the monitoring function of the committee. Goodstein, Gautam, and Boeker (2004) posit that large audit committee size is associated with delays and administrative bottlenecks. Smaller audit committees are usually less encumbered with bureaucratic problems.

Notwithstanding, Anderson and Orsagh (2004) posit that large audit committees can devote more time and resources to monitor the financial reporting process and the internal control systems. That is, a large audit committee size enables members to distribute the workload and commit more time and resources to monitor management and detect fraudulent behaviour. Similarly, Monks and Minow (2011) are of the view that larger audit committees are able to commit more time and effort to monitor management. Also, Adams and Mehran (2002) argue that some organizations need larger audit committees for effective monitoring. Empirical evidence, however, suggest that audit committee's size is inversely related to a firm's financial reporting quality. For instance, studies conducted by Carcello and Neal (2004) and Farber (2005) found negative relationship between financial quality and audit committee size. Xie et al. (2003) in their study also reported an inverse relationship between the size of the audit committee and the quality of financial reporting

### **Summary of Literature Review**

The agency problem which is associated with the separation of ownership and control in addition to the formation asymmetry between management and absentee owners create the demand for an independent auditing body such as the audit committee. Audit committee is widely recognized as a senior board committee with "front line" governance responsibilities related not merely to financial reporting, but also to the oversight of continuous disclosure and corporate reporting. Audit committees are responsible for verifying that the financial statements are fairly stated in conformity with the appropriate regulatory standards and that these statements reflect the true economic condition and operating results of the entity. Thus, the independent auditor verification adds credibility to the company's financial statements. Therefore, a quality audit is expected to constrain opportunistic earnings management (Lin et al., 2006). From the above it is obvious that accurate, reliable and detailed reporting on the work undertaken by audit committees is essential in order for shareholders and stakeholders alike to obtain assurance from the audit committee function.

Although audit committees are already well established locally as well as overseas, limited empirical research has been done to date on the responsibilities and disclosure practices thereof in Ghana. In other words, there is paucity of research on AC's roles, responsibilities, and actual operations in Ghana, although much greater study efforts have been evidenced in the USA, the UK and other western countries over the last two decades. As indicated by Spira (2002), most of the studies that have been conducted in the area of audit committees used American data and, as a result, audit committee

literature could be described as a U.S. based literature. Marx (2008) as well as Kamel and Elbana (2012) assert that empirical evidence on the roles and effect of audit committee effectiveness and financial reporting quality in African so far been incredibly little.

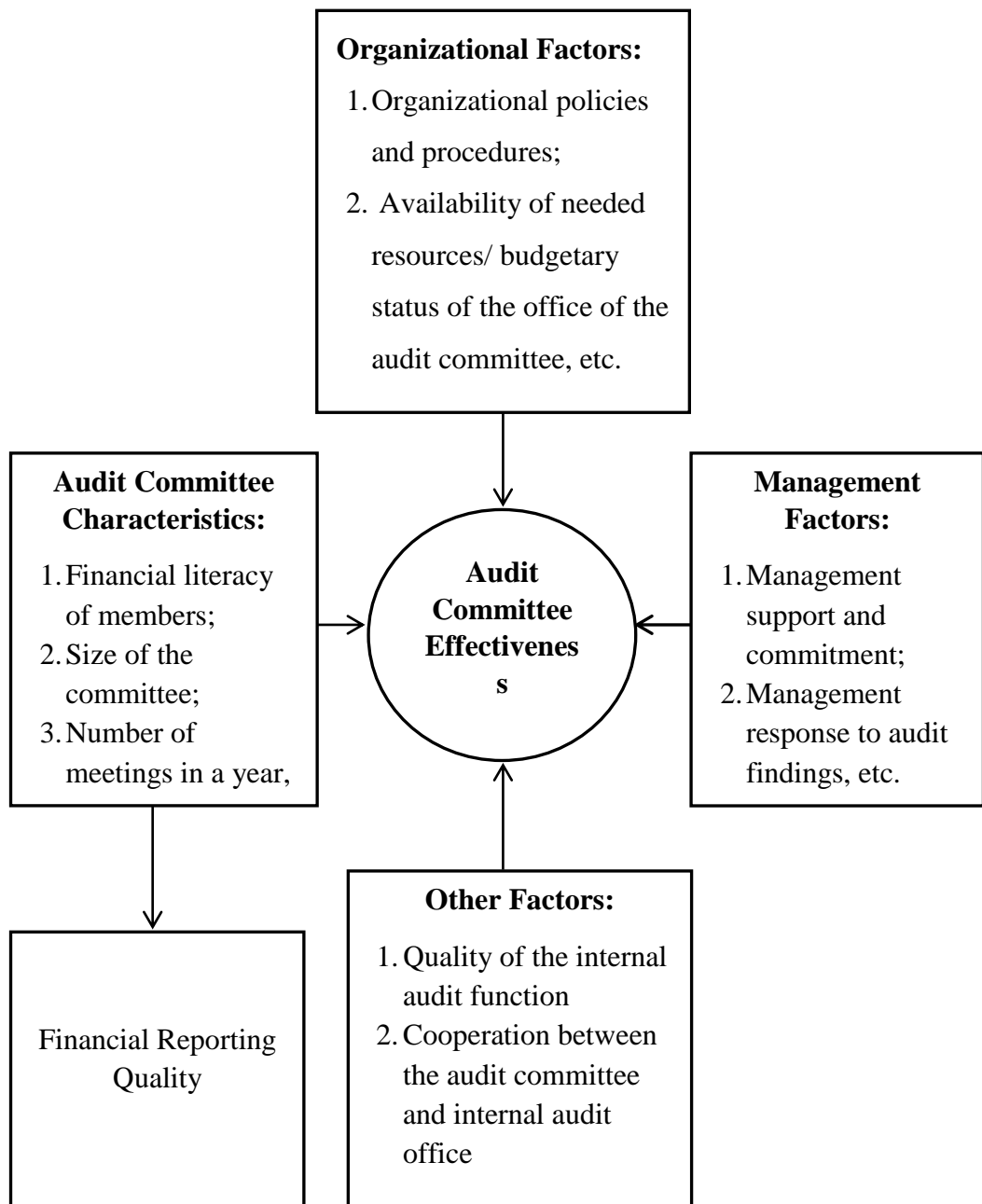
In order to promote effective functioning of the AC system in companies in Ghana, an empirical study on the effectiveness of audit committees is not only necessary but also worthwhile. Also, given the important role that an audit committee can play in the governance structure of the board regarding financial reporting, and control and risk management and other related aspects, there is a need for empirical data that can be used to assess current audit committee responsibilities and disclosure practices in order to provide a foundation for future recommendations. Moreover, members of the audit committee must clearly know and understand their roles within the organization to enable them function effectively.

Accordingly, the study seeks to examine the role effectiveness of audit committees in selected companies in Ghana.

## **Conceptual Framework**

As revealed by the extant literature, the effectiveness of an audit committee is influenced by a number of factors. These factors include the financial literacy of its members, number of meetings, the size of the committee, management support and commitment to the audit committee, the relationship between the audit committee and other auditing bodies like the internal audit and external audit, the organizational policies and procedure among others.

The organizational setting is also identified as one of the factors that affect the effectiveness of audit committees (Ghafran, 2013). Organizational setting refers to the organizational profile, internal organization and budgetary status of the internal audit office; and also the organizational policies and procedures that guide operation of the audit committee. It provides the context in which the audit committee operates. Thus, organizational setting can exert influence on the level of effectiveness that internal audit could achieve (Ghafran, 2013). The effectiveness of an audit committee is a dynamic process that results from the effect of each of the aforementioned factors. This is illustrated in Figure 1



**Figure 1: Conceptual Framework**

**Source:** Adapted with modification from Ghafran (2013)

As shown in Figure 1 (with boldface arrows), management support and commitment affect audit committee's effectiveness. Also, management commitment to implement recommendations by the audit committee improves the operations of the committee and thus makes them effective. Additionally,



favourable organizational setting characterized by policies and procedures that facilitate the operations of the audit committee will also add to the effectiveness of the committee and vice versa. Moreover, a good relationship between the audit committee and other stakeholders like the internal auditor(s) as well as audit committee members' financial literacy and other characteristics is also seen as having an effect on the audit committee's effectiveness. This study thus seeks to examine the effects of the aforementioned factors on the effectiveness of audit committees in the selected companies. The study will further determine the relationship between audit committees' frequency of meetings, size, independence, and financial expertise and companies' financial reporting quality.

## CHAPTER THREE

### METHODOLOGY

#### Introduction

This chapter deals with the research design, study area, population of the study, sample and sampling procedure, research instrument, data collection procedure and data analysis procedure.

#### Research Design

A research design is a conceptual structure which the researcher applies to the collection, measurement and analysis of data that is meant to be used in the investigation of the study problem (Kothari, 2004). It is needful for a researcher to have a research design as it facilitates the smooth sailing of the various stages within the research (Kothari, 2004). A research design tells whether the interpretations that are obtained can be generalized to a larger population or to different situations (Nachmias & Nachmias, 1996).

The case study research design adopted for this study. According to Yin (1984, p.23), “the case study research method is an empirical enquiry that investigates a contemporary phenomenon within its real-life context; when the boundaries between and context are not clearly evident; and in which multiple sources of evidence are used.” In other words, the case study research design excels at bringing people to an understanding of a complex issue or object and can extend experience or add strength to what is already known about a phenomenon or subject. The case study method involves the collection and presentation of detailed information about a particular participant or small group, frequently including the accounts of subjects themselves. A case study

looks intensely at an individual or small participant pool, drawing conclusions only about that participant or group and only in that specific context.

According to Cohen, Manion & Morrison (2007), case study as a research design focuses on individual actors or groups of actors, and seeks to understand their views of events. This study adopted the case study research design because the researcher wanted to really focus on respondents and seek their views and understanding regarding the issue considered in the study. Also, the case study research design helped the researcher to assess the real situation on the ground through an in depth study of the problem to find out in detail the main roles of audit committee and how effective they were in discharging their duties. More so, the case study research design was adopted because it enabled the conduct of a detailed analysis of a phenomenon (Soy, 1997).

### **Study Area**

The study was conducted among fifty-four (54) companies in Ghana. The companies were Ghana Commercial Bank Ltd; AngloGold Ashanti; Ghana Oil Company; Accra Brewery Company; Golden Star Resources; Fan Milk Limited; Goldfields Ghana Limited; Produce Buying Company; HFC Bank (Ghana); PZ Cussons Ghana; Unilever Ghana Limited; SIC Insurance Company; UT Bank; GN Bank; Total Petroleum Ghana; The Trust Hospital; RLG Communications; Zenith Bank Ghana Limited; Prudential Bank Limited; Azar Chemical Industries Limited; Benso Oil Palm Plantation Limited; Cadbury Ghana Limited; Ernest Chemist; Ghacem Ghana Limited; Ghana Rubber Estate Limited; Gihoc Distillery; Guinness Ghana Breweries Limited;

Kasapreko Company Limited; Kinapharma Limited; Latex Foam Rubber Products Limited; Nestle Ghana Limited; Norpalm Ghana Limited; Tarkoradi Gas Limited; Fiaseman Rural Bank Limited; Amenfiman Rural Bank Limited; Lower Pra Rural Bank Limited; Ahantaman Rural Bank; West African Mills Company Limited; Tema Lube Oil Company Limited; Tema Steel Company Limited; Amponsah Effah Pharmaceuticals; Special Ice; Ecobank Ghana Limited; Enterprise Life Insurance; Star Assurance Company Limited; Fidelity Bank Ghana Limited; Melcom Limited; First Allied Savings and Loans Limited; Guaranty Trust Bank; Glico Life; Quality Life Assurance Company Limited; Societe Generale Ghana; Regency Alliance Insurance Limited; and SBC Beverages Ghana Limited.

### **Population**

Best and Khan (1993) define a population as a “group of individuals that have one or more characteristics in common that are of interest to the researcher.” The population is “a group of people who are the focus of a research study and to which the results would apply” (Cardwell 1999, p.179). Thus, the population is the group to which the researcher would like to make inferences. It refers to all those who could possibly take part in a study. The target population for the study was all companies in Ghana that have audit committees.

### **Sample and Sampling Procedure**

A sample is a small set of a population that is used to draw conclusions about the bigger group. Sampling is the process of selecting a number of

individuals for a study in such a way that individuals represent the larger group from which they were selected. The study made use of a total of fifty-four (54) companies. The convenience sampling technique was adopted in obtaining the sample size for this study. This sampling technique was adopted due to insufficient time on the part of the researcher at the point of data collection. Hence, only more accessible companies whose audit committee members were available and willing to take part in the study were used as sample for the study. By using the convenience sampling technique, the researcher was able to achieve the desired sample size within the expected time frame. This further helped the researcher in gathering useful data and information that would not have been possible using probability sampling techniques, which have more rules governing how the sample should be selected.

### **Research Instrument**

Questionnaire was the instrument that was used for the study. Questionnaire was seen as an appropriate instrument for the data collection because of its ability to obtain large amount of information within an expected period of time without affecting the validity and reliability of the instrument (Gray, 2004). Also, questionnaire was considered appropriate because it is economical and requires less time to administer compared to other methods like face to face interview. Also, questionnaires were adopted because the respondents were all literate and could respond to the various questions without difficulties. It also gave the respondents adequate time to give well-thought out answers.

According to Oppenheim (1992), questionnaire is the best method by which reliable information can be obtained in a research of this kind; where the variable under investigation requires statement of fact and high level of confidentiality. Also, questionnaires helped in reducing bias that might result from the personal characteristics which is normally associated with interviews. One set of questionnaire was be used for the study. The questionnaire divided into six sections, thus Section A, B, C, D, E, and F. The items in Section A sought to obtain information on the demographic characteristics of the respondents. The other sections focused on the various research questions that guided the study. The questionnaire contained both open and close-ended questions. Respondents were required to respond by ticking the appropriate column and write their responses, where applicable.

### **Data Collection procedure**

The researcher obtained an introductory from the College of Distance Education, University of Cape Coast and presented it to the Chief Executive Officers or the head of the selected companies. This helped in clearing any doubt that the respondents might have developed about the research. With the help of the introductory letter, the research sought permission of the heads of the various companies to administer the questionnaire. Each respondent was given a copy of the questionnaire to complete at their own convenient time within a period of two days. This was to ensure that the respondents get enough time to respond to the questions. Completed questionnaires were collected by the researcher two days after it was given to a respondent. The collection was done during the companies' working hours.

### **Ethical Considerations**

Institutional approval for the study was sought from the companies before the study was conducted. Also, verbal consent was obtained from each respondent before he or she was made to take part in the study. The respondents were also assured of their anonymity as well as the confidentiality of the information they provided. The researcher further informed the respondents that the study was solely for academic purposes.

### **Pre-testing**

Pretesting of instrument was done using two companies not included in the study sample. pre-testing was done to check whether or not the various scales used in the questionnaire were reliable. It is also aimed at finding out the internal consistency of the various scales, thus the degree to which the various items measure the characteristics of interest. Apart from checking the reliability of the various scales, the pre-testing helped in making all the necessary corrections in the research instrument before the actual study takes place.

### **Data Analysis Procedure**

Data analysis is a whole process which starts immediately after data collection and ends at the point of processing and interpretation of results. The data that were collected from the respondents with the help of the questionnaires were first of all coded. In other words, numeric values were assigned to the various responses to the items on the questionnaire. After the coding, the data were then entered into computer-based statistical software,

Statistical Package for Social Sciences (SPSS) Version 21.0 for the windows operating system. The SPSS software was then used to analyse the data based on the objectives and research questions that guided the study. Tables and Figures were used to summarize the results that were obtained. The data were basically analysed through the following processes:

The first research question which sought to examine the roles that audit committees perform in companies in Ghana was analysed using descriptive statistics statistical procedure, precisely using frequencies and percentages. Frequencies and percentages were used to analyse this research question because the researcher was just interested in finding out the number and percentage of the respondents who responded YES or NO to the various roles of audit committees that were found on the questionnaire. This was to help in determining the roles that majority of the audit committees in companies in Ghana perform.

Also, the second research question which sought to assess the effectiveness of audit committees in the performance of the roles was also analysed using means and standard deviations. With this research question, the respondents were asked to rate the effectiveness of their company's audit committee on a scale of 1-10. The cut-point of the scale revealed a value of 5.5. Therefore, the decision rule was that any mean value less than 5.5 for a particular role implied that majority of the audit committees were ineffective when it comes to the performance of that role. On other hand, a mean value of 5.5 or more implied that majority of the audit committees were effective when it comes to the performance of that role. To determine the overall effectiveness of the audit committees when it comes to the performance of



their various roles, the mean of means value was also computed. With this also, a value less 5.5 meant that, in general, the audit committees were ineffective in the performance of their roles, while a mean value of 5.5 or more meant that the audit committees were generally effective in the performance of their various roles.

The third research question which sought to determine the factors that affect the effectiveness of audit committees was also analysed using means and standard deviations. Here also, the respondents were presented with a number of factors deemed to affect the effectiveness of audit committees. They were then asked to rate on a scale of 0-10, the extent to which each of the factors affects the performance of their company's audit committee. The cut point of the scale showed a value of 5. Hence, the decision rule was that any mean value less than 5 implied that majority of the respondents did not agree that a given factor affects the performance of their company's audit committee. On the other hand, a mean value of 5 or more implied that majority of the respondents agreed that a given factor affects the performance of their company's audit committee.

The last research question which sought to examine the relationship between audit committees' frequency of meetings, independence, and financial expertise and companies' financial reporting quality was analysed using the Spearman Rank Order ( $\rho$ ) correlation. The Spearman Rank Order ( $\rho$ ) correlation analyses was deemed appropriate for this research question because the data that were collected failed to meet some of the assumptions of parametric tests such normality, linearity and homoscedasticity. Also, almost all the data that were collected in relation to this research question were

ranked, making the Spearman Rank Order ( $\rho$ ) the most appropriate statistical procedure. Statistical significance of the relationship was tested at 0.05 level of significance. An alpha level of .05 or a confidence interval of 95% was adopted for testing the statistical significance of the relationship between the variables as it the level that is generally accepted for studies of this nature.

## CHAPTER FOUR

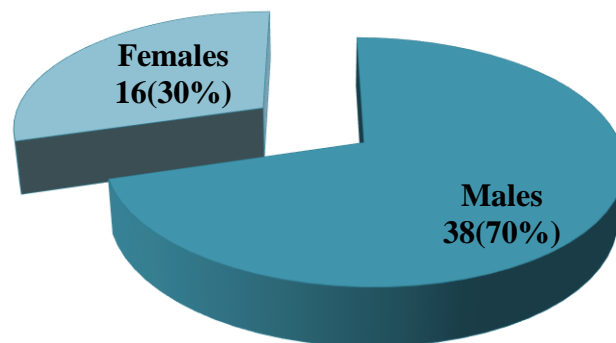
### RESULTS AND DISCUSSION

#### Introduction

This chapter presents and discusses the results of the study. The results are presented in accordance with the research questions that guided the study. Detailed discussion of answers to each research question has been presented. The presentation has been organized under two main headings. These are demographic information and analyses of the main data for the study.

#### Demographic Information

Section A of the questionnaire sought to obtain information on the respondents' demographic characteristics. The results are presented in Figure 2 and Table 1.



*Figure 2: Sex of respondents*

Results from Figure 2 show that majority 38(70%) of the respondents who took part in the study were males while the remaining 16(30%) were females. By implication, Audit Committee's membership within the selected companies is dominated by males.

**Table 1: Other Demographic Characteristics of Respondents**

| <b>Demographic Characteristic</b>                    | <b>Frequency (N)</b> | <b>Percentage (%)</b> |
|--|----------------------|-----------------------|
| <b>Highest Educational Qualification</b>             |                      |                       |
| First Degree   | 44                   | 81                    |
| Master’s Degree                                      | 8                    | 15                    |
| Doctorate Degree                                     | 2                    | 4                     |
| <b>Number of Years Served on the Audit Committee</b> |                      |                       |
| 1-3 years  | 7                    | 13                    |
| 4-6years   | 39                   | 72                    |
| Above 6years   | 8                    | 15                    |

Source: Field survey, Acquah (2016)

Results from Table 1 indicate that most 44(81%) of the respondents who took part in the study were holders of First Degree certificate. Holders of Master’s and Doctorate Degree made up 8(15%) and 2(4%) of the respondents respectively. The results imply that majority of Audit Committee’s members who take part in the study were First Degree holders.

Regarding the number of years served on a company’s Audit Committee, the results from Table 1 again shows that most 39(72%) of the respondents had served on their company’s Audit Committee for between 4-6years. Eight respondents representing 13% had served on their company’s Audit Committee for more than 6years while 7(13%) had served on the committee for between 1-3years. The results means that majority of the respondents who took part in the study were quite familiar with the activities of their company’s Audit Committee as they had served on the committee for quite a long time. Hence, all other factors being held constant, they were in a

better position to respond as accurately as possible to the various issues raised in the study.

### **Roles that Audit Committees Perform in Companies in Ghana**

Research question one sought to determine the roles that audit committees generally perform in companies in Ghana. The various roles expected of all audit committees were broadly grouped as follows: roles regarding financial reporting and accounting; roles regarding internal control; roles regarding internal auditor; roles regarding external auditor; roles regarding legal compliance; and roles regarding risk management. The results are presented in Table 2.

**Table 2: Roles that Audit Committees Perform in Companies in Ghana**

| Role  | YES |     | NO |    |
|---|-----|-----|----|----|
|   | No  | %   | No | %  |
| <b>Role in financial reporting and accounting</b>                               |     |     |    |    |
| Discusses potential emerging accounting issues                                  | 16  | 30  | 38 | 70 |
| Reviews annual financial statements before submission to the board of directors | 54  | 100 | -  | -  |
| Reviews the company's accounting policies                                       | 22  | 41  | 32 | 59 |
| Monitors integrity of financial statements                                      | 42  | 78  | 12 | 22 |
| Monitors choice of accounting policies and principles                           | 26  | 48  | 28 | 52 |
| Meets with management and external auditors to review financial statements      |     |     |    |    |
| <b>Role regarding internal control</b>  |     |     |    |    |
| Reviews effectiveness of the internal control system                            | 51  | 94  | 3  | 6  |
| Monitors the internal control process   | 23  | 43  | 31 | 47 |
| Monitors the effectiveness of the company's internal control                    | 52  | 96  | 2  | 4  |
| Review the findings of external audit on the internal control system            | 35  | 65  | 19 | 35 |

**Table 2 continued**

|   |    |     |    |    |
|---|----|-----|----|----|
| <b>Role Regarding the Internal Auditor</b>  |    |     |    |    |
| Review and approve the appointment and dismissal of the head of internal audit                  | 49 | 91  | 5  | 9  |
| Review the cooperation between internal and external audit                                      | 28 | 52  | 26 | 48 |
| Protect and enhance the independence of internal auditors                                       | 40 | 74  | 14 | 26 |
| Review and approve the annual internal audit plan and all major changes to the plan             | 51 | 94  | 3  | 6  |
| Review the effectiveness of the internal audit function   | 54 | 100 | -  | -  |
| <b>Role Regarding the External Auditor</b>  |    |     |    |    |
| Discusses the scope of external audit work  | 24 | 44  | 30 | 56 |
| Reviews the performance of external auditors  | 46 | 85  | 8  | 15 |
| Oversees the hiring, performance and independence of external auditors                          | 49 | 91  | 5  | 9  |
| Ensures that external auditors get unrestricted access to the audit committee                   | 44 | 81  | 10 | 19 |
| Always ensures that management responds to recommendations made by the external auditor(s)      | 23 | 43  | 31 | 57 |
| <b>Roles Regarding Legal Compliance</b>   |    |     |    |    |
| Monitors statutory audit of annual and consolidated accounts                                    | 24 | 44  | 30 | 56 |
| Obtains regular updates from management and company legal counsel regarding compliance matters. | 18 | 33  | 36 | 67 |
| Monitors the compliance with appropriate financial standards                                    | 42 | 78  | 12 | 22 |
| <b>Roles Regarding Risk Management</b>  |    |     |    |    |
| Review the company's policy for managing business risk  | 15 | 28  | 39 | 72 |
| Discuss with management the company's risk policies   | 20 | 37  | 34 | 63 |
| Constantly reviews areas of financial risk  | 28 | 52  | 26 | 48 |
| Review the effective functioning of the company's risk management system                        | 25 | 46  | 29 | 54 |

**Table 2 continued**

|  |    |    |    |    |
|--|----|----|----|----|
| Review the findings of external audit on risk management | 28 | 52 | 26 | 48 |
| Review trends on the company's risk profile              | 30 | 56 | 24 | 44 |

Source: Field survey, Acquah (2016)

Results from Table 2 show that when it comes to Audit Committees' (AC's) roles regarding financial reporting and accounting, majority of the Audit Committees in the selected companies perform the following roles: review annual financial statements before submission to the board of directors 54(100%), and monitors integrity of financial statements 42(78%). The above findings are in tune with a submission of the Canadian Institute of Chartered Accountants [CICA] (1992) that the specific responsibility of an audit committee is to review the annual financial statements before submission to the board of directors. Again, the findings concur with an assertion by Khamidullina (2012) that one of the primary roles of an AC is to assist the board of directors with the oversight of the integrity of the entity's financial statements and the entity's compliance with legal and regulatory reporting standards as well as performance and effectiveness of the entity's internal audit function and that of the independent auditors.

With respect to the committee's roles with respect to internal control, the results from Table 2 shows that majority of the Audit Committees in the selected companies review the effectiveness of their company's internal control system 51(94%), monitors the effectiveness of their company's internal control 52(96%), and review findings of external audit on the internal control system. Similar to the findings of this study, results of a study conducted by Collier (2002) to examine the incentives for the formation of Audit Committees in UK firms revealed that Audit Committees were

established principally to review a company's financial statements, the effectiveness of its accounting and internal control systems and the findings of external auditors.

The results of this study, however, show that majority of the Audit Committees do not monitor the internal control process 52(96%) though they do review and monitor the overall effectiveness of their company's internal control system. By implication, majority of the Audit Committees studied were not interested in the processes of their company's internal control, but their overall performance. However, a good result or performance usually comes from a well thought-out process; hence Audit Committees ought to be concerned with the processes of their company's internal control. This will help them correct any possible deviation that has the potential of crippling their companies.

In the area of the Audit Committee's roles regarding internal audit, results from Table 2 show that majority of the ACs do review and approve the appointment and dismissal of the head of their company's internal audit 49(91%), review the cooperation between internal and external auditors 28(52%), protect and enhance the independence of internal auditors 40(74%), review and approve the annual internal audit plan and all major changes to the plan 51(94%) as well as review the effectiveness of the internal audit function 54(100%). The findings corroborate findings of a study conducted by Davies (2009) that revealed that Audit Committees are responsible for measuring performance of the internal audit function; the appointment and dismissal of the heads of internal audit; and recommending the appointment and dismissal of external auditors. According to Enofe, Aronmwan, and Abadua, (2013),



Audit Committees serve as a bridge in the communication network between internal and external auditors and the board of directors. Similarly, Woolf (1997) opines that the appointment of an audit committee is intended to enhance the communication between the board of directors and both internal and external auditors.

When it comes to external audit, the results show that majority of the ACs review the performance of external auditors 46(85%), oversee the hiring, performance and independence of external auditors 49(91%), and ensure that external auditors get unrestricted access to the audit committee 44(81%). In line with the above findings, the American Institute of Certificate Public Accountants [AICPA](2009) posit that an audit committee is responsible for selecting an independent external auditor, and receiving and reviewing audit results. In a similar note, Enofe et al. (2013) assert that an Audit Committee helps in preserving auditor independence by resolving contentious issues between the auditor and the company's management. Additionally, the Canadian Institute of Chartered Accountants (2001) asserts that Audit Committees make it easier for auditors to retain their independence with clients.

Nonetheless, the results indicate that majority of the ACs fail to discuss the scope of external audit work 30(56%) and also do not always ensure that management responds to recommendations made by the Audit Committee 31(57%). These results are in variance with an argument by Dilworth (2000) that audit committees conduct a specific inquiry into the scope of and nature of work to be done by auditors.

Under legal compliance, the major role that majority of the ACs were found to be performing was the monitoring of companies' compliance with appropriate financial standards when it comes to financial reporting. Most of the ACs were, however, found not to monitor the statutory audit of their company's annual and consolidated accounts 30(56%) and also did not obtain regular updates from management and company's legal counsel regarding compliance matters 36(67%). Contrary to the findings of this study, European Commission [EC] (2006), posits that the primary duties and responsibilities of the audit committee in a company include among others the monitoring of the statutory audit of the annual and consolidated accounts.

Regarding Audit Committees' role vis-à-vis their company's risk management issues. The results from Table 2 show that majority of the ACs studied constantly review areas of financial risk 28(52%), review the findings of external audit on risk management 28(52%), and review trends on the company's risk profile 30(56%). Notwithstanding, majority of the ACs were found not be performing the following risk management functions: review of the company's policy for managing business risk 39(72%), discuss with management the company's risk policy 34(63%), and review the effective functioning of the company's risk management system 29(54%). The results imply that though most of the ACs studied were somewhat executing their roles in relation to risk management in their respective companies, the effectiveness of the existing risk policies and systems of their companies was not of much of a bother to them.

According to the UK Financial Reporting Council (2006), Audit Committees are to review a company's policy for the oversight and

management of business risks; oversee management's overall risk management strategy and ensure the required actions are taken; discuss risk management policies and practices with management; oversee the establishment and implementation of the company's risk management system; ensure that there are in place appropriate systems for identifying and monitoring risks and that the systems are operating as intended; review the current areas of greatest financial risk and how these are being managed in the company; assess whether management has appropriate controls in place for unusual types of transactions and/or any particular transactions that may carry more than an acceptable degree of risk; review the effective functioning of the risk management system; review the effectiveness of the risk management processes and procedures applied; review the findings of internal audit on risk management; and review the findings of external audit on risk management.

### **Effectiveness of Audit Committees in the Performance of Their Roles**

Research question two sought to examine how effective audit committees are in performing their various roles. With this, each respondent was asked to sincerely rate, on a scale of 1-10, the effectiveness of his or her company's Audit Committee (AC) in the performance of its roles with regard to the following areas: financial reporting and accounting, internal control, internal audit, external audit, risk management, and legal compliance. The measure of linearity of the scale showed a cut-point of 5.5. Therefore, any mean score which was less than 5.5 denoted that majority of the respondents rated that particular role as ineffective while a mean score equal to or greater

than 5.5 denoted that majority of the respondents rated that particular role as effective. The results are presented in Table 3.

**Table 3: Effectiveness of Audit Committees in the Performance of Their Roles**

| <b>Role</b>                     | <b>Mean</b>  | <b>Std. Deviation</b> |
|---------------------------------|--------------|-----------------------|
| Financial reporting             | 4.78         | 0.945                 |
| Internal audit                  | 7.34         | 0.134                 |
| External audit                  | 5.98         | 0.327                 |
| Internal control                | 6.81         | 1.267                 |
| Risk management                 | 3.50         | 1.290                 |
| Legal compliance                | 4.26         | 1.152                 |
| <b>Total Mean/ Std. Dev.</b>    | <b>32.66</b> | <b>5.115</b>          |
| <b>Mean of Means/ Std. Dev.</b> | <b>5.45</b>  | <b>0.8525</b>         |

Source: Field survey, Acquah (2016)

Results from Table 3 show that majority of the Audit Committees studied were effective in the performance of their roles regarding internal audit (Mean=7.34, SD=0.134), external audit (Mean=5.98, SD=0.327), and internal control (Mean=6.81, SD=1.267). However, they were found to be ineffective in the performance of their roles regarding the following areas: financial reporting and accounting (Mean=4.78, SD=0.945), risk management (Mean=3.50, SD=1.290), and legal compliance (Mean=4.26, SD=1.152). The mean of means revealed a value of 5.45 with a standard deviation of 0.8525. This means that, on the whole, the Audit Committees were ineffective in the performance of their roles.

In consonance with the findings of this study are findings of a study conducted by Lin (2006) among listed Chinese firms which concluded that even though a large portion of Chinese listed companies (62 percent of the responding companies) had set up audit committees, the majority of the audit committees did not function effectively as their actual operations were far behind the standards in the USA, the UK and other western countries. Another study conducted in China by Chon and Zhou (2012) revealed that most (56.4%) of the firms investigated did not have effective audit committees.

Similarly, a study conducted by Bartov et al. (2000) revealed that the Audit Committees were ineffective in the performance of their oversight roles and responsibilities in relation to corporate financial reporting, internal control, and legal compliance. However, unlike the findings of the study conducted by Bartov et al. (2000), the results of this study showed that the Audit Committees were effective when it comes to internal control. The findings of this study again lend credence to findings of a study conducted by Krishnamoorthy et al., (2012) among the Big-5 firms in the United States which revealed that the Audit Committees of the various firms were more effective in their oversight roles of external audit and internal audit compared to other roles.

Notwithstanding, the findings of this study are inconsistent with findings of a study conducted by Marx (2009) in Ethiopia which revealed that the Audit Committees studied were performing their traditional responsibilities of overseeing their company's financial reporting and risk management in addition to other roles reasonably well.

### Factors that Affect the Effectiveness of Audit Committees

Research question three sought to determine the factors that affect the effectiveness of audit committees in the selected companies. With this, the respondents were presented with a number of factors deemed to affect the effectiveness of audit committees. Each respondent was then asked to indicate the extent to which each of the factors as found in the questionnaire affect the effectiveness of the audit committee of his or her company on the scale of 0-10. The measure of linearity of the scale showed a cut-point of 5. Therefore, any mean score less than 5 denoted that effectiveness of audit committees is not affected by that factor while a mean score equal to or greater than 5 denoted that the effectiveness of audit committees is affected by that factor. The results are presented in Table 4.

**Table 4: Factors that Affect the Effectiveness of Audit Committees**

| <b>The effectiveness of your company's audit committees is affected by the following:</b>       | <b>Mean</b> | <b>Std. Deviation</b> |
|---|-------------|-----------------------|
| Ineffective internal audit system   | 2.28        | 1.134                 |
| Few number of meetings in a year  | 2.52        | 1.328                 |
| Poor financial literacy on the part of some members of the committee                            | 1.57        | 1.119                 |
| Low level of commitment on the part of some members of the committee                            | 3.51        | 0.461                 |
| Small size of the audit committee   | 2.63        | 0.502                 |
| Poor management support   | 7.79        | 0.211                 |
| Low level of management interest in the activities of the audit committee                       | 7.43        | 0.327                 |
| Poor commitment of management toward the implementation of audit committee's findings           | 7.76        | 0.133                 |
| Lack/insufficient training to keep members abreast of the current trends in auditing/accounting | 3.23        | 0.290                 |

**Table 4 continued**

|   |      |       |
|---|------|-------|
| Failure on the part of management to keep the committee abreast of changes to its business, regulatory environment, competitors, etc. | 5.11 | 0.989 |
| Lack of clear policies and procedures for the audit committee   | 1.49 | 0.716 |
| Poor internal organization of the audit committee office  | 1.22 | 0.012 |
| Lack/inadequate resources for the audit committee to effectively perform its function   | 6.12 | 0.479 |
| Wrong perception about the audit committee's function by other members in the company   | 5.56 | 1.051 |
| Poor communication between the audit committee and internal and external auditors   | 1.37 | 0.014 |
| Poor access to relevant internal audit records  | 1.01 | 0.469 |

Source: Field survey, Acquah (2016)

Results from Table 4 reveal that the effectiveness of ACs is affected by the following factors: poor management support (Mean=7.79, SD=0.211); low level of management interest in the activities of the audit committee (Mean=7.43, SD=0.327); poor commitment of management toward the implementation of audit committee's findings (Mean=7.76, SD=0.133); failure on the part of management to keep the committee abreast of changes to its business, regulatory environment, competitors, etc. (Mean=5.11, SD=0.989); Lack/inadequate resources for the audit committee to effectively perform its function (Mean=6.12, SD=0.479); wrong perception about the audit committee's function by other members in the company (Mean=5.56, SD=1.051).

The findings of this study show that most of the factors that affect the effective functioning of the Audit Committees are management related, principally in the area of management support and commitment. The findings

of this study support findings of another study conducted by Krishnamoorthy, Wright and Cohen (2012) among the Big-5 firms in the United States which revealed that lack of management support was as a key factor that hindered the nature, extent and quality of the audit committee functions.

According to Chan and Li (2008), one of the reasons for the ineffective functioning of an Audit Committee is the failure on the part of management and other employees to fully recognize the importance of the committee. This situation makes it quite difficult for the committee to get the needed from both management and other members of the organization for its effective functioning. Atu, Omimi-Ejoo, Atu and Abusomwan (2013) also opine that Audit Committee require the assistance and support of other stakeholders such as management together with pertinent information and resources to be efficient and effective in the performance of their duties. It is only when major stakeholders play their part that it can be assured that the oversight function of the audit committee is effectively achieved (Wong, 2007). It is therefore essential that management, internal and external auditors as well as audit committees themselves work with a common purpose of improving financial reporting and greater effectiveness in internal controls.

As reiterated by Mihret and Yismaw (2007), support from management in the form of resources and commitment towards the implementation of audit committee's recommendations is essential in attaining the committee's effectiveness. Also, the level of cooperation among the audit committee members and other parties in the organization such as internal auditors can have significant impact on the effectiveness of the audit committee.



The findings of this study stand in sharp contrast with findings of studies conducted by Xie et al. (2003) which revealed that the effectiveness of an audit committee is directly affected by the number of meetings that the committee holds in a year. According to the authors, an audit committee that frequently meets with the internal auditors is better informed about auditing and accounting issues. The findings are also in disagreement with findings of a study conducted by DeZoort and Salterio (2001) which revealed that greater financial expertise of audit committee members leads to a more effective audit committee. Another study conducted by Cohen, Krishnamoorthy and Wright (2002) revealed that the poor of financial expertise of audit committee members negates the effectiveness of the committee. Additionally, a study conducted by Gendron, Bedard and Gosseline (2006) concluded that audit committee financial expertise was a major determinant of audit committees' effectiveness in the three firms studied. However, in this study the effectiveness of the Audit Committees was found not to be affected by the financial expertise of the Audit Committees' members.

### **Relationship Between Audit Committees' Frequency of Meetings, Size, Independence, and Financial Expertise and Companies' Financial Reporting Quality**

Research question four sought to examine the relationship between audit committees' frequency of meetings, size, level of independence, and financial expertise and companies' financial reporting. A Spearman Rank Order Correlation ( $\rho$ ) was then conducted to examine the relationship between the aforementioned variables. A Spearman Rank Order Correlation

(rho) was adopted because analyses were performed showed some violation to of the assumptions of normality, linearity and homoscedasticity under parametric test, hence the need to adopt the non-parametric alternative. Also, the Spearman Rank Order Correlation (rho) was deemed appropriate almost all the data collected were in the form of ranks. The results of the Spearman Rank Order Correlation (rho) analysis are presented in Table 5.

**Table 5: Relationship Between Audit Committees' Size, Financial Expertise, Independence and Number of Meetings and Companies Financial Reporting Quality**

| Variable                                       |                         | Companies' financial reporting quality |
|--|-------------------------|--|
| Audit committees' size                         | Correlation Coefficient | -.017                                  |
|  | Sig. (2-tailed)         | .901                                   |
|  | N                       | 54                                     |
| Audit committees' financial expertise          | Correlation Coefficient | .034                                   |
|  | Sig. (2-tailed)         | .805                                   |
|  | N                       | 54                                     |
| Audit committees' independence                 | Correlation Coefficient | .111                                   |
|  | Sig. (2-tailed)         | .424                                   |
|  | N                       | 54                                     |
| Audit committees' number of meetings in a year | Correlation Coefficient | .053                                   |
|  | Sig. (2-tailed)         | .706                                   |
|  | N                       | 54                                     |

Source: Field survey, Acquah (2016)

Results from Table 5 show a weak and insignificant negative relationship between audit committees' size and companies' financial reporting quality ( $r=-.017$ ,  $p=.901$ ). Additionally, the results reveal a weak and insignificant positive relationship between the following variables: audit committees' financial expertise and companies' financial reporting quality ( $r=.034$ ,  $p=.805$ ); audit committees' level of independence and companies'

financial reporting quality ( $r=.111$ ,  $p=.424$ ); and audit committees' number of meetings in a year and companies' financial reporting quality ( $r=.053$ ,  $p=.706$ ).

The results imply that a larger audit committee size is somewhat associated with a lower level of financial reporting quality. However, the relationship is too weak to be considered significant ( $p>.05$ ). The results further imply that higher levels of audit committees' financial expertise, independence and meetings are associated with an increased financial reporting quality. Nevertheless, the relationship cannot be considered significant as all p-values were found to be less than .05.

The findings of this study are in incongruence with findings of a study conducted by Carcello and Neal (2004) and Farber (2005), which revealed a negative relationship between financial reporting quality and audit committee size. The results are also in consonance with a report by Xie et al. (2003) that there is an inverse relationship between the size of the audit committee and the quality of financial reporting. According to Jensen (2001), having a small number of audit committee members improves the efficiency of audit committee monitoring and control. Large audit committees give room for rowdiness which in turn lowers the monitoring function of the committee (Lipton & Lorsch, 2002). Goodstein, Gautam, and Boeker (2004) also posit that a large audit committee size is associated with delays and administrative bottlenecks. Smaller audit committees are usually less encumbered with bureaucratic problems. This, in turn, helps to improve the committee's effectiveness.

Also, the findings of this study are in tandem with findings of a study conducted by Lin, Li, and Yang (2006) when they reported an insignificant and weak positive relationship between audit committees' independence and earnings quality. Additionally, the findings lend credence to that of a study conducted by Park and Shin (2004) which did not find any significant relationship between financial reporting quality and audit committees' independence for Canadian firms. More so, Abdulrahman and Ali (2006) in their study among selected firms in Malaysia did not find any significant association between audit committees' independence and financial reporting quality of the firms. Contrary to the findings of this study, studies conducted by Klein(2002); Xie et al. (2003); Bedard, Chtourou, & Courteau (2004); Vafeas (2005); Yang and Krishnan (2005); Davidson, Goodwin-Stewart, & Kent, (2005); Krishnan and Visvanathan (2008); Koh & Woo (2010); Kent, Routledge, & Stewart (2010); and Croes (2013) revealed that an audit committee degree of independence have a significant positive relationship with firms' financial reporting quality.

With regard to the relationship between audit committees' financial knowledge/expertise and companies' financial reporting quality, the findings of this study are in support of findings of other studies conducted by Yang and Krishnan (2005) and Lin et al. (2006), which did not find any significant positive relationship between an audit committee's financial expertise and financial reporting quality. However, the findings of the current study disagree with findings of another study conducted by Baxter and Cotter (2009) in Austral and US, which revealed a negative relationship between audit committee expertise and financial reporting quality. Also, in disagreement

with the findings of the current study are studies conducted by McMullan (1996); Beasley et al. (2000); DeZoort and Salterio (2001); Abbott et al. (2004); and DeChow et al. (2006), which suggested a significant positive relationship between the financial knowledge of audit committee members and the quality of firms' financial reports (McMullan, 1996; Beasley et al., 2000; DeZoort and Salterio 2001; Abbott et al., 2004; DeChow et al., 2006). The findings of this study further contradict Beasley et al. (2000) claim that financial reporting quality is significantly related with an audit committee's independence and that financial statement fraud is more likely to happen in firms with less audit committee independence.

When it comes to the relationship the audit committees' number of meetings in a year and financial reporting quality, the findings of this study compares well with findings of studies conducted by Vafeas (2005) and Zhang, Zhou and Zhou (2007), which revealed a positive but insignificant correlation between the number of meetings of audit committees and earnings quality. Also in line with the findings of this study are studies conducted by Bedard et al. (2004) and Lin et al. (2006), which did not find any significant positive association between the frequency of audit committee meetings and financial reporting quality. Notwithstanding, the findings of this study stand in contrast with findings of a similar study conducted by Dabor (2015) which concluded that the number of meetings of an audit committee within a year has a significant positive relationship financial reporting quality. Also, in contrast with the findings of this study is another study conducted in UK by Ghafran (2013), which showed that audit committee meetings and financial expertise have a significant positive relationship with financial reporting

quality. That is, audit committees that meet three or more times per year and fully independent had a significant positive with the quality of reported earnings. However, in the current study, the relationship that was observed between the aforementioned variables was insignificant.

## CHAPTER FIVE

### SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

#### Introduction

This chapter deals with the summary of the research process, key findings, conclusions, recommendations as well as a suggestion for further research.

#### Summary of the Research Process

The main purpose of this study is to examine the role effectiveness of audit committees in selected companies in Ghana.

Specifically, the study seeks to:

1. examine the roles that audit committees perform in companies in Ghana.
2. assess the effectiveness of audit committees in the performance of their roles.
3. determine the factors that affect the effectiveness of audit committees.
4. examine the impact of audit committees' frequency of meetings, size, independence, and financial expertise on companies' financial reporting quality.

#### Key Findings

First of all, the study found out that the main roles that the Audit Committees studied perform are as follows: reviewing the annual financial statements before submission to the Board; monitoring integrity of financial statements; reviewing the effectiveness of companies' internal control system; monitoring the effectiveness of companies' internal control; reviewing findings of external audit on the internal control system; reviewing and

approving the appointment and dismissal of the head of companies' internal audit; reviewing the cooperation between internal and external auditors; protecting and enhancing the independence of internal auditors; reviewing and approving the annual internal audit plan and all major changes to the plan; reviewing the effectiveness of the internal audit function; reviewing the performance of external auditors; overseeing the hiring, performance and independence of external auditors; ensuring that external auditors get unrestricted access to the audit committee; monitoring the companies' compliance with appropriate financial standards when it comes to their company's financial report; reviewing areas of financial risk; reviewing the findings of external audit on risk management; and reviewing trends on the company's risk profile.

Also, the study found out that, on the whole, the Audit Committees studied were not effective in the performance of their duties though they were found to be performing quite a number of roles.

Additionally, the study found out that the effectiveness of ACs is affected by such factors as poor management support; low level of management interest in the activities of the audit committee; poor commitment of management toward the implementation of audit committee's findings; failure on the part of management to keep the committee abreast of changes to its business, regulatory environment, competitors, etc.; lack/inadequate resources for the audit committee to effectively perform its function; and wrong perception about the audit committee's function by other members in the company.



Last but not least, the study found a weak and insignificant negative relationship between audit committees' size and companies' financial reporting quality ( $r=-.017$ ,  $p=.901$ ). Also, a weak and insignificant positive relationship was found between the following variables: audit committees' financial expertise and companies' financial reporting quality ( $r=.034$ ,  $p=.805$ ); audit committees' level of independence and companies' financial reporting quality ( $r=.111$ ,  $p=.424$ ); and audit committees' number of meetings in a year and companies' financial reporting quality ( $r=.053$ ,  $p=.706$ ).

### **Conclusions**

The findings of this study therefore imply that:

Reviewing the annual financial statements before submission to the Board; monitoring integrity of financial statements; reviewing the effectiveness of companies' internal control system; monitoring the effectiveness of companies' internal control; reviewing findings of external audit on the internal control system; reviewing and approving the appointment and dismissal of the head of companies' internal audit; reviewing the cooperation between internal and external auditors; protecting and enhancing the independence of internal auditors; reviewing and approving the annual internal audit plan and all major changes to the plan; reviewing the effectiveness of the internal audit function; reviewing the performance of external auditors; overseeing the hiring, performance and independence of external auditors; ensuring that external auditors get unrestricted access to the audit committee; monitoring the companies' compliance with appropriate financial standards when it comes to their company's financial report;

reviewing areas of financial risk; reviewing the findings of external audit on risk management; and reviewing trends on the company's risk profile are the roles that the Audit Committees studied perform.

Also, much is left to be desired with regard to the effectiveness of the Audit Committees studied.

Additionally, the ineffectiveness on the part of the Audit Committees studied is essentially due to the following factors: poor management support; low level of management interest in the activities of the audit committee; poor commitment of management toward the implementation of audit committee's findings; failure on the part of management to keep the committee abreast of changes to its business, regulatory environment, competitors, etc.; lack/inadequate resources for the audit committee to effectively perform its function; and wrong perception about the audit committee's function by other members in the company.

More so, an audit committee's size, financial expertise, independence and number of meetings held in a year do have any significant relationship with a company's financial reporting quality.

### **Recommendations**

Based on the findings of this study, it was recommended that:

1. Management of companies should make the needed resources available to the Audit Committee of their company so as to enable the committee function effectively. In addition to this, management should provide other needed support to the committee and should be more committed in implementing the

recommendations by the committee. All these would help improve the effectiveness of the committee.

2. Also, other members of a company should be educated on the importance of having an Audit Committee within the company. This would help to dispel any wrong perceptions that they might have formed about the company's audit committee. When this is achieved, they would be more encouraged to throw their weight behind the Audit Committee in the performance of its various roles.
3. Companies should pay more attention to other factors that can affect the quality of their financial reports other than factors such as the frequency of their audit committee's meetings, size of their audit committee, financial expertise of their audit committee, and degree of independence of their audit committee. The reason is that the study did not find any significant relationship between companies' financial reporting quality and audit committees' frequency of meetings, size, financial expertise and degree of independence.

### **Suggestion for Further Research**

Based on the findings this study, it was recommended that a study should be conducted to determine the factors that affect the financial reporting of companies.

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**APPENDIX**  
**UNIVERSITY OF CAPE COAST**  
**COLLEGE OF DISTANCE EDUCATION**  
**QUESTIONNAIRE**

The purpose of this study is to examine the role effectiveness of audit committees in selected companies in Ghana. You will be contributing to the success of the study if could please respond to the various items of the questionnaire as honestly as possible. Your anonymity is greatly assured. Also, any information that you will provide will be treated with utmost confidentiality and used for the purpose of the study only.

Thank you.

**General Instruction: Please tick (✓) against the appropriate column or write your response, where appropriate in the spaces provided. Thank you.**

**SECTION A – Demographic Information**

1. Are you a male or a female? .....
2. What is your highest educational qualification? .....
3. How long have you served on this company’s audit committee? .....

**SECTION B: ROLES OF AUDIT COMMITTEES**

**Does the audit committee of this company perform each of the following roles? Please indicate your response by ticking[✓] the appropriate column.**

|    | <b>Role</b>   | <b>YES</b> | <b>NO</b> |
|----|---|------------|-----------|
|    | <b>Role in financial reporting and accounting</b>                               |            |           |
| 4. | Discusses potential emerging accounting issues                                  |            |           |
| 5. | Reviews annual financial statements before submission to the board of directors |            |           |

|     |   |  |  |
|-----|---|--|--|
| 6.  | Reviews the company's accounting policies   |  |  |
| 7.  | Monitors integrity of financial statements  |  |  |
| 8.  | Monitors choice of accounting policies and principles   |  |  |
| 9.  | Meets with management and external auditors to review financial statements                      |  |  |
|     | <b>Role regarding internal control</b>  |  |  |
| 10. | Reviews effectiveness of the internal control system  |  |  |
| 11. | Monitors the internal control process   |  |  |
| 12. | Monitors the effectiveness of the company's internal control                                    |  |  |
| 13. | Reviews the findings of external audit on the internal control system                           |  |  |
|     | <b>Role regarding the internal auditor</b>  |  |  |
| 14. | Reviews/approves the appointment and dismissal of the head of internal audit                    |  |  |
| 15. | Reviews the cooperation between internal and external audit                                     |  |  |
| 16. | Protects and enhance the independence of internal auditors                                      |  |  |
| 17. | Reviews and approves the annual internal audit plan and all major changes to the plan           |  |  |
| 18. | Reviews the effectiveness of the internal audit function  |  |  |
|     | <b>Role regarding the external auditor</b>  |  |  |
| 19. | Discusses the scope of external audit work  |  |  |
| 20. | Reviews the performance of external auditors  |  |  |
| 21. | Oversees the hiring, performance and independence of external auditors                          |  |  |
| 22. | Ensures that external auditors get unrestricted access to the audit committee                   |  |  |
| 23. | Always ensures that management responds to recommendations made by the external auditor(s)      |  |  |
|     | <b>Roles regarding legal compliance</b>   |  |  |
| 24. | Monitors statutory audit of annual and consolidated accounts                                    |  |  |
| 25. | Obtains regular updates from management and company legal counsel regarding compliance matters. |  |  |
| 26. | Monitors the compliance with appropriate  |  |  |

|     |  |  |  |
|-----|--|--|--|
|     | financial standards  |  |  |
|     | <b>Roles regarding risk management</b>                                   |  |  |
| 27. | Reviews the company's policy for managing business risk                  |  |  |
| 28. | Discusses with management the company's risk policies                    |  |  |
| 29. | Constantly reviews areas of financial risk                               |  |  |
| 30. | Review the effective functioning of the company's risk management system |  |  |
| 31. | Reviews the findings of external audit on risk management                |  |  |
| 32. | Review trends on the company's risk profile                              |  |  |

**Other roles, please specify** .....

.....  
 .....  
 .....

**SECTION C: EFFECTIVENESS OF AUDIT COMMITTEES**

Sincerely rate the effectiveness your company's audit committee on a scale of 1-10.

|     | <b>Role</b>                        | <b>Rate</b> |
|-----|------------------------------------|-------------|
| 33. | Financial reporting and accounting |             |
| 34. | Internal audit                     |             |
| 35. | External audit                     |             |
| 36. | Internal control                   |             |
| 37. | Risk management                    |             |
| 38. | Legal compliance                   |             |

**SECTION D: FACTORS THAT AFFECT THE EFFECTIVENESS OF  
AUDIT COMMITTEES**

On a scale of 0-10, sincerely rate the extent to which each of the following factors affect the effectiveness of your company’s Audit Committee.

|     | <b>The effectiveness of your company’s audit committees is affected by the following:</b>   | <b>Rate</b> |
|-----|---|-------------|
| 39. | Ineffective internal audit system   |             |
| 40. | Few number of meetings in a year  |             |
| 41. | Poor financial literacy on the part of some members of the committee  |             |
| 42. | Low level of commitment on the part of some members of the committee  |             |
| 43. | Small size of the audit committee   |             |
| 44. | Poor management support   |             |
| 45. | Low level of management interest in the activities of the audit committee   |             |
| 46. | Poor commitment of management toward the implementation of audit committee’s findings   |             |
| 47. | Lack/insufficient training to keep members abreast of the current trends in auditing/accounting                                       |             |
| 48. | Failure on the part of management to keep the committee abreast of changes to its business, regulatory environment, competitors, etc. |             |
| 49. | Lack of clear policies and procedures for the audit committee   |             |
| 50. | Poor internal organization of the audit committee office  |             |
| 51. | Lack/inadequate resources for the audit committee to effectively perform its function   |             |
| 52. | Wrong perception about the audit committee’s function by other members in the company   |             |
| 53. | Poor communication between the audit committee and internal and external auditors   |             |
| 54. | Poor access to relevant internal audit records  |             |

**Other factors, please specify** .....

.....

**SECTION E: CHARACTERISTICS OF AUDIT COMMITTEES**

55. What is the size (i.e. in terms of number) of this company’s audit committee? .....

56. How would you describe the level of financial expertise of your company’s Audit Committee members?

Very Low [ ] High [ ]

Low [ ] Very High [ ]

Average [ ]

57. How would you describe the degree of independence of your company’s audit committee?

Very Low [ ] High [ ]

Low [ ] Very High [ ]

Average [ ]

58. How many times does the audit committee of this company meet in a year? .....

**SECTION F: FINANCIAL REPORTING QUALITY**

On a scale of 1-10, sincerely rate the following as pertain to this company’s financial reporting?

|     | <b>Item</b>                                    | <b>Rate</b> |
|-----|--|-------------|
| 59. | Accuracy and truthfulness of financial reports |             |
| 60. | Reliability of financial reports               |             |

**Thanks for participating!**