



**AN EMPIRICAL INVESTIGATION INTO
AUDIT COMMITTEE PRACTICES IN
BANGLADESH: THE CASE OF COMPANIES
LISTED ON THE DHAKA STOCK
EXCHANGE (DSE)**

By
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DECLARATION

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This thesis is dedicated to my parents and my beloved wife.

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ABSTRACT

For several decades, the Audit Committee (AC) has been a subject of substantial research interest in developed countries including the U.S.A. and the U.K. However, this still remains a relative new topic in developing countries. In an attempt to examine the scenario of AC practices from the perspective of an emerging economy like Bangladesh, this study investigates the state of AC practices in the companies listed on the Dhaka Stock Exchange (DSE).

This study was undertaken through a questionnaire survey and an interview survey in order to collect the data. The respondents of these surveys consisted of four sample groups, namely: the AC Chairperson, the Company Secretary, the Head of Finance, and the External Auditor. The objective of the interviews was to complement the findings of the questionnaire survey by obtaining a greater insight into the issue.

The findings of the study indicate that the overall effectiveness of ACs in Bangladesh is not at a satisfactory level. More specifically, the observations made in the study include: (i) the ACs are mostly dominated by executive directors; (ii) the expertise (in terms of qualification and experience) of AC members is not at a satisfactory level; (iii) the AC members do not devote much time to the committee's affairs; (iv) the independent members of the committee are not adequately remunerated for the time and effort devoted to the company; and, (v) although the ACs are playing an important role in some areas including financial reporting, external auditing and internal auditing, there is still plenty of scope where the ACs can play a more proactive role. The study also found that the opinions of three sample groups namely, the AC Chairperson, the Company Secretary and the Finance Head were similar in most of the aspects of AC practices while the External Auditor group differed from the other three groups in some areas.

Furthermore, the current study identified areas that need improvement in order to obtain more effective services from the ACs in Bangladesh. These include: (i) lack of qualification of the AC members; (ii) lack of experience of the AC members; (iii) majority of executive members in the ACs; and, (iv) lack of diligence of the AC members.

The measures that can be taken to improve the effectiveness of ACs in Bangladesh include issues such as: (i) introducing new rules in relation to AC composition (in terms of minimum qualification and experience of AC members, and the number of independent members); (ii) enhancing the monitoring of compliance with the existing rules in relation to AC practices (instead of leaving them on a 'comply or explain' basis); and (iii) strengthening the internal audit functions of the company.

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LIST OF ABBREVIATIONS

AC	Audit Committee
ACCA	Association of Chartered Certified Accountants
ADB	Asian Development Bank
AGM	Annual General Meeting
AICPA	American Institute of Certified Public Accountants
BAS	Bangladesh Accounting Standard
BB	Bangladesh Bank
BDT	Bangladeshi Taka
BEI	Bangladesh Enterprise Institute
BOD	Board of Directors
BOI	Board of Investment
BRC	Blue Ribbon Committee
BSA	Bangladesh Standard on Auditing
CA	Chartered Accountants
CEO	Chief Executive Officer
CFA	Chartered Financial Analyst
CG	Corporate Governance
CIA	Central Intelligence Agency
CII	Confederation of Indian Industries
CIMA	Chartered Institute of Management Accountants
CLERP	Corporate Law Economic Reform Program
CMA	Certified Management Accountant
CSE	Chittagong Stock Exchange
DFID	Department for International Development
DSE	Dhaka Stock Exchange
EBRD	European Bank for Reconstruction and Development
FRC	Financial Reporting Council

FSU	Former Soviet Union
GCG	Good Corporate Governance
GCGF	Global Corporate Governance Forum
GDP	Gross Domestic Product
IAS	International Accounting Standard
ICAB	Institute of Chartered Accountant-Bangladesh
ICAEW	Institute of Chartered Accountants of England and Wales
ICB	Investment Corporation of Bangladesh
ICB	Investment Corporation of Bangladesh
ICMG	International Capital Markets Group
IFRS	International Financial Report Standard
IMF	International Monetary Fund
ISA	International Standard on Auditing
NACD	National Association of Corporate Directors
NASD	National Association of Securities Dealers
NYSE	New York Stock Exchange
OECD	Organisation for Economic Cooperation and Development
RDT	Resource Dependency Theory
RJSC	Registrar of Joint Stock Companies
SEBI	Securities and Exchange Board of India
SEC	Securities and Exchange Commission
VIF	Variance Inflation Factor

CHAPTER ONE: INTRODUCTION

1.1 Introduction

The attention on Corporate Governance (CG) has grown exponentially over the last two decades, especially after the major corporate collapses of some of the largest companies in the world (for example, Enron, WorldCom, Harris Scarfe, One.Tel, and Andersen). Its urgency has gained extra momentum because of the on-going global economic recession. In particular, CG is now a first order issue in most of the economies where firms are usually run by controlling shareholders (Albuquerque and Wang, 2008) and a growing numbers of companies are attempting to adopt better CG practices (Garay and Gonzalez, 2008). Its significance in terms of the overall value creation for the companies has been widely recognised by researchers. For example, Bryan et al. (2004); Chhaochharia and Grinstein (2007) and Dey (2008) highlighted that the value of a firm can be significantly affected by its CG rules and practices.

CG was traditionally known as the ways in which a firm safeguards the interests of its financiers; for example, its investors, lenders, and creditors. The modern definition, however, defines it as the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in the firm's relationship with its stakeholders; namely, the financiers, shareholders, customers, management, employees, government, and the community. This framework consists of: (i) explicit and implicit contracts between the firm and the stakeholders for the distribution of responsibilities, rights, and rewards; (ii) procedures for reconciling the sometimes conflicting interests of stakeholders in accordance with their duties, privileges, and roles; and, (iii) procedures for proper supervision, control, and information flows to serve as a system of checks-and -balances (Cadbury, 1992). The Organisation for Economic Cooperation and Development (OECD) Principles of CG states:

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate

governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. (OECD, 1999).

Researchers (such as: Genron and Bedard, 2006; Turley and Zaman, 2007; Sori et al., 2007; Osma and Noguer, 2007; and Mallin, 2010) highlighted the role of the Audit Committee (AC) as an important mechanism within the governance structure. The AC is an operating committee of a company's board of directors that is in charge of some oversight roles, including: financial reporting and disclosure; external auditing, internal auditing, and control. The committee acts as a liaison between the company's management, the board of directors, and the internal and external auditors. Millstein (1999) highlighted the evolution of ACs as a CG mechanism and pointed out that the movement to progress CG was initiated by the U.S. Securities and Exchange Commission's (SEC's) early focus on the structure and role of ACs. A growing number of recent studies (for example, Chen et al, 2008 and Beasley et al, 2009) also emphasised on the role of an AC in strengthening overall CG practices in the company. Klein (1998a) argued that if CG mechanisms are substitutable, then strong alternative CG mechanisms should mitigate the need for the firm to have an active and independent AC. The origin and further development of ACs took place mainly in the developed countries including, the U.S.A. and the U.K. and, therefore, much of the literature has been written about ACs in these countries (Vanasco, 1994; Goddard and Masters, 2000; Bedard and Gendron, 2010). Academically, there has been limited research on ACs, especially in the context of small emerging economies and no specific research, to the best of the researcher's knowledge, has been undertaken on AC practices in a Bangladeshi context.

Bangladesh has witnessed significant developments in every sector of its economy over the last two decades (as discussed in *Chapter Two*). These developments led to an increased perception of the importance of financial reports and their impact on the national economy as a whole. Some major steps have been undertaken to promote good governance practices within corporations; for example, the Security and Exchange Commission (SEC) issued a notification in 2006 with some guidelines for CG as well as

AC practices for joint stock companies listed on the two stock exchanges namely, the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE). However, despite its increasing importance, the scenario of AC effectiveness in Bangladeshi corporations remains to be studied. Therefore, this study specifically aims to conduct an empirical investigation into the practices of ACs in Bangladesh. This introductory chapter presents the background for the thesis and focuses on the following issues: research objective and questions (Section 1.2); rationale of the research (Section 1.3); methodology of the study (Section 1.4); the structure of the thesis (Section 1.5); and, conclusion (Section 1.6).

1.2 Research Objective and Questions

The objective of this research is to contribute to the understanding of the AC practices from the perspective of an emerging economy. To pursue this aim, the study solicits opinions of four important groups of respondents namely, (i) the AC chairpersons; (ii) the company secretaries; (iii) the finance heads; and (iv) the external auditors of the companies listed of the Dhaka Stock Exchange (DSE).

In line with the above objective, the study endeavours to answer the following research questions:

- (a) What is the current state of the AC practices in Bangladesh?
- (b) What are the main factors that affect the AC practices in Bangladesh?
- (c) What major steps can be undertaken to enhance the effectiveness of ACs in Bangladesh?
- (d) Is there any significant difference in the perception of different respondent groups in respect of the current state of AC practices in Bangladesh?

From the main research questions above, the following subsidiary questions are derived:

1. How are the AC members appointed?
2. To what extent do the AC members have required expertise in related areas including accounting/auditing?

3. To what extent do the AC members have sufficient experience?
4. To what extent do the ACs include independent/external directors?
5. To what extent is the size of ACs appropriate in performing their responsibilities?
6. To what extent are the ACs provided with sufficient resource?
7. To what extent are the ACs delegated required authority by the BoDs?
8. To what extent do the ACs have ready access to relevant information?
9. To what extent are the AC members willing to undertake (assume) their responsibilities?
10. To what extent do the AC members devote sufficient time to the committee activities?
11. How is the agenda of AC meetings chosen?
12. How often are AC meetings held?
13. To what extent can the AC members talk freely in AC meetings?
14. To what extent do the ACs play a role in financial reporting?
15. To what extent do the ACs play a role in external auditing?
16. To what extent do the ACs play a role in internal auditing?
17. To what extent do the ACs interact with external auditors/internal auditors/management of the company?
18. To what extent are the ACs independent?
19. To what extent are the ACs effective?
20. To what extent does the background of AC members affect AC effectiveness in Bangladesh?
21. To what extent does independence of ACs affect their effectiveness in Bangladesh?
22. Are the existing regulations in Bangladesh sufficient for effective AC practices?
23. What other measures can be taken to improve the effectiveness of ACs in Bangladesh?

1.3 Rationale of the Study

Generally, there has been limited research that specifically focuses on AC practice although it has been widely recognized as a very effective mechanism for ensuring good governance in corporate affairs. Pomeranz (1997) noted that very little is known about the actual practices of ACs and the majority of AC studies have been conducted in the context of developed countries including, the U.S.A., the U.K., Canada, and Australia (Bedard and Gendron, 2010). Therefore, the scenario of AC practices in emerging economies is still under-researched. For example, Tsamenyi et al. (2007) highlighted that, in contrast to the numerous studies on CG in developed countries, minimal research has been conducted in developing countries. The current study attempts to offer an insight into the AC practices in Bangladesh and underline the need for reform in this area. Thus, the study will contribute to the understanding of actual scenario of AC practices in developing economies and add to the knowledge in accounting.

Further, many studies such as: Kalbers and Fogarty (1993); Collier (1996); and, Collier and Gregory (1998) reported that little empirical research has been conducted to investigate actual effectiveness of ACs. Kalbers and Fogarty (1993), for instance, claimed that the formation of an AC does not provide evidence about the actual levels of monitoring that will be carried out. Sommer (1991) noted that a corporation having an AC as part of its governance structure and having an effective AC are, of course, different matters. Therefore, this study is intended to reinforce the idea that establishing an AC is one thing, but establishing an effective AC is another.

A final point on the significance of this research is its contribution to the literature in the field of AC effectiveness. Essentially, there has been very little research on the effectiveness of ACs, and their perceived role can be generally viewed as a 'vaguely unsuccessful, yet meritorious, endeavour to create a more level playing field for external and internal auditors, vis-a-vis operating management' (Pomeranz, 1997). Previous studies have discussed mainly two different frameworks of AC effectiveness. For example, DeZoort et al. (2002) proposed an AC effectiveness model which focuses on the input factors of AC (such as: composition, authority, resources, and diligence) while

Turley and Zaman (2004) explained an AC effectiveness framework, focusing on performing AC's roles (such as: roles in financial reporting, external auditing, and internal auditing) successfully. Some other researchers, however, examined the impact of the input factors of AC on the outputs such as: restatements (Abbott et al., 2004; Agrawal and Chadha 2005); fraudulent financial reporting (Beasley et al., 2000); going-concern reports (Carcello and Neal, 2000); auditor changes (Carcello and Neal 2003); and stock price reaction (DeFond et al., 2005). The AC process, or how AC members assess information and oversee activities (for example, procedure of AC meetings), has also been highlighted by some researchers (for example, Bedard and Gendron, 2010) as another important factor in developing a better understanding of AC effectiveness. Therefore, it will be more meaningful and significant if AC effectiveness is evaluated considering its input (e.g. composition), process (e.g. meeting), and output (e.g. role) dimensions. In line with this, the current study proposes an AC effectiveness model (in *Chapter Four*) considering all of these three dimensions, and investigates the effectiveness of ACs in Bangladesh accordingly. In light of the above facts, this study is necessary and will hopefully contribute significantly to the existing gap in the literature.

1.4 Research Methodology

A comprehensive review of the literature was undertaken in order to gain a thorough understanding on the subject of CG and AC in various countries. For example, in the U.K. the review included: Collier (1996); Windram (2000); Mallin et al. (2005); Chambers (2005); and Guest (2008). In the U.S.A. it included: Hawley and Williams (1996); Carcello and Neal (2003); Chen et al. (2008); Chan and Li (2008); DeZoort et al. (2008); Petra and Laukatos (2009); Krishnan and Lee (2009); and Beasley et al. (2009). In other economies such as: Australia, Nigeria, Bahrain, China, India, Pakistan and Bangladesh, the literature review included: Hussain and Mallin (2003); Allen (2005); Haron et al. (2005); Kiel and Nicholson (2006); Farooque et al. (2007); Lin et al. (2008); Jackling and Johl (2009); Ehikioya (2009); Lin and Liu (2009); Christopher et al. (2009); and Siddiqui (2010). A review of the prevailing CG environment in Bangladesh, focusing on the regulatory framework, has also been undertaken. In

addition, discussions were held with several Bangladeshi auditing and accounting practitioners and regulators. These discussions were conducted in an informal manner and in the form of an unstructured interview to facilitate the choice of modes for collecting data for this study. Following the feedback of these discussions and the methods used in similar previous studies, two stages of data collection process were deemed necessary to achieve the objective of the study.

The first stage of the data collection was the administration of a questionnaire survey to gather opinions from four separate (but important) sample groups on the current AC practices in Bangladesh. Creswell (2003) regarded survey design as a numeric description of the trends, attitudes, or opinions of the population. The questionnaire survey of this study aimed to acquire respondents' opinions on different aspects of AC practices on a 5-point Likert Scale. The broad areas of AC covered in the questionnaire included: composition, size, resources, authorities, diligence, meeting, and role. The questionnaire included some factors that affect AC practices in Bangladesh, as well as soliciting some suggestions from the respondents regarding how AC effectiveness can be improved in Bangladesh. This approach allows the researcher to identify important and emerging issues which require further explanation and insight, and this necessitated a second stage of the data collection process for this study.

The second stage involved semi-structured interviews which were undertaken after the completion of the first stage of data collection (i.e. the questionnaire survey). The prime aim of the interview survey was to complement the questionnaire survey findings as well as to gain a deeper understanding of the current state of AC practices in Bangladesh, which might not have been possible through the use of a questionnaire survey alone. Therefore, because of the unique features surrounding the research questions, and the context of this study, a combination of a quantitative and a qualitative approach was deemed necessary. Their use ensures that a comprehensive investigation has been made and that sufficient data has been collected to answer the research questions. Using both methods of data collection also enabled triangulation of the findings and made the research more robust and reliable.

1.5 Structure of the Thesis

The chapter by chapter outline of the thesis is illustrated in Figure 1.1. It is divided into eight chapters. The current chapter discussed the background and the rationale for the study, outlined the research objectives and briefly presented the research methodology to be used in the study. This chapter essentially draws attention to the need for comprehensive research into AC practices in Bangladesh. *Chapter Two* outlines an overview of the CG environment in Bangladesh, including a brief discussion of the economy and regulatory framework. *Chapter Three* reviews the research literature pertinent to CG and includes a discussion on the theoretical underpinning of the research, different CG models, and the AC's roles in the CG arena. *Chapter Four* evaluates the literature on various aspects of ACs such as: composition, process, roles, effectiveness, and developments of ACs. *Chapter Five* provides a discussion of the research methodology and design of the study. This chapter illustrates the two stages of data collection, namely the administration of the questionnaire survey and the conduct of the semi-structured interview surveys. The research hypotheses have also been described in this chapter. *Chapter Six* discusses the questionnaire survey findings in two parts namely, descriptive statistics and inferential statistics. *Chapter Seven* discusses the results of the interview survey and triangulates these with the findings of the questionnaire survey. Finally, *Chapter Eight* presents a summary of the thesis and highlights the major policy implications of the study. The chapter also admits some limitations of the study and guides the scope for further research.

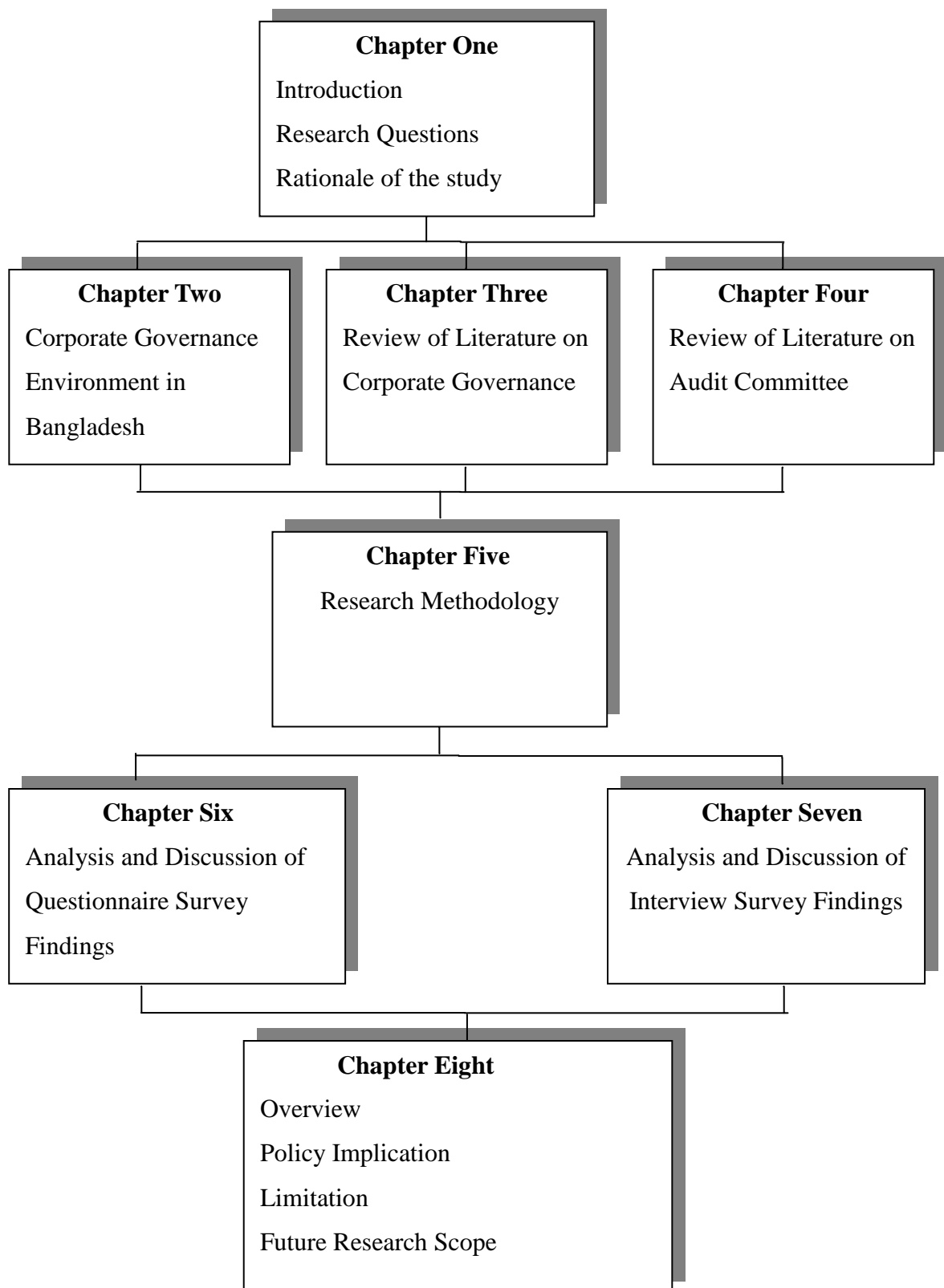


Figure 1.1: Outline of the Thesis

1.6 Conclusion

This introductory chapter highlights the background of the research and also gives a brief introduction to the research problem and research questions. The existing gap in the literature is illustrated and the rationale of the study has been highlighted. The chapter also justifies the research by pinpointing the lack of empirical research on the issue, its contribution to accounting knowledge, and its potential benefits to Bangladesh. At the end, the road map of how the thesis has been laid out is depicted and discussed.

Interestingly, Li and Harrison (2008) noted that country-specific factors heavily influence CG practices and, therefore, it is important to give a brief introduction to the prevailing CG environment in Bangladesh, including its economic condition and the regulatory framework in relation to CG practices. Therefore, the next chapter outlines the CG environment, particularly, the economic and regulatory environment present in Bangladesh.

CHAPTER TWO: THE CORPORATE GOVERNANCE ENVIRONMENT IN BANGLADESH

2.1 Introduction

Corporate Governance (CG) is strongly linked to the larger environment within which firms operate (LaPorta et al., 1998, 1999). In particular, CG environment of a country mainly encompasses its economy, capital market, and regulatory framework. This study deals with Audit Committee (AC) practice which is a key mechanism of CG arena, this chapter therefore, provides an overview on the current CG environment in Bangladesh. This chapter has been divided into seven sections. Section 2.2 presents an economic overview of Bangladesh and Section 2.3 discusses the capital market environment. The institutional framework of CG in Bangladesh is presented in Section 2.4. The CG regulatory environment in Bangladesh is discussed in Section 2.5 whilst the CG codes and guidelines for Bangladeshi companies are outlined in Section 2.6 and finally, Section 2.7 summarises the chapter.

2.2 Economic Overview

Bangladesh is considered to be one of the developing economies in South Asia. According to the gradation by the International Monetary Fund (IMF), Bangladesh in 2010 has significantly improved in terms of its economy size and was ranked the 44th largest economy in the world whereas it was ranked the 49th largest economy in 2009. The Bangladesh economy has grown at the rate of 6% to 7% annually over the past few years. Although more than half of the Gross Domestic Product (GDP) is generated through the service sector, nearly two-thirds of Bangladeshis are employed in the agricultural sector. In addition, garment exports and foreign remittances made a significant contribution to the economic growth of the country. A brief overview of the Bangladeshi economy is provided in the following subsections.

2.2.1 Economic History

East Bengal, a province of undivided India, was historically a prosperous region of South Asia. As early as the thirteenth century, the region was developing as an agrarian economy. In particular, Dhaka (now the capital city of Bangladesh) grew into an important commercial city during the Mughal Empire (1674-1818). After the partition of India and Pakistan in 1947, the united Pakistan's five-year plans opted for a development strategy which was based on industrialisation. But, the lack of natural resources meant that East Pakistan (now Bangladesh) was heavily dependent on imports, creating a balance of payments problem. Without a substantial industrialisation program, or adequate agrarian expansion, the economy of East Pakistan steadily declined. Following the violent events of 1971, which led to independence, the new nation had few experienced entrepreneurs, managers, administrators, engineers, or technicians. There were critical shortages of essential food grains and other staples because of wartime disruptions. External markets for jute had been lost because of the instability of supply and the increasing popularity of synthetic substitutes. The foreign exchange resources of the new state were minuscule, and the banking and monetary system was unreliable. The war of independence had crippled the country's major infrastructure, including the transportation system.

However, Bangladeshi leaders slowly began to turn their attention to developing new industrial capacity and rehabilitating its economy. In 1980's, government undertook some major economic policies (such as: privatising public industries, reinstating budgetary discipline, and liberalising the import regime) in order to encourage and attract private investment and accelerate the economic progress. In the late 1990s, the government's economic policies became even more entrenched and some of the early gains were lost, which was highlighted by a precipitous drop in foreign direct investment in 2000 and 2001. According to the World Bank Report, foreign reserves dropped markedly in 2001-2002, US\$1.58 billion on 30 June 2002. However, with a smooth and exponential growth thereafter, on 31 December 2010 total foreign reserves

stood at US\$10.70 billion¹, which is the 63rd largest reserve in the world. Therefore, it can be said that the aid-dependence of the country has significantly been reduced in recent years.

2.2.2 Gross Domestic Product Growth

GDP and its growth is a very powerful indicator of the economic condition of any country. The GDP of Bangladesh at market price along with its growth are shown in the following table.

Table 2.1: Analysis of GDP and its Growth (in GDP, Billion Bangladeshi Taka-BDT)

Description/Fiscal Year	2005-06	2006-07	2007-08	2008-09	2009-10
GDP (Market price)	4157.28	4724.77	5458.22	6147.95	6905.71 ²
GDP (Constant price)	3952.85	4424.59	5017.23	5771.52	6516.83
Growth Rate	6.63%	6.43%	6.19%	5.74%	6.02%

Source: Bangladesh Economic Review, 2009-10 and Bangladesh Bureau of Statistics, 2008-09

Table 2.1 shows that GDP has grown steadily over the last five years at a rate of 6% to 7%. The growth rate of GDP in 2009-10 was 6.02% and this was higher than that of some neighbouring countries including Myanmar (5.26%) and Pakistan (4.79%)³. It is important to note that even in years of on-going world recession; Bangladesh has been able to maintain a steady GDP growth rate. A sector wise breakdown is presented in Table 2.2 to give a better picture of the growth rate of GDP in Bangladesh.

¹ Source: "The World Fact Book: Reserves of Foreign Exchange and Gold", Central Intelligence Agency (CIA), U.S.A: January 31, 2011.

² USD 1= BDT 67.36 (June 30, 2006); 67.58 (June 30, 2007); 67.44 (June 30, 2008); 67.69 (June 30, 2009); and 67.97 (June 30, 2010), source: <http://www.gocurrency.com/v2/historic-exchange-rates.php?>

³ Source: GDP Growth Rate List by the Central Intelligence Agency (CIA) World Factbook, 2010.

Table 2.2: Analysis of GDP (in Billion BDT) and its Growth by Sector

Subsector	Description	2005-06	2006-07	2007-08	2008-09	2009-10
Agriculture and Forestry	GDP	622.23	701.24	802.01	894.26	993.32
	<i>Growth (%)</i>	5.23	4.69	2.93	4.10	4.36
Fishery	GDP	163.17	177.83	197.90	218.06	241.30
	<i>Growth (%)</i>	3.91	4.07	4.18	4.16	4.50
Mining and Quarrying	GDP	46.43	53.22	61.52	70.91	81.96
	<i>Growth (%)</i>	9.26	8.33	8.94	9.84	10.5
Industry (Manufacturing)	GDP	689.23	811.78	939.01	1064.45	1187.44
	<i>Growth (%)</i>	10.77	9.72	7.21	6.68	5.92
Electricity, Gas and Water	GDP	53.92	55.90	60.70	65.42	71.77
	<i>Growth (%)</i>	7.67	2.10	6.77	5.91	6.98
Construction	GDP	327.97	375.43	438.54	501.25	572.24
	<i>Growth (%)</i>	8.31	7.01	5.68	5.70	6.81
Wholesale and Retail Trade	GDP	569.84	660.11	782.20	882.76	982.16
	<i>Growth (%)</i>	6.75	8.04	6.82	6.21	5.30
Hotel and Restaurant	GDP	28.53	32.89	38.89	44.60	51.19
	<i>Growth (%)</i>	7.45	7.52	7.55	7.58	7.62
Transport, Storage and Communication	GDP	432.06	489.08	569.07	642.80	713.95
	<i>Growth (%)</i>	7.98	8.03	8.55	8.01	7.20
Financial Intermediations	GDP	66.84	77.44	89.55	102.45	115.95
	<i>Growth (%)</i>	8.50	9.18	8.89	8.99	8.35
Real Estate, Renting and Other Business Activities	GDP	321.57	349.29	380.58	416.16	456.00
	<i>Growth (%)</i>	3.69	3.76	3.75	3.81	3.84
Public Administration and Defence	GDP	110.36	127.43	144.27	163.60	199.30
	<i>Growth (%)</i>	8.15	8.41	6.21	7.01	14.90
Education	GDP	99.35	117.76	135.31	154.94	182.58
	<i>Growth (%)</i>	9.05	8.96	7.80	8.05	11.15
Health and Social Work	GDP	90.22	103.07	118.19	133.91	153.98
	<i>Growth (%)</i>	7.79	7.64	7.02	7.20	9.05
Community and Social Services	GDP	382.83	435.68	502.00	583.64	674.91
	<i>Growth (%)</i>	4.09	4.58	4.62	4.70	4.74

Table 2.2 shows that some sectors such as: Health and Social Work; Education; Financial Intermediaries; Public Administration and Defence; Transport and Communication; and Hotel and Restaurant grew at a steady rate of more than 7% in recent years. It must be noted however, that Bangladesh economy has not yet been able to achieve its long expected double digit GDP growth rate. This happened mainly because the slow growth of one large sector (i.e. Agricultural sector), and also decrease in the growth rate of another large sector (i.e. Industry and Manufacturing sector).

2.2.3 Savings

Savings tend to become investment in the country and therefore, it is a key indicator of an economy. The savings are of broadly two types, namely: domestic savings and national savings. A country's domestic saving is defined as household (private) saving as a percent of household sector disposable income, while national saving is the sum of the savings of both the private sector and the public sector. National saving is generally equal to a nation's income minus consumption and government purchases. Table 2.3 presents the rate of savings (as a percentage of GDP) for the recent five fiscal years.

Table 2.3: Analysis of Savings as a Percentage of GDP

Fiscal Year	Domestic Savings	National Savings
2005-06	20.25	27.67
2006-07	20.35	28.66
2007-08	20.31	30.21
2008-09	20.09	29.57
2009-10	19.78	29.65

Source: Bangladesh Economic Review, 2009-10

Table 2.3 shows that the domestic savings rate in Bangladesh is currently around 20%, and the national savings rate has generally been around 30% over the last five years. It is relevant to mention here that the national savings rate in Bangladesh is almost similar to that of India (around 30%) and higher than that of Pakistan (around 15%).

2.2.4 Investments

For economic development savings need to be invested and investment is therefore, another important economic indicator of a country. Table 2.4 presents the year wise rate of investment for the previous five fiscal years.

Table 2.4: Analysis of Investments as a Percentage of GDP

Fiscal Year	Total Investment	Govt. Investment	Private Investment
2005-06	24.65	6.00	18.65
2006-07	24.46	5.45	19.01
2007-08	24.21	4.95	19.26
2008-09	24.37	4.70	19.67
2009-10	24.35	4.62	19.74

Source: Bangladesh Economic Review, 2009-10

The above table shows that government investment declined from 6% to 4.62% of GDP in the last five years, while private investment has slightly increased. This slow down in investment mainly happened because of various political instabilities (including strikes, hartals, arrest of many political leaders and businessmen by then military dictated caretaker government etc.) during the period when the businessmen were reluctant to invest in Bangladesh.

From the above discussions, it can be concluded that since independence in 1971 Bangladesh has made significant economic progress with good standing major macroeconomic fundamentals such as: GDP, savings and investment. The GDP growth over the last five years consistently remained above 6 percent. The economy has shown remarkable resilience despite the losses caused by two consecutive destructive cyclones (i.e. ‘Sidr’⁴ in 2007, ‘Ayla’⁵ in 2008), and also the adverse effects arising from an

⁴ Cyclone Sidr was the strongest named cyclone in the Bay of Bengal. Sidr formed in the central Bay of Bengal, and quickly strengthened to reach peak 1-minute sustained winds of 260 km/h (160 mp/h), which would make it a Category-5 equivalent tropical cyclone on the Saffir-Simpson Scale. Save the Children and Red Crescent Society estimated that the number of deaths could be up to 10,000.

⁵ Cyclone Aila hit the Bangladesh / India border on Monday 25 May 2009 causing widespread destruction; millions of people have been affected.

unprecedented price hike of crude oil in the international market. The satisfactory growth of the import-export trade, an increasing trend in the flow of remittance, and the favourable balance of the current account have kept the external sector stable. As a result, the on-going global economic recession, as well as the earlier East Asian financial crisis of the 1990s⁶, did not have a significantly adverse impact on the economy of Bangladesh.

2.3 Capital Market

Recently, the capital market in Bangladesh has significantly expanded in terms of number of securities, trade volume, and market capitalisation. There are two stock exchanges in Bangladesh namely, the Dhaka Stock Exchange (DSE) and the Chittagong Stock Exchange (CSE). Basic laws that regulate capital market are: (i) Securities Act 1920; (ii) Securities and Exchange Ordinance, 1969; (iii) Securities and Exchange Commission Act 1993; (iv) Stock Exchange Transaction Regulations, 1998; and, (v) Depository Act 1999. The market is continuously monitored by a dedicated regulator: the Securities and Exchange Commission (SEC). The following subsections briefly discuss the role of these three key players in Bangladeshi capital market.

2.3.1 Securities and Exchange Commission

The SEC was established under the Securities and Exchange Commission Act. 1993 with the objective to ensure the compliance of capital market laws, rules and regulations by the intermediaries and persons and institutions related to the capital market. The chairman and members of the Commission are appointed by the government and have overall responsibility to administer securities legislation. The SEC is a statutory body and it is attached to the Ministry of Finance. Missions of the SEC include: (i) protecting the interests of securities investors; (ii) developing and maintaining fair, transparent and

⁶ Also called the "Asian Contagion", this was a series of currency devaluations and other events that spread through many Asian markets beginning in the summer of 1997. The currency markets first failed in Thailand as the result of the government's decision to no longer peg the local currency to the U.S. dollar. Currency declines spread rapidly throughout South Asia, in turn causing stock market declines, reduced import revenues and even government upheaval.

efficient securities markets; and (iii) ensuring proper issuance of securities and compliance with securities laws. The functions of the SEC are discussed in a later part of this chapter (subsection 2.4.1); however, the three main monitoring activities of the SEC are briefly discussed as following.

2.3.1.1 Market Categorisation

The stocks and securities listed both on the DSE and the CSE are categorised into five groups (namely, A, B, G, N and Z) on the basis of their profitability, operation, failure to hold an AGM, and accumulated losses. The SEC monitors whether the securities are categorised properly. The securities of a company that holds a regular AGM and has paid 10% or more in dividends in the previous financial year are placed in category 'A'. Category 'B' includes the securities of companies that hold a regular AGM but has paid less than a 10% dividend in the previous financial year. The companies which are yet to start their commercial operations are included in category 'G' and the newly listed companies up to their first AGM after listing are included in category 'N'. Finally, category 'Z' includes securities of those companies that do not hold a regular AGM, and/or has paid no dividend in the most financial year and/or has accumulated a loss which is higher than the paid up capital. This categorization helps the stakeholders in taking informed decisions by indicating the status of companies.

2.3.1.2 SEC Surveillance

The SEC has a surveillance system to ensure the protection of investors' interests and to safeguard the integrity of the markets. The SEC keeps a constant vigil on the activities of stock exchanges to ensure the effectiveness of the surveillance system.

2.3.1.3 Supervising Intermediaries and Resolving Complaints

The SEC supervises whether the capital market intermediaries (e.g. brokers/dealers/merchant banks etc.) and stock exchanges are operating according to the securities laws. Furthermore, it resolves the complaints received against issuer companies under the securities laws.

2.3.2 Dhaka Stock Exchange

The Dhaka Stock Exchange (DSE)⁷ was established in 1954 as the East Pakistan Stock Exchange Association Ltd. and it started formal trading in 1956. It was renamed as the Dhaka Stock Exchange Ltd in 1964. After the liberation war in 1971, trading was discontinued for five years due to a nationalisation policy, trading resumed in 1976. The DSE is a self-regulatory not-for-profit organization and supervises the functions of listed companies. Transaction and transfer of most of the securities listed on the DSE are now executed in electronic form. Number of total securities (including companies, debentures, mutual funds, treasury bonds, and corporate bonds), market capitalisation, and the general price index of the DSE in last five years are presented in the following table.

Table 2.5: Analysis of DSE Securities, Market Capitalisation, and Price Index

Description	June 30, 2006	June 30, 2007	June 30, 2008	June 30, 2009	June 30, 2010	Change 2009-10
Total Listed Securities	303	325	378	443	450	1.58%
Total Listed Companies	256	259	271	282	243	(13.83%)
Market Capitalization (Billion Taka)	215.42	475.86	931.03	1241.30	2700.74	117.57%
Market Capitalization as (% of GDP)	5.18	10.07	17.06	20.19	43.92	117.53%
General Price Index	1040.47	1764.18	2588.03	2520.15	5111.63	102.83%

Source: SEC Annual Reports of 2006-07; 2007-08; 2008-09; and 2009-10

It can be seen in Table 2.5 that the number of securities as well as companies listed on the DSE increased every year from 2006 till 2009. This was because new companies and securities were listed every year. It should be highlighted that the number of listed companies decreased by around 14% in 2009-10. This happened because a total of 35 companies were delisted from the DSE and sent to the ‘Over The Counter (OTC)’ market mainly for their non-compliance of the rules and regulations of the DSE and the SEC. The table also shows that the end of June 2010, the total market capitalization

⁷ The DSE is registered as a Public Limited Company and its activities are regulated by its Articles of Association rules & regulations and bye-laws along with the Securities and Exchange Ordinance, 1969, Companies Act 1994 & Securities & Exchange Commission Act, 1993.

amounted to a total 2700.74 billion taka, as opposed to 215.42 billion taka on 30 June 2006. It is important to note that market capitalization has significantly increased (more than 100%) in 2009-10. The total market capitalisation as of 30 June 2010 was 43.92% of the total GDP of that fiscal year, while it was only 5.18% in 2005-06. The general price index increased from 1040.47 to 5111.63 in the last five years, despite a slight decrease in 2008-09. The table reflects that the market capitalization and price index of the DSE have expanded at an unusually higher rate (more than 100%) in 2009-10.

2.3.3 Chittagong Stock Exchange

The Chittagong Stock Exchange (CSE) commenced operations in October, 1995. It is also a self-regulatory not-for-profit organization and its management structure is the same as that of the DSE. The CSE started the first on-line trading system in the Bangladesh capital market in 1998. The number of total securities and companies, and the price index of the CSE in the last five years are presented in the following table.

Table 2.6: Analysis of CSE Securities and Price Index

Description	June 30, 2006	June 30, 2007	June 30, 2008	June 30, 2009	June 30, 2010	Change 2009-10
Total Listed Securities	213	219	231	245	232	(5.31%)
Total Listed Companies	198	204	216	227	204	(10.13%)
General Price Index	2879.19	5194.77	9050.56	10477.67	18116.05	72.90%

Source: SEC Annual Reports of 2006-07; 2007-08; 2008-09; and 2009-10

Table 2.6 shows the similar picture of the CSE as was shown in Table 2.5 in relation to the DSE. The general price index increased from 2879.19 to 18116.05 in the last five years, and there was a 72.90% increase in 2009-10. The number of listed securities as well as companies declined because of the delisting of some companies from the stock exchanges as explained in case of the DSE.

2.4 Institutional Framework of Corporate Governance in Bangladesh

It is a widely accepted fact that institutions play a crucial role in shaping governance. A sound institutional framework is a precondition for good governance and a strong institutional set-up can foster accountability, transparency, equity and fairness (Farooque et al., 2007). Currently, in Bangladesh there is no strict CG rule for the companies to comply with. As discussed earlier, the SEC, the DSE, and the CSE are the three key players in Bangladeshi capital market. However, few other organisations such as: the Bangladesh Bank (BB), the Registrar of Joint Stock Companies and Firms (RJSC), the Investment Corporation of Bangladesh (ICB), play some important roles in this respect. Aside from these, the Board of Investment (BOI) provides some support services, while the Institute of Chartered Accountant-Bangladesh (ICAB) regulates financial reporting standards. In this regard, Bhuiyan and Biswas (2007) noted that the SEC, the BB, and the ICAB are some of the pioneer bodies working to ensure better CG in Bangladesh. The following subsections discuss the role of some of the key regulators who monitor CG practices within Bangladeshi corporations.

2.4.1 The Securities and Exchange Commission

As stated earlier, the SEC was established under the Securities and Exchange Commission Act, 1993. The SEC is a statutory body and it is attached to the Ministry of Finance. The main functions of the SEC include:

- Regulating the business of the Stock Exchanges, or any other securities market;
- Registering and regulating the business of stock-brokers, sub-brokers, share transfer agents, merchant bankers and managers of issues, trustee of trust deeds, registrar of an issue, underwriters, portfolio managers, investment advisers and other intermediaries in the securities market;
- Registering, monitoring, and regulating collective investment schemes, including all forms of mutual funds;
- Monitoring and regulating all authorised self regulatory organisations in the securities market;
- Prohibiting fraudulent and unfair trade practices in any securities market;

- Promoting investors' education and providing training for intermediaries of the securities market;
- Undertaking investigation and inspection, inquiries and audit of any issuer or dealer of securities, the Stock Exchanges and intermediaries; and,
- Conducting research and publishing information.

2.4.2 Stock Exchanges

Despite the fact that the majority of business corporations in Bangladesh are not listed on any of the stock exchanges (Uddin and Choudhury, 2008), the capital market appears to be dominated by the equity market, based on two stock exchanges: the DSE and the CSE. As already stated, the DSE was established in 1954 and the CSE started its operations in 1995. Both exchanges are self-regulated, private sector entities which must have their operating rules approved by the SEC. Each stock exchange: (i) establishes listing requirements; (ii) approves, suspends or removes listing privileges of companies; (iii) monitors listed companies in compliance with legal regulatory provisions; and, (iv) permits dual listing. The stock exchanges are registered as a public limited company. Their activities are regulated by its Articles of Association rules, regulations, and bye-laws, along with: the Securities and Exchange Ordinance, 1969, Companies Act 1994, and the Securities and Exchange Commission Act, 1993. The major functions of the two stock exchanges include:

- Listing of companies (as per the Listing Regulations);
- Providing the screen based automated trading of listed securities;
- Settlement of trading (as per the Settlement of Transaction Regulations);
- Market administration and control;
- Market surveillance;
- Monitoring the activities of listed companies (as per the Listing Regulations);
- Publication of a monthly review; and
- Announcement of price sensitive or other information about listed companies through online communication.

2.4.3 Bangladesh Bank

The central bank of Bangladesh (known as the BB) was established via the Bangladesh Bank Order, 1972 (P.O. No. 127 of 1972). The BB operates as a modern, dynamic, effective, and forward-looking central bank to manage the country's monetary and financial system, with a view to stabilising the internal and external value of Bangladeshi Taka conducive to rapid growth and development of the economy. To uphold the vision, and in pursuant with the Bangladesh Bank Order of 1972 the BB's mission is to promote and maintain macroeconomic and price stability through:

- Formulating and implementing appropriate monetary policy consistent with the country's national development goals;
- Pursuing prudent policies to ensure stable internal and external value of Taka;
- Identifying policy priorities for implementation by the government through assessing the transmission channels and the interactions of monetary policy with fiscal and other macroeconomic policies and their impact on the economy;
- Proposing necessary legislative measures to attain the central bank's objectives and perform its functions, including strategies and regulations for, and supervision of, banking companies and financial institutions, with the aim of providing efficient financial intermediation and financial services to large, medium, small, and micro enterprises and to pro-poor activities ;
- Giving advice to the government on the interaction of monetary policy with fiscal and exchange rate policies, on the impact of various policy measures on the economy; and,
- Analysing priority macroeconomic issues for policy advice, and the dissemination of information to attain the central bank's social responsibility.

2.4.4 Registrar of Joint Stock Companies and Firms

The RJSC is the sole authority which facilitates formation of companies and keeps track of all ownership related issues as prescribed by the laws in Bangladesh. It is primarily responsible for the registration of public limited companies. However, it also deals with the private companies, foreign companies, trade organisations, societies, and partnership

firms. The registered firms are legally obliged to send all financial and non-financial information to the RJSC, which in turn examines the level of compliance of the firm in accordance with the Companies Act, 1994, and other regulations. The Companies Act also empowers the RJSC to investigate any improper activities in connection with the violation of the act and to take disciplinary measures (ADB, 2003). The two major functions and activities of the RJSC are:

- To incorporate companies (including trade organisations), societies, and partnership firms under the respective Companies Act, 1994, Societies Registration Act, 1860 and Partnership Act, 1932; and,
- To administer and enforce the relevant statutory provisions of these acts in relation to the incorporated companies (including trade organisations), societies and partnership firms.

2.4.5 The Investment Corporation of Bangladesh

Institutional investors, being an important part of the capital market, can improve the transparency and accountability of the board and management, and protect both the firm's interests and those of the general investors. The Investment Corporation of Bangladesh (ICB) plays a pivotal role for the small and medium investors through mutual fund operations, investors' scheme, and portfolio management. The government controlled ICB was incorporated in 1976 under the Investment Corporation of Bangladesh Ordinance 1976. Since then, the ICB has expanded its operational scope in three broad areas: merchant banking, mutual fund operations, and stock brokerage activities. The ICB has floated 15 of a total of 31 listed mutual funds that currently exist in the stock markets. Chowdhury and Chowdhury (1998) observed that the ICB is making a significant contribution to the development of the country's capital market by creating both demand and supply of securities. The investors' account scheme of the ICB is an effort to create demand for securities in the capital market through mobilising the general investors' savings into that market. At the same time, it enhances the supply of attractive securities through the flotation of several mutual funds and unit certificates.

2.4.6 Board of Investment

The Board of Investment (BOI) was established by the Investment Bank Act of 1989 to promote and facilitate investment in the private sector, both from domestic and overseas sources, with a view to contribute to the socio-economic development of Bangladesh. It is headed by the Prime Minister and is a part of the Prime Minister's Office. Major functions of the BOI include:

- Providing necessary facilities and assistance in the establishment of industries;
- Implementing investment related government policies;
- Preparing the investment schedule;
- Registering private sector industrial projects; and,
- Identifying competitive investment sectors and facilitating investment by providing information and services.

2.4.7 The Institute of Chartered Accountants of Bangladesh (ICAB)

One of the most critical challenges of CG in Bangladesh is the absence of uniform standards in financial reporting and auditing practices, in both listed and non-listed firms. For example, a study of the World Bank and the IMF conducted by Rahman and Zannat (2003) identified the ‘compliance gaps’ between the applicable accounting standards and actual practices, as major weaknesses of corporate financial reporting. The study indicated that some auditing firms undercut others through compromising on the audit fees, and so violated the directives of the ICAB (ICAB, 2003). The ADB (2003) observed that the accounting standards and tax regulations appear to benefit controlling shareholders of the business groups in relation to maximising the profits and dividends of the controlling shareholders, redirecting profit (to other business units), to minimise overall tax liability, and to investing in the most profitable unit by ignoring the interests of the minority shareholders of the listed firm (or unit). In addition, Sobhan and Werner (2003) argued that these accounting standards do not require firms to disclose many financial and non-financial details, and so help firms to demonstrate a favourable picture. The study referred to the problems of auditing in Bangladesh as a ‘vicious circle’ where the firms and shareholders are reluctant to pay higher audit fees

while the audit firms find very little motivation to provide quality personnel and auditing with such low remuneration. Therefore, the statutory framework of accounting and auditing in Bangladesh needs to be strengthened in order to improve the investment climate, attract foreign investment, mobilise domestic savings, underpin securities market development, facilitate the healthy growth of financial markets, and enable regulatory bodies.

A professional self-regulatory body named 'the ICAB' was set up under the Bangladesh Chartered Accountants Order, 1973 with an aim to bring uniformity in accounting and auditing practice of the organizations. The ICAB regulates the auditing firms in line with the Bangladesh Chartered Accountants Order, 1973, Chartered Accountants Bye-laws, 1973, and the directives or decisions of the ICAB Council. Following the recommendation of the International Federation of Accountants (IFAC), the ICAB has adopted thirty-two International Accounting Standards (IASs) as Bangladesh Accounting Standards (BASs) and also eight International Financial Reporting Standards (IFRSs). The ICAB has also adopted thirty-six International Standards on Auditing (ISA) as Bangladesh Standards on Auditing (BSA). Based on the principles and best practices of the CG of the OECD and other developed and developing economies, the ICAB has developed codes of CG and recommended their inclusion in the Securities and Exchange rules (Ahmed, 2004).

2.5 Regulatory Environment

Shleifer and Vishny (1997) concluded that the legal protection of investors is an essential element of an effective CG system. CG is affected by: (i) legislative content, such as shareholder protection laws (La Porta *et al.*, 1998); (ii) judicial efficiency (Klapper and Love, 2004); and (iii) support for business (Klapper and Love, 2004), which are cumulatively described as regulation. To understand the corporate environment in any country, a review of the legal requirements relating to corporate entities is necessary. Despite the government's inability to legislate the personal integrity of key players (Walker, 2003), the pertinent legal system which significantly

varies around the world is a universally important CG mechanism in order to provide the protection of investors' rights (La Porta et al., 1998, 1999b, 2000; Cornelius, 2005). Major corporate laws and regulations governing the financial and non-financial firms in Bangladesh include: the Companies Act, 1994; the Bank Companies Act, 1991; the Financial Institutions Act, 1993; the Bangladesh Bank Order, 1972; the Bankruptcy Act, 1997; the Securities and Exchange Ordinance, 1969; the Securities and Exchange Commission Act, 1993; the Securities and Exchange Rules, 1987; the Insurance Act, 1938; Insurance Corporations Act, 1973; and the Income Tax Ordinance, 1984. Moreover, there are subsequent amendments of the above acts, together with numerous rules, schedules or notifications issued by the regulatory and professional bodies to exercise their supervisory and surveillance activities. Whilst the scope of these acts is briefly discussed in the subsequent sections, this section outlines the drawbacks of the existing Companies Act, along with the inconsistencies in the existing laws and regulations.

The Companies Act, 1994 (the Act) is the prime corporate law of the country that defines the operational boundaries for Bangladeshi firms with respect to their incorporation, governance principles, structures and responsibilities, and transparency and accountability. It governs a number of areas, including: the creation, functioning and dissolution of companies; the relationship of shareholders to a company; periodic disclosure and audit requirements; the functions of the RJSC; and, the jurisdiction of the courts in relation to companies. The Act defines the rights of both the majority and the minority shareholders. Shareholders are not intended to get involved in the day-to-day management of a company. However, the Act highlights some supervisory functions to be undertaken by the shareholders in the form of rights to attend meetings, appoint and remove directors, and to obtain financial information, as well as approve the balance sheet annually. The Act also provides various mechanisms for shareholders to enforce these rights. The principal mechanism is the ability to bring a suit for minority protection under Section 233 of the Act. It also establishes the overall power and responsibilities of the RJSC (and other regulatory bodies), and sets broader guidelines for the judiciary to make judgements on all corporate affairs.

The ADB (2003) identified various loopholes in the existing Companies Act, and made a number of recommendations for the Companies Act, 2004. The ADB observed the following deficiencies in developing and enhancing an appropriate environment for CG in relation to shareholder rights and board structures.

- The notice period for the annual general meeting (AGM) is too short; for example, generally 14 days and 21 days for special resolutions;
- Firms are given more flexibility to hold their AGMs, with negligible penalties for not holding them. Virtually, no authority is left to the SEC;
- In the absence of any provision on the place of the AGM the sponsors can choose to hold the meeting in remote areas so as to stop minority shareholders from attending;
- Provision of proxy voting can be made without requiring the issues of voting to be clearly explained in the proxy form;
- There is no provision for cumulative voting for the election of directors, or for minority representation on the board;
- A shareholder resolution is not needed for several corporate decisions, such as: related party transactions, large borrowing, anti-takeover devices and spin-off of a significant subsidiary;
- There are no provisions for having an Audit Committee (AC), an independent director, or a quorum for the directors' meeting;
- There is no measure to protect whistle-blowers from direct or indirect retaliation for reporting improper activities; and
- There are inadequate provisions for the procedure and timing for declaring dividends and for disciplinary measures for the non-payment of dividends.

While the Act remains outdated in the context of a dynamic corporate world, several positive legislative initiatives have recently been undertaken to give the central bank more authority and responsibility. For example, the Bangladesh Bank (Amendment) Act, 2003, the Bangladesh Bank (Nationalisation) (Amendment) Act, 2003, and the Bank Company (Amendment) Act, 2003, were approved by the Bangladeshi Parliament in order to redefine the roles and responsibilities of the BB, giving it more authority and

accountability for its activities. Moreover, the Money Laundering Prevention Act, 2002, and subsequent amendments appear to assign the BB with greater responsibility for preventing money laundering offences. Apart from the SEC, the BB plays an important role in the monitoring of CG practices within the country's financial institutes. In Bangladesh, financial sectors are subject to close monitoring and supervision by both the BB and the SEC. As a result, more restrictions are imposed on this sector while the non-financial sectors are, to some extent, a little more relaxed (Bhuiyan and Biswas, 2007).

However, the lack of consistency and compatibility amongst various corporate laws and regulations remains critical to the development of CG. The inconsistent laws, and overlapping of powers and responsibilities, tend to be major deterrents for the regulatory agencies to exercise their monitoring and surveillance activities. This, in turn, makes the financial reporting and auditing practices of some firms more problematic; this is especially true for the banks, leasing, and insurance companies that operate under multiple regulators. In reality the government cannot legislate the personal integrity of key players (Walker, 2003), and no amount of legislation can substitute for the trust, faith, and confidence necessary for Good Corporate Governance (GCG) practices (Chaudhury, 2004). As the lead regulatory body overseeing corporate accounting and reporting, the SEC has a critical role to ensure that public company boards are properly structured and organised. It also has the responsibility to ensure that it has the resources to accomplish the objectives of adding value to shareholders, minimising the risk of the key shareholders, and it should hold management responsible for corporate results (Walker, 2003).

2.6 Corporate Governance Guidelines in Bangladesh

Although no remarkable corporate scandals have so far emerged in Bangladesh to demonstrate the necessity of CG, the stock market crashes in 1996⁸ (which left investors

⁸The DSE all shares price index rose to 3648.75 on 5th November, 1996 starting from 865 on 1st June, 1996- 322% increase within a space of only 158 days. The Market Capital that was Tk. 56.52 billion by

wary of the capital market for many years) and recently in 2011⁹ are worth remembering. Although there is no recognized CG code in Bangladesh, a complete code of CG was developed for Bangladeshi companies by Bangladesh Enterprise Institute (BEI)¹⁰ in 2003, with direct support from: the Department for International Development (DFID), the Commonwealth Secretariat, and the Global Corporate Governance Forum (GCGF). Subsequently, the ICAB came up with a series of CG principles and rules to be followed (Mazumder, 2006). The code for CG practices developed by ICAB was based on the OECD principles of CG (discussed in *Chapter Three*) and other best practices (Ahmed, 2004). Furthermore, in 2006 the SEC issued a notification (as an order) included some CG guidelines for the companies listed on the stock exchanges. These guidelines are very similar to the guidelines in the CG code that was developed by BEI and ICAB.

2.6.1 Code of Corporate Governance for Bangladesh

In August 2003 the Bangladesh Enterprise Institute (BEI) invited a number of prominent individuals from the private sector, the government, NGOs, and other relevant bodies to begin the process of formulating a code of CG for Bangladesh. Convening this taskforce on CG was an outcome of BEI's research and advocacy work on strengthening CG practices in Bangladesh. Members of the taskforce provided essential guidance and direction to the development of the new code. In addition, distinguished guest experts were invited to certain taskforce meetings and they provided invaluable input and expertise on specific aspects and sections of the code. The code of CG, therefore, prescribes the principles, procedures, and process through which better

end 1995 reached Tk. 168.11 (137% increase) by end 1996 (Mazumdar, 2006).

⁹ The DSE all price share index fell down by 41.66% within a spate of less than 3 months (i.e. DSE General Price Index fell down from over 8918.51 (December 05, 2010) to 5203.08 (February 28, 2011).

¹⁰ The Bangladesh Enterprise Institute (BEI) was established in 2000 as a non-profit research centre focusing on the growth of private enterprise in Bangladesh. It promotes and articulates issues of importance to the private sector and seeks to influence policy and to initiate measures crucial to the development of a market-oriented economy as well as to promote the sustainable growth of trade, commerce and industry. In 2003, the BEI formulated a Code of Corporate Governance for Bangladesh with the assistance from some international donors, namely: the Department for International Development (DFID), the Commonwealth Secretariat and the Global Corporate Governance Forum (GCGF).

CG practices may gradually be introduced. As such, the code is organised into principles and guidelines. Organisations can start on the path to better CG first by acknowledging the principles of CG and then incorporating them through their own initial implementation strategies, which they must nevertheless justify and explain. Siddiqui (2010) noted that, consistent with CG codes in other parts of the world, the BEI CG code incorporated notions of independent directors, separation of the chairman and the CEO, and the institution of an audit committee. The CG guidelines given by the BEI and the ICAB recommend a single tier board structure (where the directors are elected by the shareholders), the presence of independent directors on the board, and the separation of the chairman and the CEO.

2.6.2 SEC Guidelines on Corporate Governance

One of the most recent and significant developments in CG in Bangladesh is SEC's notification no. SEC/CMRRCD/2006-158/Admin/02-08 (issued on 20 February 2006) where detail guidelines on company's board and AC in terms of their size, membership, chairmanship, reporting authorities, and responsibilities are stated. The companies have to either comply with these guidelines or explain for their non-compliance. Both stock exchanges have also included these guidelines in their respective listing requirements. These guidelines are presented in detail as following:

1.00 BOARD OF DIRECTORS:

1.1. Board's Size

The number of board members of the company should not be less than five, and not more than twenty.

Provided, however, that in the case of banks and non-bank financial institutions, insurance companies and statutory bodies for which separate primary regulators like Bangladesh Bank, Department of Insurance etc. exist, the board of those companies should be constituted as may be prescribed by such primary regulators in so far as those prescriptions are not inconsistent with the aforesaid condition.

1.2. Independent Directors

All companies should encourage effective representation of independent directors on their board of directors so that the board, as a group, includes core competencies considered relevant in the context of each company. For this purpose, the companies should comply with the following:

- (i) At least one tenth (1/10) of the total number of the company's board of directors, subject to a minimum of one, should be independent directors.
- (ii) The independent director(s) should be appointed by the elected directors.

1.3. Chairman of the Board and Chief Executive

The positions of the chairman of the board and the chief executive officer of the companies should preferably be filled by different individuals. The chairman of the company should be elected from among the directors of the company. The board of directors should clearly define respective roles and responsibilities of the chairman and the chief executive officer.

1.4 The Directors' Report to Shareholders

The directors of the companies should include following additional statements in the directors' report prepared under section 184 of the Companies Act, 1994:-

- (a) The financial statements prepared by the management of the issuer company present fairly its state of affairs, the result of its operations, cash flows and changes in equity.
- (b) Proper books of account of the issuer company have been maintained.
- (c) Appropriate accounting policies have been consistently applied in preparation of the financial statements, and that the accounting estimates are based on reasonable and prudent judgement.
- (d) International Accounting Standards, as applicable in Bangladesh, have been followed in preparation of the financial statements, and any departure there from has been adequately disclosed.
- (e) The system of internal control is sound in design and has been effectively implemented and monitored.

- (f) There are no significant doubts upon the issuer company's ability to continue as a going concern. If the issuer company is not considered to be a going concern, the fact along with reasons thereof should be disclosed.
- (g) Significant deviations from last year in operating results of the issuer company should be highlighted and reasons thereof should be explained.
- (h) Key operating and financial data of at least preceding three years should be summarised.
- (i) If the issuer company has not declared a dividend (cash or stock) for the year, the reasons thereof should be given.
- (j) The number of Board meetings held during the year and attendance by each director should be disclosed.
- (k) The pattern of shareholding should be reported to disclose the aggregate number of shares (along with name wise details where stated below) held by: (i) Parent/Subsidiary/Associated companies and other related parties (name wise details); (ii) Directors, Chief Executive Officer, Company Secretary, Chief Financial Officer, Head of Internal Audit and their spouses and minor children (name wise details); (iii) Executives; and (iv) Shareholders holding ten percent (10%) or more voting interest in the company (name wise details).

2.00 CHIEF FINANCIAL OFFICER (CFO), HEAD OF INTERNAL AUDIT AND COMPANY SECRETARY:

2.1. Appointment

The company should appoint a Chief Financial Officer (CFO), a head of internal audit and a company secretary. The board of directors should clearly define respective roles, responsibilities and duties of the CFO, the head of internal audit, and the company secretary.

2.2. Requirement to Attend Board Meetings

The CFO and the company secretary of the companies should attend meetings of the BoDs, provided that the CFO and/or the company secretary should not attend

such part of a meeting of the board of directors which involves consideration of an agenda item relating to the CFO and/or the company secretary.

3.00 AUDIT COMMITTEE:

The company should have an audit committee as a sub-committee of the board of directors. The audit committee should assist the board of directors in ensuring that the financial statements reflect true and fair view of the state of affairs of the company and in ensuring a good monitoring system within the business. The audit committee shall be responsible to the board of directors. The duties of the audit committee should be clearly set forth in writing.

3.1. Constitution of Audit Committee

- (i) The audit committee should be composed of at least three members.
- (ii) The board of directors should appoint members of the audit committee who should be directors of the company and should include at least one independent director.
- (iii) When the term of service of the committee members expires or there is any circumstance causing any committee member to be unable to hold office until expiration of the term of service, thus making the number of the committee members to be lower than the prescribed number of three persons, the board of directors should appoint the new Committee member(s) to fill up the vacancy(ies) immediately or not later than 1 (one) month from the date of vacancy(ies) in the committee to ensure continuity of the performance of work of the audit committee.

3.2. Chairman of the Audit Committee

- (i) The board of directors should select one member of the audit committee to be chairman of the audit committee.
- (ii) The chairman of the audit committee should have professional qualification or knowledge, understanding and experience in accounting or finance.

3.3. Reporting of the Audit Committee

3.3.1. Reporting to the Board of Directors

- i) The audit committee should report on its activities to the board of directors.
- (ii) The audit committee should immediately report to the board of directors on the following findings, if any:-
 - (a) Report on conflicts of interests; (b) Suspected or presumed fraud or irregularity or material defect in the internal control system; and (c) Suspected infringement of laws, including securities related laws, rules and regulations.

3.3.2. Reporting to the Authorities

If the audit committee has reported to the board of directors about anything which has material impact on the financial condition and results of operation and has discussed with the board of directors and the management that any rectification is necessary and if the audit committee finds that such rectification has been unreasonably ignored, the audit committee should report such finding to the commission, upon reporting of such matters to the board of directors for three times or completion of a period of 9 (nine) months from the date of first reporting to the board of directors, whichever is earlier.

3.4. Reporting to the Shareholders and General Investors

Report on activities carried out by the audit committee, including any report made to the board of directors under condition 3.3.1 (ii) above during the year, should be signed by the chairman of the audit committee and disclosed in the annual report of the issuer company.

4.00. EXTERNAL/STATUTORY AUDITORS

The issuer company should not engage its external/statutory auditors to perform the following services of the company; namely:-

- (i) Appraisal or valuation services or fairness opinions;(ii) Financial information systems design and implementation; (iii) Book-keeping or other services related

to the accounting records or financial statements; (iv) Broker-dealer services; (v) Actuarial services; and (vi) Internal audit services.

5.00 REPORTING THE COMPLIANCE IN THE DIRECTOR'S REPORT

The directors of the company shall state, in accordance with the annexure attached, in the directors' report whether the company has complied with these conditions.

2.7 Conclusion

The purpose of this chapter was to present an overview on the CG environment in Bangladesh. It is demonstrated that although the economy of Bangladesh is gradually improving, the capital market is yet to make a significant contribution to the overall economic development of the country. The current CG environment prevailing in Bangladesh still does not provide sufficient legal, institutional, or economic motivation for stakeholders to encourage and enforce CG practices; hence, failure in most of the constituents of CG is witnessed in Bangladesh (Haque et al. 2007). Of the CG codes for Bangladeshi corporations, the most significant development is the SEC guidelines on CG, as well as AC practices, which were issued in 2006.

This chapter has presented an overview of the CG environment in Bangladesh. Since the study focuses on the AC practice which is an aspect of CG, the next chapter reviews the literature on the various facets of CG.

CHAPTER THREE: CORPORATE GOVERNANCE - A LITERATURE REVIEW

3.1 Introduction

The aim of this chapter is to provide a comprehensive review of the literature on Corporate Governance (CG) which is relevant to the current study. The chapter is divided into nine sections. Section 3.2 discusses the concept of CG and focuses on its evolution. Section 3.3 outlines the theories contributing to the development of CG. Section 3.4 discusses some of the CG principles and guidelines, whilst the various CG models being practised around the world are highlighted in Section 3.5. CG practices in developing countries in general, and in Bangladesh in particular, are discussed in two separate sections namely, Section 3.6 and Section 3.7, respectively. The role of the Audit Committee (AC) as a CG mechanism is presented in Section 3.8 and, finally, Section 3.9 summarises the chapter.

3.2 The Issue of Corporate Governance

In recent years, academic attention on CG has grown exponentially, especially after the collapse of many large companies around the world (as mentioned in *Chapter One*). These companies were blamed because of their lack in business ethics, fraudulent accounting practices, and weak regulations. The collapse of these companies was also a wake-up call for many in the developed countries because, prior to these high profile bankruptcies and failures, many commentators had blamed only developing countries for poor CG practice, and lack of disclosure and transparency. The need for strong governance is evidenced by the various reforms and CG standards which were developed, at both national and international levels, such as: the Sarbanes-Oxley Act in the U.S.A., CLERP 9¹¹ in Australia, Combined Code in the U.K., and the Organization

¹¹In Australia, the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 (also known as CLERP 9) became law on 1 July 2004.

for Economic Development [OECD] Code¹². The urgency of CG gained momentum because of the on-going global economic recession and it is now a first order issue in most of the economies where firms are often run by controlling shareholders (Albuguerue and Wang, 2008). More companies in a growing number of countries are increasingly attempting to adopt better CG practices (Garay and Gonzalez, 2008).

CG generally means the system by which business corporations are directed and controlled. More specifically, it implies the relationship between all the stakeholders in a company, the way in which a company is governed, and how it deals with the various interests of its customers, shareholders, employees and society at large. Daily *et al.* (2003), and Udayasankar and Das, (2007) defined CG as the determination of the broad uses to which organisational resources will be deployed and the resolution of conflicts among the myriad participants in organisations. Further, it has been described as:

Corporate governance is the process of supervision and control intended to ensure that the company's management acts in accordance with interest of shareholders” (Parkinson, 1994, cited in Solomon, 2007).

Similarly, Lewis (1999) defined CG as:

The whole system of rights, processes and controls established internally and externally over the management of a business entity with the objective of protecting the interests of all stakeholders.

Leadership, direction, control, transparency, and accountability attributes lie at the heart of sound and effective CG according to Huse (2005); and Van den Berghe and Louche, (2005) [cited in Jamali et al., (2008)]. It can be argued that CG encompasses the entity's Board of Directors (BoDs) and its overall organisation structure, management, and ACs (Rezaee, 1997). CG emanates from a set of relationships, and it is imposed through a separation of ownership from managers. In this regard, Sir Adrian Cadbury observed that:

¹²The ‘OECD Principles of Corporate Governance’ were endorsed by OECD Ministers in 1999 and have become an international benchmark for policy makers, investors, corporations and other stakeholders.

Corporate governance is considered to be withholding balance between economic and social goals and between individual and community goals. The governance framework is required to encourage the efficient use of resources and equally to ensure accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society (Cadbury, 1992; 2000; 2003).

Over the last two decades CG has become of increasing importance to managers, academics and policy makers. The attention which is now given to the CG structure of a firm seems to imply that it has a critical impact on the responsive ability of a firm to those external factors that impinge on its performance. A substantial review of the literature shows that these concerns are in reality not entirely new; for example, Berle and Means (1932) noted the relative lack of accountability of corporate managers and argued that corporate performance would be improved if corporations had monitors to oversee the managers (Bhagat and Jefferis, 2002). Cadbury (2002) goes further and claims that CG has been with us since companies began to take their present form. Meanwhile, Higson (2003) argued that although CG is not a new phenomenon, it certainly came to prominence in the 1990s. The Chartered Institute of Management Accountants (CIMA) reported that before 1980 there was no reference to the term CG in either professional or academic literature (CIMA, 1999). However, Millstein (1999) stated that the report of Blue Ribbon Committee (BRC) frames the issue of improving corporate financial reporting in the CG context because the evolution of modern CG that began in the 1970s was rooted in financial reporting issues. Similarly, Vinten (1998) claimed that CG is not a new issue, and stated that it may be dated back to when incorporation with limited liability became available in the nineteenth century, with the need for legislation and regulation.

More attention has been paid to CG over the past few years due to the debate surrounding the recommendations of the Cadbury Committee in 1992 on the financial aspects of CG (Collier, 1997). Keasey and Wright (1997) argued that there is no doubt that CG has been one of the key business topics of recent years, and that it will continue to be so for the foreseeable future. In the U.K., for example, several influential proposals have been produced with an attempt to settle the practical issues (Cadbury,

1992, 1995; Greenbury, 1995; Hampel, 1998; Turnbull, 1999; Higgs, 2003, FRC, 2008, 2010). Academic interest in these issues has significantly grown as concern on CG gains ascendancy in corporate board rooms and the offices of policy makers. Evidence for this can be seen in the number of recently published studies on issues relating to CG (for example, Braun and Sharma, 2007; Chan and Li, 2008; Dey, 2008; Chen et al., 2008; Rajagopalan and Zhang, 2008; John and Young, 2008; Beasley et al., 2009; Brown et al., 2009; Choi et al., 2009; Garcia-Meca, and Sanchez-Ballesta, 2009; Hoitash et al., 2009; Jackling and Johl, 2009; Krishan and Lee, 2009; Laux and Laux, 2009; Ward et al., 2009; and Siddiqui, 2010).

In addition, several recent studies (for example, Brennan, 2006; Kiel and Nicholson, 2006; Mueller, 2006; Chong and Lopez-de-Silance, 2006, 2007; Raja and Kumar, 2007; Larker, et al., 2007; Choi, et al. 2007; Kroll, et al., 2008; Bhagat and Bolton, 2008; Soobaroyen and Sheikh-Ellahi, 2008) attempted to assess the impact of CG on organisational performance. Almost all of these studies have found a positive relation between key CG variables and a firm's performance. There are, however, a few notable exceptions to this rule; for example, Bhagat and Bolton (2008) found a negative association between board independence and a firm's performance. Nevertheless, CG is considered by many as a performance driver of a firm and a guarantee of the credibility of its financial reports (Mir and Seboui, 2008). It is also seen as a means of improving efficiency in the economy (Ahmed and Yusuf, 2005). In addition, McConomy and Bujaki, (2000) argued that a key objective of CG system should be the enhancement of shareholders' value.

An effective CG system also helps in ensuring an appropriate division of power among shareholders, the BoDs, and management (McConomy and Bujaki, 2000). Keasey and Wright (1997) noted that the importance of Good Corporate Governance (GCG) was in motivating managerial behaviour towards improving the business; or, in other words, of directly controlling the behaviour of managers. GCG contributes to better company performance by helping a board in discharging its duties in the best interests of the shareholders (FRC, 2010). Also, Ow-Yong and Guan (2000) noted that the importance

of CG is its contribution to both business prosperity and accountability. The idea of CG is to provide a framework to strengthen the internal control mechanism to check irregularities in companies. The role of effective practice of CG is in constraining earning management has been noted by Garcia-Meca and Sanchez-Ballesta (2009). Cornett et al. (2009) also argued for independence board in order to constraint earning management. Solomon (2007) suggested that CG is the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity.

Keasey and Wright (1997) argued that the key elements that constitute CG concern include: (i) the enhancement of corporate performance via supervision or monitoring of management performance; and (ii) the assurance of management accountability to shareholders and other stakeholders. These aspects of governance and accountability are closely interrelated and introduce both the efficiency and the stewardship dimensions to CG. They revolve around the accountability of those in control of companies to those with the residual financial interest in corporate success, normally the shareholders; however, when a company is approaching insolvency other stakeholders (such as, creditors) become part of the widening discussion (Vinten, 1998). Abbott and Parker (2002) claimed that the effectiveness of the monitoring function is increased by the inclusion of external (i.e. non-management) directors. External/non-executive directors, who are presumably independent of management, reduce opportunities for the board to become an instrument of top management and they limit the management's ability to benefit themselves at the expense of shareholders. The board of the company is the key to the adoption and implementation of CG best practices (Hussain and Mallin, 2003). A study conducted in a Bahraini context by Hussain and Mallin (2002) found that the best CG practices are present in those companies that have BoDs which are dominated by external directors.

Therefore, it can be argued that CG generally describes the way that companies are managed and controlled, ensuring the successful operation of the organisation within the

legitimate boundaries, while still satisfying the needs of stakeholders. Because of its significance CG has become a top priority for regulatory bodies, with the objective of providing better and more effective protection to all stakeholders (Ahmad, 2004). CG mechanisms are believed to enable companies to attract financial and human capital, to perform efficiently, and to generate long-term economic value for their shareholders, while respecting the interests of stakeholders and society as a whole.

3.3 Theoretical Underpinning of Corporate Governance

The development of CG has been affected by theories from a number of disciplines, including: Finance, Accounting, Law, Management, and Organisational Behaviour (Mallin, 2010). In other words, a number of different theoretical frameworks have recently evolved to explain and analyse CG (Solomon, 2007). The seminal work of Jensen and Meckling (1976) proposed an ‘Agency Theory’, which was based upon conflicts of interest between various contracting parties, namely: shareholders, corporate managers, and debt holders. Since then a huge body of literature has evolved to explain both the nature of these conflicts and the means by which they may be resolved. Blair (1995) identified four major perspectives for the CG issue: Agency Theory, Transaction Cost Theory, Market Myopia Theory, and Stakeholder Theory. In addition, the relevance of Stewardship Theory and Resource Dependence Theory (RDT) are also supported in a number of different CG studies. The development of CG is a global occurrence and, as such, is a complex area including legal, cultural, ownership, and other structural differences. Therefore, some theories may be more appropriate and relevant to some countries than others (Mallin, 2010). Despite the concept of CG encompasses a number of theories, the researcher believes that agency theory and stakeholder theory will make the most significant contribution to the current study. However, all of these theories are discussed in more detail below, focusing on their contribution in the development of CG. Figure 3.1 illustrates the main theories that have significant contribution to the development of CG.

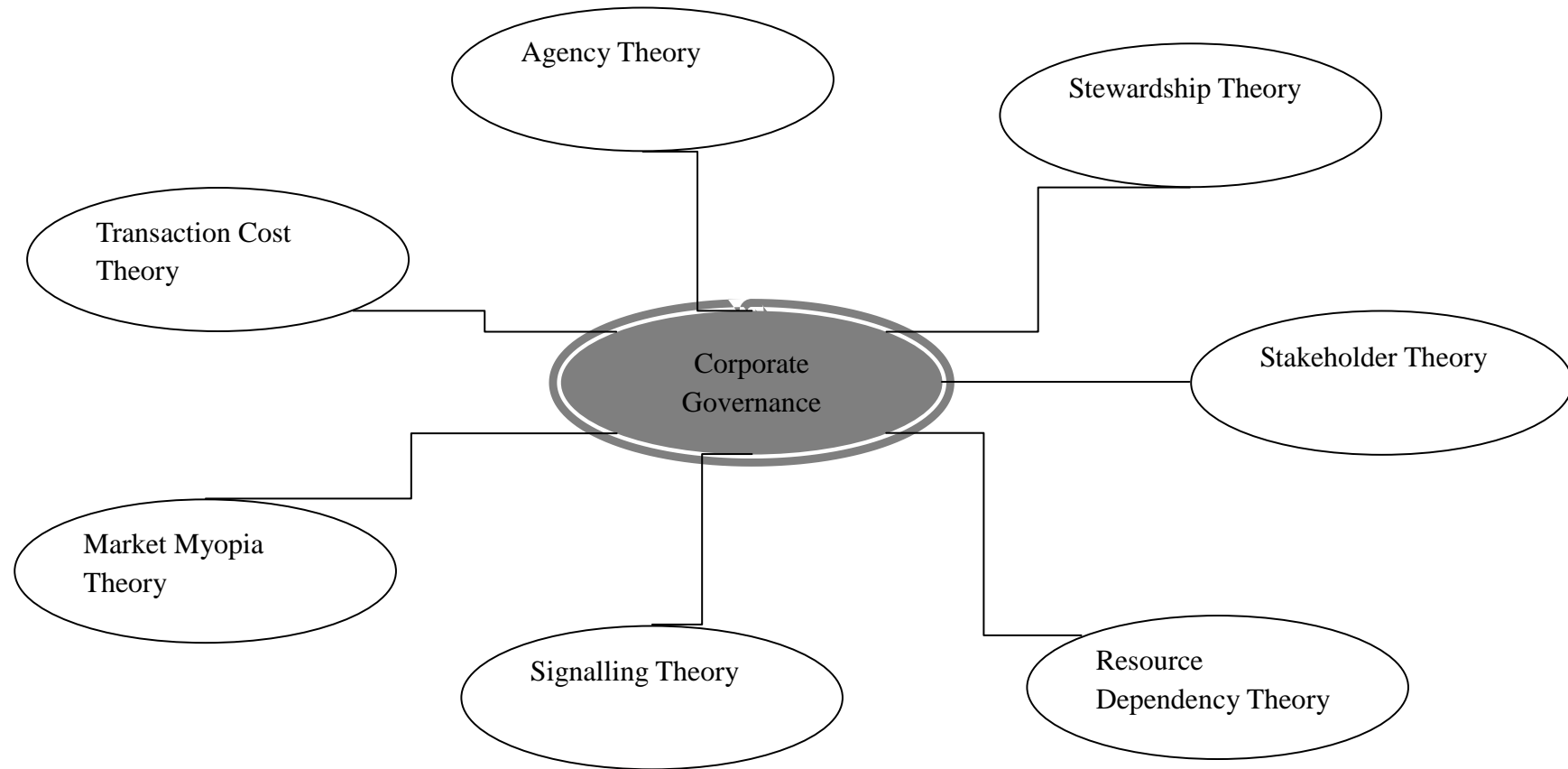


Figure 3.1: Theories Relating to Corporate Governance

3.3.1 Agency Theory

CG is a broad theory concerned with the alignment of management and shareholder interests (Grant, 2003). It has been described further:

Many definitions of corporate governance stress the potential conflicts of interest between insiders (managers, boards of directors, and majority shareholders) and outsiders (minority shareholders and creditors) of the company. The set of internal and external mechanisms to balance these conflicts of interest is usually known as CG (Garay and Venezuela, 2008).

Therefore, CG specifies the distribution of rights and responsibilities among the different actors inside the corporation, which are: Chief Executive Officer (CEO), board members, managers, shareholders and stakeholders (Goyer, 2001). Arthur Levitt defined CG as the relationship between the investor, the management team and the BoDs of a company (Levitt, 2002). Larcker et al., (2007) emphasised on CG as the set of mechanisms that influence the decisions made by managers when there is a separation of ownership and control. Osman (2006) further argued:

The need for CG arises from the potential conflicts of interests among stakeholders in the corporate structure. These conflicts of interest often arise from two main reasons. First, different stakeholders have different goals and preferences. Second, the stakeholders have imperfect information as to each other's actions, knowledge, and preference.

CG finds its foundation in the 'world of incomplete contracts' (Hart, 1995 cited in Ward et al., 2009). Incomplete contracts exist when agents and/or managers possess more information than do the principals and/or shareholders and, therefore, the interests of agents and principals have the potential to diverge. In highlighting the relevance of agency theory in CG, Christopher et al. (2009) noted that the essential concern of CG arises from the separation of ownership and control in modern public corporations. Imam and Malik (2007) noted that the need for CG arises from the potential for agency conflict. The key agency problem is between the controlling owner-management and outside shareholders. Jensen and Meckling (1976) defined an agency relationship as: "a contract under which one person (the principal) engages another person (the agent) to

perform some services on his/her (the principal's) behalf'. Agency relationship is also defined as a contractual process whereby owners delegate some of their authorities and responsibilities to a team consisting of expert member(s), and they then expect this team to exercise their expertise in the best interests of the firm's operational success. Muth and Donaldson (1998) described agency relationship as delegation of power by the owner to the management. Eisenhardt (1989) discussed two main causes of agency problems, namely: conflict of interests, and different attitudes towards risk between owner and management. Agency theory focuses on the notion of an agency relationship in which the principal delegates responsibilities to the agent, risk is shared between the entities, and there is a potential conflict of interest (Eisenhardt, 1989). In line with agency theory, the central problem of CG is how the shareholders ensure that self-seeking executives act in the shareholders' interests rather than their own (Hendry, 2005). Berle and Means (1932) argued that when shareholders are not able to monitor management properly, the company's assets might be used for the welfare of management instead of maximising the company's wealth.

Chrisman et al. (2004) noted that this conflict arises from information asymmetry between owners' and managers, and so there exists a gap between the two. Agency problems of moral hazard and adverse selection, in particular, develop under information asymmetries between agents and principals. In this respect, Chrisman et al. (2004) also described that one of the main causes behind this conflict is the information asymmetry between owners and managers, which emerges because of a knowledge gap about the company's internal operations. The principals (owners) need quality information to monitor, control, and motivate the agents; whereas, the agents (management) have full control over the information flow. This sometimes leads to information asymmetry which, in turn, becomes the cause of the agency problem (Lazarides and Drimpetas, 2008). These problems occur when managers in possession of information make decisions that are self-serving, such as: engaging in executive perquisites, shirking behaviour (moral hazard), or misrepresenting their skills and abilities (adverse selection) in the hiring process (Eisenhardt, 1989; Rutherford and Buchholtz, 2007; Rutherford et al, 2007). Jensen and Meckling (1976) further reported

that the extent of agency conflicts varies across the firms, depending on the level of discretionary power which is applied by the management.

The separation of ownership and control allows controlling shareholders to pursue private benefits (Albuquerque and Wang, 2008). Sometimes, shareholders may prioritise their own welfare at the cost of other stakeholders, and so they tend to influence management decision in order to maximise short term profit. Management prefers to maximise the wealth of the firm by earning sustainable long term profits. Consequently, conflicts of interests between owners and management emerge and can grow exponentially. Management decisions and activities need to be monitored for accountability purposes. Close monitoring is possible when owners themselves can actively participate in this monitoring process. However, because of the high cost involvement, and in some cases due to the lack of expertise and knowledge, they cannot be actively involved in the process. Nevertheless, the board has to set monitoring mechanisms because of their oversight responsibilities to shareholders (Johnson et al., 1996).

In respect of emerging economies, Peng and Heath (1996) contended that the lack of legality for formal governance mechanisms creates a weak governance environment, which can create a potentially severe agency problem. Young et al. (2001) identified some of the factors that make the agency problem worse in emerging economies, for example: family ownership and control, state owned enterprises, poor legal protection of minority shareholder rights, concentrated ownership structures, and strategy and competitiveness. Family ownership has an informal but powerful influence on CG, although it is not clear under which conditions it provides a net gain (Schulze et al, 2002). In emerging economies, many firms are controlled by families (La Porta et al., 1999a). This family ownership structure is frequently found in Bangladesh (Uddin and Choudhury, 2008). Siddiqui (2010) also noted that concentrated ownership is a common phenomenon in Bangladeshi companies. Schulze et al. (2001) argued that the relations between principals (i.e. family owners) and agents (i.e. family-member managers) are probably based on emotions, sentiments, and informalities, which results in less

effective monitoring of family managers. This means that family owners and family-member managers not only reduce the effectiveness of any internal and external control mechanisms, but they also expose their firms to a self-control problem which harms both themselves and those around them. Family ownership may sometimes cause 'weak governance' and 'low trust' environment that offers little protection against traditional principal-agent conflicts (Dharwadkar et al, 2000). In fact, in all countries reformers have begun attempting to reduce the power of family-owned business groups. Since the family members hold the majority of shares in family ownership, they could be considered as large shareholders. The benefits of large shareholders are theoretically clear (such as having the interest, as well as the power, to get their money back). Large investors represent their own interests, which need meet the interests of other investors, employees, and managers in the firm (Shleifer and Vishny, 1997). Large investors usually dominate the board and exercise undue influence on management decisions. Orbay and Yurtoglu (2006) argued for the presence of large shareholders as a potential solution to the typical agency problem between manager and dispersed shareholders. However, Shleifer and Vishny (1997) recognised that large investors may tend to maximise their wealth and ignore the wealth of other investors and employees. They do so particularly when their control rights significantly exceed their cash flow rights, which usually happens if there is a substantial departure from one-share one-vote (Grossman and Hart, 1988).

Fama and Jensen (1983) indicated that it is the role of BoDs to reduce agency problems and costs arising from the separation of ownership from decision control. Solomon (2007) described some of the ways in which shareholders can monitor company management and help to resolve agency conflicts. Hoitash et al. (2009) contended that agency problem can be mitigated through effective internal control over financial reporting imposed by owners. Many studies have suggested some incentives to motivate management in minimising the agency problem (for example, Ward et al., 2009). Watts and Zimmerman (1986) explained a positive agency theory by linking managerial incentives for voluntary financial disclosure. Again, in some circumstances, instead of acting as substitutes, monitoring and incentive alignment may act as complements to

one another. This can be happening where the presence or addition of one mechanism strengthens the other, and so leads to more effective governance in addressing agency problems. For instance, Rutherford et al. (2007) empirically examined the complementarities of board monitoring and the CEO incentive systems, and found that CEO stock options complemented boards that monitor through formal meetings.

Meanwhile, Dharwadkar et al. (2000) contended that this may require more than 50% ownership. Dominated majority ownership structures are likely to prevail across the corporate landscape and are able to effectively control Principal-Agent problems, and can consequently become the rule in emerging economies. In emerging economies, dominating ownership structures are associated with the need to resolve Principal-Agent problems. One recommended way to resolve this problem that has been argued in literature is to include an independent, external director on the board. Jackling and Johl (2009) argued for the agency theory and agreed with the study of Nicholson and Kiel, (2007) who noted that the greater proportion of outside directors in the board, the higher the corporate performance of the firm. Ehikioya also agreed to one notion of this theory and found that CEO duality (same person holding both positions of CEO and Chairman) has an adverse impact on a firm's performance. However, Jackling and Johl (2009) disagreed with the notion and did not find any evidence to conclude that a CEO's duality roles have any detrimental effect of corporate performance. Advocates of CG have identified internal and external governance mechanisms that reduce the agency problem (Agarwal and Knoeber, 1996 cited in Ehikioya, 2009). Dey (2008) found that firms with greater agency conflicts have better CG mechanism in place. Their study also argued that role of various CG mechanisms in a firm are a function of the level of agency conflicts in the firm. Sanchez-Ballesta and Garcia-Meca (2007) described CG as a means of reducing agency conflict in the firms. DeZoort et al. (2002) argued that in order to deal with the problems arising from agency relationship, the BoDs has to assume the oversight roles of a monitoring CEO and other managers, approving a firm's strategies and evaluating their control systems.

While the board usually hires an expert and knowledgeable body to oversee management activities on its behalf, the AC is a subcommittee under the CG framework to which the board delegates some of its crucial oversight responsibilities. Chen et al. (2008) studied non-U.S. companies trading shares in the U.S. market, and argued that effective AC can resolve agency problems of foreign companies no matter which CG model is being followed in the company's home country (different CG models are discussed in a later section of this chapter). Dey (2008) found the level and intensity of agency problem is less in those firms where ACs are more effective in terms of composition and functioning. The AC alleviates the agency problem by facilitating the timely release of unbiased accounting information by managers to shareholders, creditors and so on; thereby, reducing the information asymmetry between insiders and outsiders (Klein, 1998b). Since managers usually do not have to interact frequently with shareholders, a distance in terms of trust might exist due to this communication gap. The AC can act as a bridge of such gap. Chen et al. (2008) found that the AC can help to maintain contact between a management and its shareholders. They also mentioned that the effectiveness of an AC in resolving agency problems is also applicable to foreign companies, even though their home countries adopt different CG systems. Since an AC mainly performs the monitoring role, the effect of this committee on a firm's performance is better explained by agency theory than by the other theories (Bedard et al., 2008). Therefore, the AC has been well recognized by researchers and practitioners alike as an effective mechanism in minimising the agency conflict in a company.

3.3.2 Stewardship Theory

As mentioned earlier, agency theory argues that shareholders' interests require protection by the separation of ownership from control. Stewardship theory argues that shareholders' interests are maximised by sharing the roles of board chair. However, many studies have found that both theories are equally relevant to CG issues. For example, Kashif (2008) studied the relationship between CG and a firm's performance in two different financial markets (i.e. the Malaysian and Australian financial markets) and found results that confirm the CG relevance of both agency theory and stewardship

theory. One of the basic assumptions of this theory is that the agents have access to superior information. Since the principals cannot always monitor the agents' behaviours and activities, it raises a concern that the agents will take advantage of this position to maximise their self-interest at the expense of the principals (Beaver, 1981). Davis et al. (1997) noted that the essential assumption underlying the prescriptions of stewardship theory is that the behaviours of the executive are aligned with the interests of the principals. In other words, those principals who are not directly involved in the running of the business always feel that they are at a disadvantage compared to those agents who have access to more information. This is further exacerbated by the assumption that agents always seek self-interest as they are not the owners of the company. Further, the agents' roles in society may conflict because they are both members of the community and self seeking individuals (Lewis and Collins, 1990).

Cornelius (2005) defined CG as the stewardship responsibility of corporate directors to provide oversight for the goals and strategies of a company, and also to foster their implementation. Stewardship theory, therefore, favours governance mechanisms that support and empower the firm's management and disfavors those that monitor and control it. Stewardship theory suggests that the most crucial factor influencing organisational performance and shareholder returns is designing the organisational structure so that managers can take effective action (Chitayat, 1985). It is acknowledged that stewardship theory adopts a contrasting view of the duality-performance debate (Braun and Sharma, 2007). Advocates of stewardship theory argue that authoritative decision-making under the leadership of a single individual (as both chairman and CEO) leads to an increase in the firm's performance (Donaldson and Davis, 1991; Jackling and Johl, 2009). This theory proposes that managers do have similar interests to the corporation, in that the careers of each are linked to the attainment of organisational objectives, and their reputations are interwoven with the firm's performance and shareholder returns (Davis et al., 1997 cited in Young and Thyll, 2008). Accordingly, the focus is on the inside directors' ability to promote shareholders' value through their superior knowledge of the company (Beasley et al., 2009). Stewardship theory advocates the value of self-motivation towards what is good,

assuming that managers, or the board of a firm, are self-motivated to serve the best interests of the firm and its owners. Given the absence of an inner motivational problem among executives, stewardship theory focuses on facilitative, empowering structures that allow effective and efficient decision making by managers.

Stewardship theory presumes that executive managers, far from being opportunistic, are honest and that they are good stewards of the corporate assets (Muth and Donaldson, 1998; Nicholson and Kiel, 2007). Donaldson and Davis (1994) argued that the managers are good stewards of corporations who, being motivated by their own achievement and responsibility needs, work hard to increase shareholders' wealth. According to this theory, the economic performance of a firm is improved if power and authority are concentrated in a single executive who is both CEO and chairman. Depth of knowledge, commitment, access to current operating information and technical expertise are vital to run a company efficiently, and CEOs, who are deemed to possess these advantages, will be able to provide more effective leadership if they also hold the chair's position on the board. The idea of trusteeship echoes the stewardship theory in many ways (Kay and Silberston, 1995) since it puts emphasis on the concept that managers have numerous motivations other than simply maximising their own benefits. Earlier, Etzioni (1975) argued that managers, when faced with a situation which brings no direct personal advantage, may still base their job on a sense of duty. Hawley and Williams (1996) claimed that this would lead to a situation where either the boards are mainly executive-dominated or there are no boards at all. Turnbull (1997) suggested that boards can be made redundant with the presence of a dominant active shareholder, particularly when the shareholder is a family or government. Tricker (1996) noted that company law imposes a fiduciary duty upon managers towards the shareholders and, therefore, managers can be easily trusted with the stewardship of the company assets. In short, the stewardship theory of CG thrives on the concept of managers being self-motivated towards working for the best interest of the company and other related parties. Each stakeholder plays an important part in creating an environment where transparency and accountability are encouraged, enforced, and rewarded. Tricker (1984) described accountability in stewardship theory as the means by which those who manage and

oversee the affairs of the company are held to account for their stewardship of corporate assets.

3.3.3 Stakeholder Theory

Although stakeholder theory has evolved gradually since the 1970s (Solomon, 2007), one of the pioneering expositions of this theory was introduced by Freeman in 1984 when he defined a stakeholder as: “*any individual or group who can affect or is affected by achievement of the organization’s objectives*”. Stakeholder theory takes account of a wider group of constituents rather than simply focusing only on shareholders (Mallin, 2010). Thus, stakeholders can include shareholders, employees, suppliers, customers, creditors, communities in the vicinity of the company’s operations, and the general public. Some extreme proponents of this theory suggest that environment and future generation can also be included as stakeholders. One commonality characterising all definitions of stakeholders is to acknowledge their involvement in an ‘exchange’ relationship (Pearch, 1982; Freeman, 1984; Hill and Jones, 1992). Stakeholder theory highlights that the interests of different groups, and argues for the possibility of favouring one group’s interest over that of another (Jones and Wicks, 1999). It also suggests that the company is a separate organisational entity, and that it is connected to different parties in achieving a wide range of purposes (Donaldson and Preston, 1995).

Proponents of the stakeholder theory emphasise that the corporation could not exist without the contributions of groups like customers, employees, the community of which it is a part, and the environment; therefore, managers should consider how their decisions affect these other constituents (Stovall et al., 2004). McAlister et al. (2003) argued that this theory presumes a collaborative and relational approach to business and its constituents. Supporters of this theory argue that the CG problem turns round the objective function of the corporation. The notion that the firm's goal is to maximise shareholders' welfare is regarded as being too narrow. Rather, they suggest that the goal of the firm should be extended to include the maximisation of the welfare of other stakeholders, such as: employees, creditors, suppliers, customers, the environment, and

the community (Freeman, 1984). Solomon (2007) contended that a basis for stakeholder theory is that companies are so large, and their impact on the society is so pervasive, that they should discharge accountability to many more sectors of the society than solely their shareholders; they should include employees, suppliers, customers, creditors, communities in the vicinity of the company's operations, and the general public. Creditors have an interest in getting their loans repaid on schedule; suppliers have an interest in securing fair prices and dependable buyers; customers have a stake in getting value for money. Basically, this theory is used to help understand the groups and individuals that can affect, and are affected by, the achievement of an organisation's purpose, and those effects may be economic, regulatory, technological, social, political and managerial.

In support of stakeholder theory, Donaldson and Preston (1995) pointed out that managers are responsible to deploy their wise decisions and best efforts in obtaining benefits for all stakeholders. Similarly, Wang and Dudley (1992) noted that the BoDs cannot ignore its responsibilities in safeguarding a stakeholder's interests. CG ensures the conformance of corporations with the interests of investors and society by creating fairness, transparency and accountability in business activities among employees, management and the board (Oman, 2001). John et al. (2008) reported that corporate risk taking and growth of the firm are positively associated with the quality of stakeholders' protection. However, sometimes excessive risk taking by the firm leads to the value of the firm being destroyed (Goel and Thakor, 2008), which is contradictory with stakeholder theory. Sternberg (1997) rejected stakeholder theory because she considered it to be incompatible with business or with CG. In her view, the theory rules out the goal of business which is to maximise long-term owner value. Turnbull (1997) disagreed with Sternberg's arguments because she had inadequate empirical evidence to support her views, and this supported the theory. Previously, stakeholder theory was believed to be an opponent of agency theory because of many significant differences between these two theories. But in recent years, there is a growing perception among theorists and practitioners that these two paradigms may in fact be compatible and they can be combined within one single paradigm (Wheeler et al., 2002). Hill and Jones (1992) also

argued that stakeholders theory and agency theory perspectives of organisational phenomena are no longer viewed as mutually exclusive interpretations, instead they may indeed be interpreted in one single model.

Therefore, it is clear that a growing body of literature and empirical evidence argues that by taking account of all stakeholders, instead of shareholders alone, the company is more likely to achieve the long term profit maximisation which is also conducive to sustainable wealth maximisation. Hillman et al. (2001) found that the inclusion of stakeholders on the board merely improves their relation and performance. They emphasised the board effectiveness in this regard. A well-functioning AC ensures a better CG practice in a firm, which ultimately leads to the overall welfare of many stakeholders. Dey's (2008) conclusion is notable in this respect, he mentioned that an organisation's performance and stakeholders' value are positively affected by various governance mechanisms, including AC. Stakeholders' interest have been emphasized in the definition of effective AC given by DeZoort et al. (2002). They argued that the ultimate goal of the AC is to protect all stakeholders' interests and welfare.

3.3.4 Resource Dependency Theory

Some researchers (for example, Cohen et al., 2007b) have found some similarities between RDT and agency theory. RDT proposes that actors lacking in essential resources will seek to establish relationship with (i.e. be dependent upon) others in order to obtain needed resources. In fact, RDT claims that the mutual appointment of directors generates benefits to the firm in terms of higher performance. This claim was supported by the findings of a recent study by Jackling and Johl (2009). The study found that the larger the board size was then the higher was the corporate performance. This notion has also previously been argued by Hilman and Dalziel (2003); Dalton, et al. (1998) and Pearce and Zahra (1992). RDT is useful in addressing the role of directors as boundary spanners between the organisation and the environment (Pfeffer and Salancik, 1978 cited in Young and Thyll, 2008). Directors' professional appointments (lawyers or bankers, for example) enhance the organisational functioning by providing access to

resources needed by the firm. RDT theory suggests that the external parties' ability to command those resources which are vital for an organisation, gives those parties power over it. This means that if a foreign partner brings a resource necessary for the company's success, then the external partner will gain power relative to the local partner. It also implies that a partner's control will be focused on those activities to which this partner brings resources. This theory, therefore, leads to the conclusion that the partners' ability to govern a firm depends not only on the relative size of their equity holdings, but also on the significance of the essential tangible and intangible resources which they bring to the firm (Child et al., 1997).

Organizational success in RDT is defined as organisations maximising their power (Pfeffer, 1981). Research on the bases of power within organisations began as early as Weber (1947), and has included much of the early work conducted by social exchange theorists and political scientists. A generalisation of power-based arguments from intra-organizational relations to relations between organizations began as early as Selznick (1949). RDT characterises the links among organisations as a set of power relations based on exchange resources. Resource dependence asserts that the board's primary role is to assist management with strategy and resource acquisition (Cohen et al. 2007a; Nicholson and Kiel 2007). Board's role is that of helper or partner, rather than a monitor of the management (Beasley et al., 2009). In emerging economies, it is likely that local partners and local markets are unable to provide the more sophisticated resources required by firms. This leads them to becoming highly dependent on their foreign partners for items such as technology, management systems, training, and professional support services. Most emerging economies suffer from the shortage of fund, expertise, and institutional channels to adequately finance their working capital requirements, or expansion investment; Bangladesh is no exception in this regard. RDT implies a reasonable reliance on the foreign partner in overcoming these lacks and shortages.

3.3.5 Signalling Theory

Signalling theory has been developed to explain the problems of an information imbalance in the labour markets, it also looks at how this can be reduced by the party with more information signalling to others (Morris, 1987). Basically, the theory has got some similarities to agency theory because it also recognises the separation of ownership and control in modern corporations, and it suggests that market pressures on management motivates management to disclose all of the information which is material to investors (Ross, 1979). However, one of the basic assumptions of this theory, which makes it slightly different from agency theory, is that there are signalling costs that are inversely related to the quality of information (Morris, 1987). Despite information imbalances, management has motives to provide quality information to reduce signalling costs (especially the effect on share price). Managers with superior information on the demand for its product disclose more to convince both competitors and the capital market of the quality of its product, thereby increasing the value of the firm's stock. Similarly, the firm would also like to convince its competitors that demands are low, which reduces the competitors' output and increases the informed firm's profit (Gigler, 1994). Morris (1987) further argued that when the sellers of information provide a general disclosure then the buyers of information will not be able to differentiate the products, resulting in no change in price.

On the other hand, if sellers of high quality products disclose more, the buyers of information will be able to differentiate the product, resulting in higher prices. But for sellers of lower quality products then it will be to their advantage not to disclose extra information as buyers may be able to differentiate the product, causing the price to be low. In short, Morris (1987) indicated that the signalling motives are greater when the quality of the product is high. Ross (1979), however, argued that firms with no information, or with bad news, also have to give signals, just like those with good news, in order to distinguish their firms from others. In the case of firms with bad news, Skinner (1994) stated that the managers of these firms also have a legal motivation to disclose the bad news as they may cause reputation losses if they fail to do so at the appropriate time. Ross (1979) further asserted that for firms which have previously

made a disclosure, a failure to do so later will be regarded by the market as a signal that the unpublished data are harmful, thus it logically builds a powerful motivation to disclose, even on the part of those firms with really bad news.

In fact, signalling theory is based on the assumption that information is not equally available to all parties at the same time and, therefore, that information asymmetry is the rule. Signalling theory states that corporate financial decisions are signals sent by the company's managers to investors in order to shake up these asymmetries. Therefore, corporate affairs should be clearly disclosed to the stakeholders so that they can take their rational and informed decision. The role of the AC as a CG mechanism in ensuring full disclosure of corporate affairs has been widely recognised, and will be discussed in more detail in a later section of this chapter.

3.3.6 Market Myopia Theory

Keasey et al. (1997) indicated that the proponents of Market Myopia Theory implicitly assert that the goal of a firm is not only to maximise shareholder's wealth, but also to maximise other stakeholders' wealth. Charkham (1994) and Sykes (1994) noted that the Market Myopia Theory identifies the short-term as the central problem in the Anglo-Saxon CG system (which is discussed in Section 3.5). They argue that the capital market produces excessive pressure on a corporation's managers to focus excessively on short-term stock price gain at the expense of long-term growth and investments (such as research and development). According to Keasey et al. (1997) the share price is not a reliable guide to the future value of the firm. Moreover, this theory suggests that one of the roles of accounting is to provide information for the capital markets through a process of formal and informal sets of contracts between self-interested parties (Adhikari and Tondkar, 1992). Thus, the information needs of these users act as constant pressure on companies to increase both the quality and quantity of their disclosure. This view has been supported by Gray and Roberts (1989) who pointed out that stock market pressures appear to dominate political pressures in encouraging disclosure. The theory suggests that the impetus for disclosure is to help in reducing investor uncertainty and,

therefore, risk and the required rate of return (Cooke, 1989). A lower rate of return to shareholders means a lower cost of capital for the company, and this is in line with the company's objective to raise capital at the lowest possible cost (Spero, 1979). In addition, the lower the uncertainty or risk perceived by investors then the higher will be the share price. This is made possible by making disclosure that will enhance the company's image and reputation in the eyes of potential investors (Gray and Roberts, 1989).

3.3.7 Transaction Cost Theory

Like agency theory, transaction cost theory also deals with the issues regarding how to co-ordinate the individual interests of both owner and management in order to protect the best interest of the shareholders at large. However, one of the fundamental differences between agency theory and transaction cost theory is that the former considers that managers pursue their perquisites while the latter describes how managers are often opportunistic. The central idea of transaction cost theory, as proposed by Williamson (1996), is that corporations experience massive economic costs, and corresponding economic advantages, in each transaction that they carry out. Solomon (2007) noted that: *“Transaction cost theory is based on the fact that companies have become so large and complex that price movements outside companies’ direct production and the markets coordinate transaction”*. Williamson (1996) pointed out: *“Transaction cost theory has been developed to facilitate an analysis of the comparative costs of planning, adapting and monitoring task completion under alternative governance structure”*. Williamson’s (1996) study argued that the unit of analysis in transaction cost theory is a transaction which occurs when any goods or service is transferred across a technologically separate interface. According to Williamson (1996), transaction cost theory arises firstly from two human factors (for example, bounded rationality and opportunism), and secondly from three environmental factors (for example, uncertainty, small number of trading and asset specificity). Williamson further argued that the three dimensions of a transaction affect the type of governance structure which is chosen for the transactions which are: asset specificity,

uncertainty, and frequency. As asset specificity and uncertainty increase, the risk of opportunism increases. Thus, decision-makers are more likely to choose a hierarchical governance structure. As frequency increases, the comparative advantage of using market governance structures decreases because the costs of hierarchical governance structures can be amortised across more instances of the transaction.

The above discussion indicates that CG literature has investigated the role of the board in quite some detail and has presented various theories. It is evident that no single theory in isolation can provide a complete understanding of the board's role (Daily et al., 2003; Lynall et al., 2003; Nicholson and Kiel, 2004; 2007; Jackling and Johl, 2009). Similarly, Tricker (2009) pointed out: "*Corporate governance, as yet, does not have a single widely accepted theoretical base nor a commonly accepted paradigm... the subject lacks a conceptual framework that adequately reflects the reality of corporate governance*". Despite the marked differences between the various theories, all attempt to describe the same problems, but from a different perspective. The above discussion has also depicted many commonalities among them in terms of their key concepts. CG mechanisms, an effective AC in particular, can contribute directly or indirectly to these theories. CG is still seeking its theoretical foundations; however, the main theory that has affected its development, and that provides a theoretical framework within which it most naturally seems to rest, is agency theory (Mallin, 2010). She also noted that stakeholder theory is coming more into play as companies increasingly become aware that they cannot operate in isolation to a wider stakeholder constituency. Further, it is clear that agency theory is related to most of the theories discussed above, and it encompasses the basic idea of these theories. AC is believed as an effective mechanism in resolving an agency problem in an organisation (Chen et al., 2008; Dey, 2008; Bedard et al., 2008). AC's role in reducing agency gap is stated by Sarens et al. (2009) as:

The AC attempts to protect the principals' interest by monitoring the agents' actions and thus reduces the information asymmetry that exists between the owners, management and other stakeholders.

3.4 Guidelines on Corporate Governance

A number of countries across the world have introduced or revised CG codes during the last two decades. Despite some contextual differences between the countries, the common aims of these codes were to ensure more transparency and accountability in corporate affairs, as well as to increase investors' confidence in the stock market as a whole. The development of the codes has often been driven by financial scandal, corporate collapse, or similar crises (Mallin, 2010). There is no universal code of CG; however, events in the corporate world (such as the collapse of many giant corporations, the changing pattern of share ownership, and the internationalisation of cross-border portfolios) have led various countries and international organisations to develop some principles of CG which may be followed in the context of different countries (Hussain and Mallin, 2002 cited in Reaz, 2006). One of the most influential guidelines has been the 1999 OECD Principles of CG. Apart from OECD principles, some other CG guidelines (for example, Cadbury Committee, 1992, 1995; Greenbury Committee, 1995; Hampel Committee, 1998; and Turnbull Committee, 1999) are also frequently used as useful references. The Combined Code (2003) of CG was initially issued in 1999, a revised edition was published in 2003. The Combined Code integrates the previous guidelines given by different committees. The following subsections discuss the main contents of the OECD principles and the Combined Code.

3.4.1 The OECD Principles

The OECD principles were originally issued in 1999, and have since become the international benchmark for CG. They form the basis for a number of reform initiatives, by both the government and private sectors. The principles were revised in 2003 to take into account the developments in CG since 1999. The new principles were agreed by OECD governments in April 2004. These principles, which are non-binding, have been widely accepted as providing the broad framework for countries to use. It is expected that countries should then adopt their own country-owned CG frameworks; taking account their unique culture, and regulatory and legislative systems.

Table 3.1: OECD Principles of Corporate Governance

Principle	Explanation
(1) Ensuring the basis for an effective CG framework	The CG framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.
(2) The rights of shareholders and key ownership functions	The CG framework should protect and facilitate the exercise of shareholders' rights.
(3) The equitable treatment of shareholders	The CG framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
(4) The role of stakeholders in CG	The CG framework should recognise the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound corporations.
(5) Disclosure and transparency	The CG framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
(6) The responsibilities of the board	The CG framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

The OECD principles of CG, which were originally adopted by the thirty member countries of the OECD, have become a reference tool for countries all over the world (Jesover and Kirkpatrick, 2005). While evaluating OECD principles, Krambia-Kapardis and Psaros (2006) noted that:

Guiding much of the corporate governance reform in developing economies has been the OECD principles of corporate governance, issued in 1999. While the OECD Principles have been an important benchmark for many countries to base their corporate governance strategies around, there also have been some problems in their implementation. A review of the 1999 principles by an OECD established Steering Group led to a revamping of the principles in 2004. In summary, the Steering Group found that while the principles were sound, there were problems with respect to their implementation. Inter alia, two key areas where the principles were not being upheld were in respect of independent boards of directors and independent auditors. In respect of both of these areas the revised 2004 OECD principles of corporate governance have been strengthened.

3.4.2 Combined Code on Corporate Governance

Although the first version of the U.K. Code on CG was produced in 1992 by the Cadbury Committee, the Combined Code was formally issued in 1999 in order to provide guidance on some key aspects of CG such as: BoDs, remuneration, accounting and auditing, and relations with shareholders. It was again revised in 2003, when it incorporated the substance of the Basel Committee Report (2001), the Higgs Report (2003), and the Smith Guidelines (2003). It is now known as the U.K. Corporate Governance Code (the Code). All companies with a premium listing of equity shares in the U.K. are required under the listing rules to report on how they have applied the code in their annual report and accounts. Stock exchange listed companies are required to report on how they have applied the main principles of the code. They either confirm that they have complied with the code's provisions or, where they have not complied, they are requested to provide an explanation. The code is reviewed and updated at regular intervals by the Financial Reporting Council (FRC). In May 2010, the FRC issued a new edition of the code which has been applied to the financial years beginning on or after 29 June 2010. The code comprises principles on five broad sections, which are outlined as following (FRC, 2010):

Section A: Leadership

- Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.

- There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.
- The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.
- As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.

Section B: Effectiveness

- The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.
- There should be a formal, rigorous, and transparent procedure for the appointment of new directors to the board.
- All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.
- All directors should receive induction on joining the board, and they should regularly update and refresh their skills and knowledge.
- The board should be supplied in a timely manner with information in a form, and of a quality, appropriate to enable it to discharge its duties.
- The board should undertake a formal and rigorous annual evaluation of its own performance, and that of its committees and individual directors.
- All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Section C: Accountability

- The board should present a balanced and understandable assessment of the company's position and prospects.
- The board is responsible for determining the nature and extent of the significant

risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

- The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management, and internal control principles; and for maintaining an appropriate relationship with the company's auditor.

Section D: Remuneration

- Levels of remuneration should be sufficient to attract, retain, and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of the executive directors' remuneration should be structured so as to link rewards to corporate and individual performance.
- There should be a formal and transparent procedure for developing policy on executive remuneration, and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.

Section E: Relations with Shareholders

- There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.
- The board should use the AGM to communicate with investors and to encourage their participation.

3.5 Corporate Governance Models

The governance structure of a corporation in a given country is determined by several factors, including: the legal and regulatory framework outlining the rights and responsibilities of all parties involved in CG; the de facto realities of the corporate environment in the country; and, each corporation's articles of association. Therefore, it

is possible to outline a ‘model’ of CG for a given country. Amidst growing recognition of sound governance, different countries are addressing the issue of CG from different angles (Becht et al., 2005). A system of CG refers to a country-specific framework of legal, institutional, and cultural factors through which stakeholders can influence managerial behaviour (Li and Harrison, 2008). There are several such country-specific systems that work as determinants of CG practices around the world. While CG is emerging as an increasingly crucial area of modern management due to recent corporate meltdowns, frauds and criminal investigations, researchers have signalled the need for ‘new theoretical perspectives and new models of governance’ (Jensen, 2001; Monks and Minow, 2004; Daily et al., 2003 cited in Young and Thyil, 2008). One significant effect of national environmental differences is a variation in corporate ownership structures (Charkham, 1994; Shleifer and Vishny, 1997). Jenkinson and Mayer (1992) distinguished between two broad categories of corporate ownership structure across countries. In one category, which includes the U.K. and the U.S.A., ownership is more dispersed among a large number of unrelated individual and institutional investors. In the other category, there are the countries of Continental Europe (lead by Germany) and Japan, in which the ownership of individual firms is often concentrated within a small number of directly related firms, banks, and families. However, a number of scholars, such as Scott (1985), DeJong (1989) and Moerland (1995ab), have all suggested that there are four systems of CG, which originate from relatively rich and industrialised countries, they are:

- (i) Anglo-Saxon System (i.e. U.S.A., U.K., Canada, Australia etc.);
- (ii) Japanese System;
- (iii) Germanic System (i.e. Germany, Netherlands, Switzerland, Sweden, Austria, Denmark, Norway, Finland); and
- (iv) Latin European System (i.e. France, Italy, Spain, Belgium, Portugal).

3.5.1 Anglo-Saxon System of Corporate Governance

Maximisation of ‘shareholders’ value’ is a central element in the Anglo-Saxon governance system. The three major players in this CG system are: management,

directors, and shareholders. The Anglo-Saxon model assumes the separation of ownership and control in most publicly-held corporations. The interests of shareholders and management may not always coincide. Laws governing corporations in countries using the Anglo-Saxon model attempt to reconcile this conflict in several ways. Most importantly, they prescribe the election of a board of directors by shareholders and require that boards act as fiduciaries for shareholders' interests by overseeing management on behalf of shareholders. Management often has a strong influence over relatively weak boards. The Anglo-Saxon system mainly stems from the governance practices of the U.S.A., the U.K., and some other English-speaking countries such as Canada and Australia. According to Weimer and Pape (1999), firms in these countries must commit themselves to the priority objective of maximising shareholder wealth, and they have strong legal back-up to protect the shareholders' interest through laws that give rise to the principle of 'one share one vote' (Franks and Mayer, 1990). Corporations in countries which follow the Anglo-Saxon model are usually governed by one single BoDs which consists of both internal and external members. The external, or non-executive, directors supervise and advise the managerial directors on major policy decisions in line with the best interest of the shareholders (Lorsch and MacIver, 1989).

According to FIBV (1996), the stock market is very strong and active in Anglo Saxon countries. The Anglo-Saxon countries have an active market for corporate control, referred as a 'takeover market', with common takeover techniques such as mergers, tender offers, proxy fights and leveraged buy-outs (Weimer and Pape, 1999). Abowd and Bognanno (1995) found that performance-based remuneration is an important part of the total managerial compensation in the U.S.A., accounting for one third of total compensation of CEOs in 1992. The lengths of economic relationships mark another characteristic of CG systems, these relationships tend to be short-term in the Anglo-Saxon system. Such short-term and unstable relationships result from unrestricted markets for capital, labour, goods, and services which ensure rapid adjustment to changing circumstances (Gelauff and Den Broeder, 1996). In particular, the AC is currently becoming as a widely accepted governance mechanism in the corporations. As more countries are converging toward an Anglo-Saxon model of CG, ACs are widely

accepted to establish confidence in financial markets (Collier and Zaman, 2005 cited in Chan and Li, 2008).

Therefore, the Anglo-Saxon model is characterised by: share ownership of individual, and increasingly institutional; investors not affiliated with the corporation (known as outside shareholders or ‘outsiders’); a well-developed legal framework defining the rights and responsibilities of three key players (i.e. management, directors, and shareholders); and a comparatively uncomplicated procedure for interaction between shareholder and corporation, as well as among shareholders during or outside the AGM.

3.5.2 Japanese System of Corporate Governance

The Japanese model is characterised by: a high level of stock ownership by affiliated banks and companies; a banking system characterised by strong, long-term links between bank and corporation; a legal, public policy and industrial policy framework designed to support and promote ‘*keiretsu*’¹³; boards of directors composed almost solely of insiders; and a comparatively low (in some corporations, non-existent) level of input of outside shareholders, caused and exacerbated by complicated procedures for exercising shareholders’ votes.

Equity financing is the most important source of fund for Japanese corporations. Insiders and their affiliates are the major shareholders in most Japanese corporations. Consequently, they play a major role in both individual corporations and in the system as a whole. Conversely, the interests of outside shareholders are marginal. The percentage of foreign ownership of Japanese stocks is small, but it may become an important factor in making the model more responsive to outside shareholders. In the Japanese model, the four key players are:

- (i) Bank (a major inside shareholder);

¹³ A ‘*keirets*’ is a set of companies with interlocking business relationships and shareholdings. It is a type of business groups linked by trading relationships as well as cross-shareholdings of debt and equity.

- (ii) Affiliated company or ‘*keiretsu*’ (a major inside shareholder);
- (iii) The management; and
- (iv) The government.

It should be noted that the interaction among these players serves to link relationships rather than balance powers, as in the case in the Anglo-Saxon model. The Japanese model may be pictured as an open-ended hexagon:

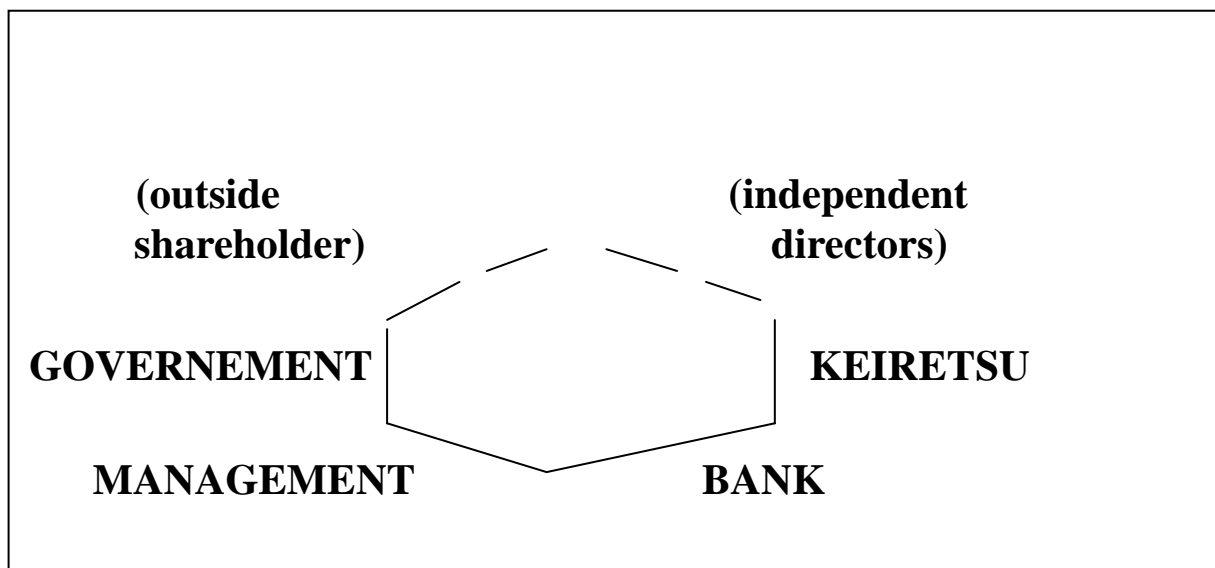


Figure 3.2: Japanese Model of Corporate Governance

The base of Figure 3.2, with four connecting lines, represents the linked interests of the four key players: government, management, bank, and ‘*keiretsu*’. The open lines at the top represent the non-linked interests of non-affiliated shareholders and outside directors, because these play an insignificant role.

The Japanese system is more driven by the cultural dimension of the CG when compared to other systems of governance. It can be argued that 'family values' encompass all characteristics of the Japanese governance system. In legal aspects, the ICMG (1995) have suggested that little emphasis is placed on litigation in Japan. The BoDs of Japanese firms include an office of representative directors and an office of

auditors. Aoki (1984a) and Corbett (1994) claimed that Japanese firms often set up an informal sub-structure of the BoDs, which results in the inclusion of both inside and outside members. In the Japanese model, employees and shareholders exert considerable influence on managerial decisions. Aoki's (1984ab) studies present a model which views Japanese firms as a coalition of the body of employees and the body of shareholders, which is targeted and mediated by the management. Japanese commercial codes view shareholders as important stakeholders, but for cultural reasons their role is different from those in the other governance systems (ICMG, 1995). Zielinski and Holloway (1991) suggested that sometimes the shareholders hold shares for symbolic reasons; for example, because they are considered as a ticket of admission to the corporate network.

As shown in Figure 3.2 (p. 68), the government is one of the key players in the Japanese CG system; for example, the government directed industrial policy guides the governance of Japanese corporations. The Japanese government has been pursuing an active industrial policy to assist Japanese corporations since the 1930s. Furthermore, the Japanese government encourages the formation of '*keiretsu*' and maintains close relationships with these business groups. Similarly, the '*keiretsu*' ensures government representation on the company's board (Aras and Crowther, 2009).

Japanese banks are believed to be salient influential stakeholders in the Japanese system (Harrison, 1997; Corbett, 1994). The Japanese stock market is the oldest in Asia, playing a very active role in the economy (Harrison, 1997). Because takeovers are frowned upon (Moerland, 1995a), there is no active market for corporate control in Japan. The ownership structure is marked by stable cross-holdings between financial and non-financial companies and, consequently, ownership is more widely dispersed than in the Germanic system but the concentration is still higher than in the U.S.A. Abowd and Bognanno (1995) suggested that performance-based pay is not very common in Japan. The ICMG (1995) indicated that the issue of managerial remuneration is of much less interest to stakeholders than in many other countries. According to Weimer and Pape (1999), the presence of '*keiretsu*' and the concept of

long-term employment together with 'familyism' indicate long-term and stable economic relationships in the Japanese governance system.

3.5.3 The Germanic System of Corporate Governance

The German CG model differs significantly from both the Anglo-Saxon and the Japanese model, although some of its elements resemble those of the Japanese model. In Germany the legal system is quite explicit in finding that firms do not have a sole responsibility to pursue the interests of shareholders. Indeed, this CG system is somewhat ambivalent towards minority shareholders, allowing them the scope for interaction by permitting shareholders' proposals but also permitting companies to impose voting rights restrictions. Most German corporations have traditionally preferred bank financing over equity financing. As a result, German stock market capitalisation is small in relation to the size of the German economy. Furthermore, the level of individual stock ownership in Germany is low, reflecting the traditionally conservative investment strategy of most Germans. It is not surprising, therefore, that the German CG structure is geared towards preserving relationships between the key players, notably banks and corporations.

The Germanic system considers corporations as autonomous economic entities which, rather than concentrating on shareholder benefits alone, value partnership among different stakeholders (Moerland, 1995a). Studies by Edwards and Fischer (1994), and Kaplan (1995) suggest that most of the Germanic system countries have a two-tier board system comprising a management board and a supervisory board. Legally the supervisory board monitors the management board, but in practice it gives advice to the management board on major policy decisions and possesses the authority to appoint or dismiss the management board. The influence of independent shareholders on managerial decision-making is limited in the Germanic model because the Anglo-Saxon trademark of 'one share, one vote' does not prevail. Another characteristic of the Germanic system is that large banks are very influential stakeholders of corporations. Banks in Germany can hold large share blocks, unlike in the U.S.A. where such a

practice is legally restricted (Weimer and Pape, 1999). The ICMG (1995) suggested that the economic relationship among stakeholders is generally long-term. Gelauff and Den Broeder (1996) indicated that sizeable and stable shareholdings by non-financial corporations and banks facilitate long-term and stable economic relationships in the Germanic system of CG. However, the stock markets in the Germanic system play a far less active role than in Anglo-Saxon countries, and it is rare to find a market for corporate control in this system (Weimer and Pape, 1999). The ownership structure of Germanic countries may be responsible for inactive or weak markets of corporate control because concentrated ownership, which is common in Germany, can more easily and directly influence managerial actions.

Three unique elements of the German model distinguish it from the other models. Firstly, the German model prescribes two boards with separate members. This implies that German corporations have a two-tiered board structure consisting of a management board (composed entirely of insiders, that is, executives of the corporation) and a supervisory board (composed of labour/employee representatives and shareholder representatives). The two boards are completely distinct and no one may serve simultaneously on a corporation's management board and supervisory board. Secondly, the size of the supervisory board is set by law and cannot be changed by shareholders. Thirdly, in Germany and other countries which follow this model, voting right restrictions are legal and limit a shareholder to voting a certain percentage of the corporation's total share capital, regardless of share ownership position.

3.5.4 Latin European System of Corporate Governance

Latin European countries follow a CG system which is something of a hybrid cross between the Anglo-Saxon system and the Germanic system, showing a closer resemblance to the latter (Weimer and Pape, 1999). For example, firms in France have the option to choose from either a one-tier board system (as in the U.S.A. and U.K.), or a two-tier board system (as in Germany). The ICMG Report (1995) indicated that around 98 per cent of the listed companies have chosen the unitary, or one-tier, board

system, leaning towards the Anglo-Saxon model. Similarly, shareholders in the Latin European system have more influence than in the Germanic system, yet their influence is less decisive than that in the Anglo-Saxon system. In addition, the employees' influence on managerial actions is less institutionalised than in the Germanic system (DeJong, 1989). Shareholder influence in Latin European countries stems from financial holdings and cross shareholdings, and government and family control (Moerland, 1995ab). For example, although in France and Spain shareholding by banks is as important and as common as it is in Germany, Italy is closer to the Anglo-Saxon system. Stock markets play a very negligible role in Latin countries when compared with Anglo-Saxon environments; however, Moerland (1995b) suggested that despite the absence of an active takeover market there have been more hostile takeovers in this system than in the Germanic. Again, a concentrated ownership structure in Latin countries explains the absence of the market for corporate control, which is more akin to the Germanic model. As in the Germanic system, performance-based compensation is not very common in Latin countries; however, Abowd and Bognanno (1995) argued that the percentage of executive remuneration in France is similar to that in the U.K. and Canada.

It is clear from the above discussion that CG models differ according to the variety of capitalism in which they are embedded. Cuervo (2002) argued that no one single model of CG appears to be applicable everywhere. According to Franks and Mayer (1994), the differences in CG models between countries do not occur because of the way in which financial systems are used to fund the companies, but rather because of the differences in the way that ownership and control are organised. It may vary by country and sector and, even for the same corporation, over time, depending on: the differences in market structures, development of the institutional framework, legal and regulatory systems, and cultural and societal values (Iskander and Chamlou 2000; Cuervo 2002). There seems to be a recent pattern of convergence in CG systems. As Iskander and Chamlou (2000) mentioned that the globalisation of markets seems to provide firms with the impetus to converge operational and governance practices in the form of reduced risks for the investors, and a decreased cost of capital to the firm. Cuervo (2002) however, observed that the trend of convergence does not necessarily entail a movement towards

a single model, but rather a transition in the direction of common guiding principles of information, transparency, and accountability.

Therefore, despite the four different models which have been discussed, they come from two dominant school of thoughts namely: (i) the Anglo-Saxon Model (also known as the liberal model); and (ii) the Continental European and Japanese Model (also known as the coordinated model) (Clarke, 2007; Rossouw and Sison, 2006; Solomon and Solomon, 2004 cited in West, 2009). While, the liberal model that is common in Anglo-Saxon countries tends to give priority to the interests of shareholders, the coordinated model recognises the interests of workers, managers, suppliers, customers, and the community. Each model has its own distinct features. Thus, the liberal model of CG encourages radical innovation and cost competition, whereas the coordinated model of CG facilitates incremental innovation and quality competition. It is important to note that all CG models have evolved mainly in developed countries on the basis of the CG practices which are conducted in those countries. On the other hand, developing or least developed countries follow developed countries in this respect. However, CG practices in terms of models vary across these economies. The next section discusses the CG practices of developing economies.

3.6 Corporate Governance Practices in Developing Countries

In contrast to the numerous studies on CG in developed countries, limited research studies have been undertaken on the extent to which the CG issues of developed economies are applicable to emerging economies. The minimal research, conducted on the use of CG in developing countries, mainly focuses on the CG practice of an individual country. The increasing pace of globalisation and democratisation in most developing countries, however, calls for the enhancement of governance practices in these countries (Reed, 2002). The attention to the developing world's CG becomes more necessary when it is realised that the success of on-going economic reforms largely depends on the quality of CG (Nenova, 2004). Oman (2001) stressed the importance of implementing sound CG for the sake of development, suggesting that its use can

increase the flow, and decreases the cost of financial capital and can stimulate productivity growth. Developing countries are constantly seeking investment, particularly foreign investment, into trade and industry, and CG plays an important role in tapping investment by boosting investor confidence. Deregulation and privatisation has created scores of new firms with millions of new investors, including: shareholder-suppliers of equity finance, creditor suppliers of debt finance, and employee-suppliers of human capital (Oman, 2001).

Several studies have regarded the development of appropriate CG system as one of the greatest challenges of low-income countries in achieving sustainable financial sector development and economic growth (e.g. Nenova 2004; Oman and Blume 2005; Iskander and Chamlou 2000). The particular importance of a robust CG regime in developing countries is evident in several recent studies that have advocated a strong system for encouraging inward investment and nourishing long-term economic growth (Johnson et al., 2000; Lynham et al, 2006; Visser et al., 2006). Important changes have indeed been occurring in CG systems in all major industrialised, and even some emerging countries, in recent years (De Nicolo et al., 2008 cited in Yoskikawa and Rasheed, 2009). CG in developing economies is gradually attracting attention (Oman, 2001; Lin, 2001). This has been given impetus as the East Asian crises, along with debt crises in Russia and Brazil, have exposed the problems of poor CG in developing, as well as emerging, markets (Allen, 2005; Oman et al., 2003). The growth in international capital flows to developing countries stresses the importance of improved CG.

Apart from the widely discussed Anglo-Saxon and Continental European models, another governance system seems to aggregate multiple related shareholders acting within and across business groups in Asia and Latin America (Cuervo 2002). In most developing economies the most common pattern of ownership is family-based rather than the Berle and Means (1932) pattern of dispersed ownership. Singh et al. (2002) argued that the family-based system of CG is often associated with relationship banking. This means that the family-based system is almost identical to the bank-based Continental European model. In this respect, the nature of governance problems in the

relationship based system is fairly different from that of the market-based systems in the Anglo-Saxon economies (Tsui and Gul 2000; Singh et al. 2002; La Porta et al., 1999a). As Rajan and Zingales (1998) stated: "... *Market-based systems require transparency as a guarantee of protection ... By contrast; relationship-based systems are designed to preserve opacity, which has the effect of protecting the relationship from the threat of competition*". The actual ownership of family-run companies is opaque given the widespread use of pyramiding, cross-holdings, and the use of non-public trusts (Chakrabarti et al., 2008). The study of Ehikioya (2009) found an adverse effect on a firm's performance if its board includes two or more members from the same family. The characteristics of family-owned businesses are that they are expected to have unique agency problems which are linked with CG and a firm's performance (Jackling and Johl, 2009). The uniqueness of this agency problem was explained by La Porta et al. (1999b) who suggested that although the agency problem in developed countries is between managers and shareholders, in developing countries the problem exists between the majority and minority shareholders.

Ahunwan (2002) argued that in some cases where the conflict between managers and shareholders arises in developing countries, it is worsened by ill-functioning capital markets, information asymmetry, and a lack of adequate infrastructure. Developing countries' corporate structures are characterised by the majority shareholder's desire to maintain control over firms, the reliance on debt finance, weak financial markets, and an ineffective legal system (Rabelo and Vasconcelos, 2002). An optimal solution to a firm's governance problem seems to be constrained by the institutional, legal and political environment in a developing economy. Western governance mechanisms might not be suitable for use in Asia because of the dominance of family-controlled and relationship-based governance structures (Prowse 1994; Tsui Gul, 2000). Singh et al. (2002) argued that the market-based system has specific governance problems, which involve agency costs, asymmetric information and incomplete contracting. They also argue that the family-based system not only solves the agency problems far better than the Anglo-Saxon model, but also escapes from short-termism as well as the speculative problems of the stock market-based model. Moreover, this system tends to be more beneficial to

the long-term economic development of emerging economies. The relationship-based system of some emerging markets (as well as of European countries like Germany) has very successful records of fast long-term growth, which is often superior to that of the Anglo-Saxon countries. Nevertheless, Van Den Berghe and Carchon (2003) outlined several pitfalls of the family based governance system, including: conflicts of interest, higher monitoring costs, and higher asymmetries. Shleifer and Vishny (1997) and Barclay et al. (1993) also observed that large controlling shareholders can cause agency problems because they tend to maximise their wealth at the expense of minority shareholders.

In a seminal World Bank study that outlines the CG agenda for developing nations, Nenova (2004) noted that developing countries face challenges in various areas in terms of sound CG. The author argued that the main governance problem in low-income countries is value transfer from non-controlling shareholders or stakeholders to that of dominant large shareholders. Such abuse becomes easier with concentrated ownership (which is often in the hands of a few families), ineffective disclosure practices, a weak legal framework and enforcement, and problems in the audit environment. The rise of governance in developing countries is the result of poor economic performance and the consequent high international debt levels which necessitate the intervention of international financial bodies such as the World Bank. Increased focus on governance issues is included by these bodies as part of the general reforms (Reed, 2002). Thus, the World Bank, the IMF, and the IFC have worked to encourage the improvement of governance levels in emerging markets (McKinsey, 2001). The OECD Principles of Corporate Governance, issued in 1999 and subsequently revised in 2004, also includes much guidance about corporate governance reform in developing economies. Measures to improve CG in developing countries that have been suggested include: encouraging the use of equity instead of debt for growth, increasing overall investor confidence through governance issues (such as shareholder rights and increased transparency), strengthening of capital market structures (such as listing requirements and banking reforms), and encouraging the use of competition to improve the performance of domestic firms (Reed, 2002 cited in Tsamenyi et al., 2007).

A detailed picture of CG in the Former Soviet Union (FSU) states has been provided by the research of Estrin and Wright (1999). Taking advantages of provisions of the 1989 legislation, under which enterprises had options to buy out, insider dominance became overwhelming in these economies (Filatotchev et al., 1992; Estrin and Wright, 1999; Frydman et al., 1996; Boycko et al., 1995; Buck et al., 1999). Following the initial transitions, inefficiency of the FSU states that capital markets exacerbated the CG problems by inhibiting the takeover mechanisms (Estrin and Wright, 1999). In many FSU countries, outside ownership was obstructed, as was evident in the Russian case. Bleaney et al. (1999) reported that there was large entrenchment by management in terms of purchasing shares from employees, and resistance to takeover by outsiders. Despite the official endorsement of relevant accounting legislation, there have been serious problems in its enforcement for financial reporting purposes in FSU states (Estrin and Wright, 1999). This problem is more severe in private companies: firstly, where there are pervasive effort to hide profit (EBRD, 1998); secondly, where the practice of tunnelling may imply that assets are transferred out of firms by controlling owners without other owners being aware (Harris, 1997); thirdly, where reported asset value could be fictitious (Shama and Merrell, 1997); and fourthly, where only a board seat may enable one to acquire necessary information (Wright et al., 1998).

A report by the World Bank (2003) highlighting the practices of CG in Chile revealed that the Chilean system attempts to ensure shareholder rights through formal ownership registration and full disclosure of information to shareholders. However, taking advantage of concentrated ownership many controllers maintain control at 67 per cent in order to make fundamental corporate decisions, thereby ignoring small and outside shareholders. Although Chilean corporate law restricts cross-holdings, dual class shares with restrictive/preferential rights to appoint directors are allowed. Firms in Chile must disclose the identities of their twelve largest shareholders. However, it is possible that conglomerates may be controlled through private holding companies and, therefore, in reality it can be difficult to identify a firm's controller. Chile has a market for corporate control to a limited extent (Walker, 2001). Abuse of corporate assets and abuse in connected party transactions remain a recurrent problem in Chile. The CG system

requires companies to disclose information (such as financial statements, directors' and auditors' reports, board members' compensations, purchase of shares and sale of company securities and any related party transactions) yet, despite these requirements, there are no obligations on the firms to disclose some important information (such as changes in equity, company objectives, material foreseeable risk factors, internal control, and material issues regarding stakeholders and governance structures and policies). Moreover, the accounting and audit standard followed in the Chilean corporate sector falls far behind the international accounting and audit standards. Concerns are increasing (particularly in small to medium size Chilean firms) regarding the quality, qualification, and commitment of the board members (Spencer, 2000).

As in many other developing countries, the debate about, and developments in, CG in South Asia does not have a long history. Godbole (2002, 1996a, 1996b) indicated that the large business empires holding control of firms through family and/or concentrated ownership often ignore stakeholders' interest, which leads to a perspective that CG in India is still an 'infant'. In support of this view, Dadiseth (1997) and Basu (1999) suggested that the CG model in India failed to address important issues (such as corporate conscience and consciousness, and the culture of transparency in organisations). The need for a credible and strong regulatory mechanism is urgent in order to strengthen CG practice in India because the current situation is far from satisfactory (Mehta and Godbole, 2002). Various reforms were undertaken in the 1990s to improve CG in India. The formation of the Securities and Exchange Board of India (SEBI) in 1992 was a particularly significant event. The establishment of the SEBI resulted in the formation of four major committees, they are: Bajaj Committee in 1996, Birla Committee in 2000, Chandra Committee in 2002, and the Narayanan Murthy Committee in 2003. The aim of these committees is to review governance issues and to propose governance laws and reforms. Many of the governance reforms and recommendations advocated by these committees were formally implemented by the SEBI, for example through the enactment of 'clause 49' of the listing agreements. These reforms include increasing the number of outside directors, dealing with the issue of duality, and the existence of financial expertise of directors.

India is not alone in this move towards CG; for example, in Pakistan there is now a code for CG to which all listed companies are now required to comply. Sri Lanka also has a code of best practice on CG drawn up by the Institute of Chartered Accountants of Sri Lanka. In each country, the codes have begun the process of encouraging or requiring companies to recognise the importance of GCG practices. However, the mere emergence of detailed governance codes in developing countries does not necessarily mean that de facto practices will improve (Wanyama et al., 2009).

While this section has discussed on CG practices in developing economies (including the FSU, Chile, and India), the next section gives particular focus on the CG practices in Bangladesh.

3.7 Corporate Governance Practices in Bangladesh

There is evidence to suggest that there are country specific factors that may impact on setting the framework of CG (Guest, 2008; Cornelius, 2005). Li and Harrison (2008) found that national economy and culture have dominant influence on CG structure in a country. Bhuiyan and Biswas (2007) noted that in Bangladesh, although no remarkable corporate scandals have emerged to feed the necessity of corporate governance, the stock market crash of 1996 which left investors wary of the capital market for many years is worth remembering. Bangladesh has lagged behind some of its neighbours in CG development (Gillibrand, 2004) because of a number of specific factors, including the legal and regulatory environment. Recently, Siddiqui (2010) highlighted the persistent weaknesses in the Bangladeshi CG regime. He also explained that Bangladesh has failed to develop a recognised code of CG. The first substantial initiative was taken by a private consulting firm, the Bangladesh Enterprise Institute (BEI), in August 2003 when it conducted a diagnostic study in this field (as described in *Chapter Two*). Based on their study, the BEI published the CG code for Bangladesh in March 2004 (BEI, 2004). Subsequently, the Institute of Chartered Accountants of Bangladesh (ICAB) issued a set of principles and rules to be followed (Mazumdar, 2006). In January 2006, the SEC has issued an order with some CG guidelines for the

companies listed on DSE to be followed on a ‘comply or explain’ basis. The issue of CG in financial and non-financial firms has received considerable attention and recognition as one of the most critical developmental issues in Bangladesh (Haque et al., 2006; Haque, 2007). They also reported that most of the companies in Bangladesh do not come to the capital market to meet their financing needs, partly because of the controlling owners’ fear of losing control and meeting increased disclosure requirements. The concept of CG in general and minority shareholders’ rights in particular, is generally unfamiliar to the general investors in Bangladesh (Haque, 2007).

Although Siddiqui (2010) highlighted that Bangladesh has adopted an Anglo-Saxon model of CG, the CG system prevailing in Bangladesh is arguably a hybrid of outsider-dominated market-based systems (i.e. the market or compliance based model of the U.S.A. and the U.K.) and the insider-dominated bank-based systems (i.e. the control or relationship-based model of Germany and Japan) (Farooque et al., 2007). Some of the institutional features of Bangladesh include: a less developed capital market which results in a weak stock market (Islam and Khaled 2005), the absence of an active market for corporate control, generally concentrated ownership, high reliance on bank financing, a passive managerial labour market, and poor incentive contracts for management. The economic negligence experienced by the country under British colonial rule for nearly two centuries has been a significant contributor to the country’s poor institutional and corporate base. As a result, the corporate environment in Bangladesh lacks an effective market based CG system. Although broadly categorised as a common-law country, Bangladesh has a relatively unsophisticated legal and regulatory framework. The problems of a weak regulatory regime are further aggravated by poor enforcement of whatever laws and statutes exist to secure satisfactory outcomes.

Similarly, the financial reporting environment in Bangladesh (i.e., general disclosure framework in accounting and auditing) is not in accordance with full conformity with international standards. In fact, financial disclosure is made primarily to satisfy the tax authorities rather than meet the needs of investors, and markets do not necessarily

reward more transparent firms. The SEC in Bangladesh has made it mandatory for listed companies to comply with International Accounting Standards (IASs) and International Standards on Auditing (ISAs) as applicable in Bangladesh in form on Bangladesh Accounting Standards (BASs) and Bangladesh Standards on Auditing (BSAs) respectively. In relation to the reliability and comparability of financial information, Karim and Ahmed (2005) noted that the general level of compliance of Bangladeshi firms to IASs is at very satisfactory level.

Lack of adequate disclosure is another issue that has weakened CG in Bangladesh. Ahmed and Nicholls (1994) examined the level of Bangladeshi corporate compliance with the local disclosure requirements. They constructed an index of disclosure consisting of 94 mandatory items and applied it to a sample of 63 listed companies. Using stepwise regression analysis, Ahmed and Nicholls (1994) found that the level of corporate compliance with Bangladeshi disclosure requirements is significantly and positively associated with companies being subsidiaries of multinational companies ($p < 0.05$), their accounts audited by large firms ($p < 0.05$), and their accounts prepared by qualified accountants ($p < 0.10$). The size of the company has no significant association with, the level of mandatory disclosure in the Ahmed and Nicholls (1994) study.

The corporate sector in Bangladesh is predominantly owned and controlled by founder families or groups of families, or foreign owners. Siddiqui (2010) found that the corporate sector in Bangladesh is characterised by high ownership concentration. Uddin and Choudhury (2008) found that families have a dominant presence in all aspects of CG in Bangladesh. Farooque et al. (2007) and Haque et al. (2006) also noted extensive family control over corporate firms prevailing in Bangladesh. Similarly, Imam and Malik, (2007) found that the ownership of firms is largely concentrated in a few hands that directly control the business. This ownership structure is by no means similar to the pyramidal structure found in Japan and some other East-Asian countries. Most of the families in Bangladesh hold shares independently in a particular company or group of companies that they control. The prevalence of family-owned businesses, together with state ownership, thus plays a significant role. The listed companies are not free from this

prototype of governance, which is fittingly called ‘family capitalism’ or ‘crony capitalism’¹⁴ (ADB, 2003). Under the Companies Act 1994, a maximum of 50 percent of the total issued capital can be retained by sponsor directors (i.e., the promoters of the company who also act as directors until the first directors are elected) while going public. The remaining portion is distributed to the general public, financial institutions, non-resident Bangladeshis, and employees of issuing companies.

Therefore, the ownership structure has evolved as a dominant mechanism of governance. Although La Porta et al. (1999a) found that family-ownership is a common everywhere; the influence of such ownership in corporate affairs is more visible in developing economies like Bangladesh (Uddin and Choudhury, 2008). Families who hold a large portion of shares of the company have extensive influence on the decision-making process. Corporate boards generally lack independence due to founder-family control, with minimal representation of minority shareholders and institutional investors. Haque et al. (2006) mentioned three key features of CG in Bangladesh (i.e. concentrated ownership and sponsors’ control, family oriented board and family aligned executive management) all of which are signs of weak CG in practice. In many cases, the current system in Bangladesh does not provide sufficient legal, institutional, or economic motivations for stakeholders to encourage and enforce GCG practices. As a result, there are few rewards for companies that institute GCG practices and no penalties for failing to do so.

Although Uddin and Hopper (2003), and Muzumder (2006) noted that the most powerful stakeholders in Bangladeshi corporations include the BoDs, auditors and regulators, dominant shareholding families have treated BoDs as conduits for implementing their own agenda. The important decisions involving company affairs are made at family meetings and such decisions are given a stamp of approval in board meetings merely to ensure that the legal requirements under the Companies Act are met

¹⁴ Crony capitalism is a term describing an allegedly capitalist economy in which success in business depends on close relationships between business people and government officials. It may be exhibited by favouritism in the distribution of legal permits, government grants, special tax breaks, and so forth.

(ADB, 2003). The intertwining of management and the board reduces the opportunities for the board to prevent insider dealing and preferential treatment. Minority shareholders' rights are largely ignored or suppressed. Even non-executive directors fail to give independent judgement in enhancing corporate wealth for all shareholders because the nominees tend to have business or social connections with the controlling shareholder group (ADB, 2003). The above features of corporate firms create an inevitable conflict between dominant shareholder(s) and minority shareholders, as indicated by Williamson (1979), Grossman and Hart (1980), Fama and Jensen (1983) and Shleifer and Vishny (1986). Oman et al. (2003) contended that the key potential conflict of interest in developing, transition, and emerging market countries (like Bangladesh) tends to arise, not between managers and shareholders like in the U.S. and the U.K., but between controlling shareholders and other shareholders, on the one hand, and investors, on the other. There are plenty of opportunities for controlling shareholders of unethical business practice or to expropriate wealth from outside shareholders. This is central to the quality of CG in Bangladesh impacting firm performance as predicted by agency theory.

Ahmed and Yusuf (2005) regretted that the current system in Bangladesh does not provide sufficient legal, institutional, or economic motivation for stakeholders to encourage and enforce CG practices. Poor bankruptcy laws, no push from the international investor community, limited or no disclosure regarding related party transactions, weak regulatory system, general meeting scenario, lack of shareholder active participations are some of the individual constituents that have been identified by Ahmed and Yusuf (2005). Desired level of reforms in institutions or sectors can begin to provide the internal and external motivation for transparency and accountability that will lead to better CG. Bangladesh is currently trying to attract more investment, both from domestic and foreign investors, to improve its economic performance. To achieve these, there should be more recognition that CG is integral and necessary to the development of the private sector in Bangladesh. Although the studies noted that the scenario of CG practices in Bangladesh is not at the expected level, the regulations in terms of investor protection which existed in Bangladesh has been regarded more

investor friendly than that of the neighbouring countries. For example, the World Bank has ranked Bangladesh as 20th for 'Investor Protection' ranking¹⁵, which is the best among all south Asian countries while India, Sri Lanka, and Vietnam were ranked 29th, 70th, and 143rd, respectively.

3.8 Role of the Audit Committee in Corporate Governance

The AC is arguably the most important of the subcommittees which is formed by the board (Mallin, 2010). A growing number of studies (such as: Genron and Bedard, 2006; Turley and Zaman, 2007; Sori et al., 2007; Chen et al., 2008 and Beasley et al., 2009) have recently been undertaken which emphasise the roles of the AC in strengthening overall corporate governance. CG has a positive impact on corporate auditing processes, and vice versa (Lin and Liu, 2009; Turley and Zaman, 2001). The true effectiveness of auditing is subject to the actuality and the development of the CG environment, including AC practice (Holm and Laursen, 2007). Lin and Liu (2009) further noted that CG plays an important role in enhancing the effectiveness of the audit function. In the effort to devise ways of bringing about good governance in companies, one of the issues that has taken an increasing importance is how best to harness the oversight process to achieve more fully the goal of quality corporate financial reporting. This brought about the idea of AC, which is at the core of the corporate financial reporting process (BRC, 1999).

Furthermore, Pomeranz (1997) claimed that the AC is being recognised as simply another board committee, although one which has to work in tandem with the entire board. Moreover, Jonas and Young (1999) pointed out that in today's corporate environment, concepts such as board accountability and AC effectiveness are increasingly important topics of discussion, and they are also increasingly becoming subject of CG studies and surveys. Jennings (2002) argued that the goal in the creation of independent ACs is to provide shareholders with the assurance that someone from

¹⁵ Source: International Finance Corporation (World Bank) Ranking (2011) on 'Doing Business: Measuring Business Regulations.

outside the company is watching over the activities, practices, and behaviours of managers and the company's employees. Mautz and Neary (1979) claimed that the AC is indeed a useful device that can provide an additional safeguard in CG. Smith (2003) claimed that ACs would be beneficial, not only in increasing the level of assurance against catastrophic failure and gross malfeasance but it would also offer improvements on a wider front, raising the overall standard of CG for all companies that establish ACs.

Millstein (1999) claimed that prior to the 1970s the boards of directors were management-dominated, passive, and generally inert. Such passivity was largely overlooked and boards of directors were not expected to do much more than rubber-stamp the management's decisions. Burke et al (2001), after a review of the BRC (1999) and other recommendations concerning CG and ACs, noted that: "*the essence of these recommendations to ACs is that effective internal control leads to responsible financial reporting*". Klein (1998a) argued that if CG mechanisms are substitutable, then strong alternative CG mechanisms should mitigate the need for the firm to have an active and independent AC. In 2001, the Basel Committee (2001), which had twenty members and a chair from many international countries, issued a paper on internal audit in banking organisations and the relationship of the supervisory authorities with internal and external auditors. The solution they recommended was the creation of a permanent AC to meet the practical difficulties that may arise from the board's task to ensure the existence and maintenance of an adequate system of controls. The AC plays an instrumental role in ensuring the quality of financial reporting (Abbott and Parker, 2000). Rezaee and Lander (1993) described this as a visible interest by boards of directors, and especially audit committees, in ethical behaviour, strong internal controls, and enforcement procedures to limit the risk that fraud will occur. Again, Rowland (2002) claimed that:

The new rules strive to further the monitoring model and activate the BoDs with respect to the financial reporting process by creating audit committees that are independent, capable, and imbued with the incentive to oversee management's production of financial statements.

Verschoor (1992) described the significance of ACs on CG:

The establishment of standing audit committees of the BoDs in public corporations followed by their assumption of greater oversight responsibilities for matters of internal control, financial reporting, and auditing has been described by at least one prominent authority as the most significant new development affecting corporate governance in this century.

Burke et al (1996) further claimed that the AC is of critical importance in fulfilling the oversight responsibilities of governing boards with regard to an organisation's financial reporting, internal controls, and external audit process. Similarly, Datta (2000) pointed out that a system of GCG promotes a relationship of accountability between the principal actors of sound financial reporting, that is: the board, the management and the auditor. It holds the management accountable to the board, and the board accountable to the shareholders. The role of an AC flows directly from the board oversight function. It also acts as a catalyst for effective financial reporting. The BoDs has primary responsibility for the financial statements which are prepared by the accounting function. The BoDs delegates the responsibility for overview of the financial reporting process and the external and internal audit functions to an AC, in which case there should be close communication between the AC and the internal and external auditors (Rainsbury et al., 2008). Klein (1998b) noted how an AC can alleviate the agency problem in the firm, and can also reduce the information asymmetry between insiders and outsiders. Bradbury (1990) also argued that ACs reduce information asymmetry between executive and non-executive board members. DeZoort (1997) mentioned that the ACs assume the important responsibility of representing boards of directors on oversight matters related to financial reporting, auditing, and overall CG. Their study further noted that, in an effort to protect the shareholders' interests, the ACs monitor management, the external auditor, and the internal auditor. Moreover, Datta (2000) discussed that a proper and well functioning CG system exists when the three main groups (i.e. the board, the management, and including the internal and the external auditor) responsible for financial reporting form the three legged stool that supports responsible financial disclosure and active oversight.

Since the AC is a sub-committee of the full board and monitors this process, the AC has an important role to play in the process. Among the different committees that can be created to monitor the actions of the BoDs, previous research assigns the AC a very important role within the governance structure (Osma and Noguer, 2007). In discussing the importance of ACs as a mechanism for CG, Millstein (1999) pointed out that the movement to progressive CG, which included regulatory and voluntary measures to improve overall board independence and oversight, was initiated by the U.S. Securities and Exchange Commission's (SEC's) focusing on financial reporting and structure ACs. It is totally consistent, therefore, that GCG practice points to the AC as the focal point for improvements in financial reporting (Millstein, 1999). Rezaee (1997), after a review of current reports and recommendations concerning ACs, said that: *"these reports underscore the oversight role of the AC as an important factor in promoting the quality of CG and enhancing public confidence in the financial reporting process"*. Furthermore, DeZoort (1997) explained that corporate boards and ACs have incentives to avoid the negative consequences (e. g. litigation and damage to reputation) of failed monitoring efforts. Although the AC is only one dimension of a broad-based CG, a lack of appropriate AC oversight can ultimately contribute to corporate failure and diminish public confidence in the mechanism (DeZoort and Salterio, 2001). Conversely, recent evidence suggests that strong CG has the potential to increase audit effectiveness and efficiency by reducing: firstly, the auditor's perceptions of client business risk; secondly, the auditor's control risk judgements for specific audit assertions; and thirdly, the amount of planning substantive testing.

However, Pomeranz (1997) highlighted that the mere labelling of a group of directors as 'the AC' will not by itself create an effective monitoring organisation. Likewise, Kleinman and Farrelly (1996), and Archambeault and DeZoort (2001) claimed that the use of ACs does not necessarily mean that CG is being practised effectively. Also, Barker (2002) questioned the suggestion that better ACs are the solution to the crisis of trust in the profession, because if CG in general is defective, then a better mechanism for selecting the boards of directors is required. The answer to poor standards of audit, inadequate controls, poor financial accounting and low ethical standards as Barker

(2002) described: *"It is not an audit committee which will act as watchdog, but higher standards of ethical behaviour, frank disclosure and a real understanding of the duties imposed on a professional which, when applied will lead to trust without policies"*.

3.9 Conclusion

The issue of CG has gained attention since the early twentieth century. The many corporate collapses in the late 1990s and early 2000s have highlighted the need to make management and directors of public companies more accountable, and they have led governments to actively promote higher standards of CG. It has been described as: *"Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies"* (FRC, 2010). It is the process carried out by the BoDs, and its related committees, on behalf of, and for the benefit of, the company's stakeholders, to provide direction, authority, and oversights to management (Sobel, 2005). CG ensures that shareholder rights are safeguarded, stakeholders' interests are reconciled, and that a transparent environment is maintained wherein each party is able to assume its responsibilities and contribute to the corporation's growth and value creation (Page, 2005 cited in Jamali et al., 2008). Murthy (2006) argued that GCG in a corporate set-up maximises the value of the shareholders legally, ethically, and on a sustainable basis, while ensuring equity and transparency to all stakeholders. An effective CG system has been found elsewhere to assist in the attainment of high level financial performance and market valuation (Klapper and Love, 2004; Rajagopalan and Zhang, 2008).

In the context of the growing separation of ownership and control, issues such as economic performance and corporate sustainability have provided the impetus for an added focus on CG. The dominating theory in CG supports the existence of agency problems, which are particularly embedded in governance where opportunism is institutionalised and executives are presumed to be rationally economic (Lubatkin et al., 2005; cited in Ward et al., 2009). Like other South Asian countries, family based ownership pattern of firms is a common CG feature in Bangladesh and concepts of the

Anglo-Saxon CG model dominate in the local practice of CG. The discussion on international principles and practices of CG clearly indicates that there is no single governance style which is followed around the world, but it can be seen that most developing economies follow the concepts of the Anglo-Saxon model. However, the developing economies are clearly less advanced in the area of CG and need a more stringent focus on their practices because their corporate sector characteristics greatly differ from those in the developed world. Hence, it is not wise to completely replicate Western governance practices in developing countries. Rather, a detailed picture of their own CG scenario would pave a way to develop a more prudent governance framework by understanding the underlying problem areas.

This chapter has focused on CG literature including its theoretical underpinnings and developments across the world. Discussion of CG literature in this chapter also argues that one of the key mechanisms under a CG system is the AC which is the research issue of this study. Therefore, it is important to review the studies conducted on AC practices and the next chapter therefore, evaluates the academic literature on the various facets of ACs.

CHAPTER FOUR: THE AUDIT COMMITTEE IN CONTEXT-A LITERATURE REVIEW

4.1 Introduction

The literature discussed in the last chapter has already pinpointed that the Audit Committee (AC) is one of the key mechanisms in Corporate Governance (CG). A competent, committed, and independent AC has been described as ‘one of the most reliable guardians of the public interest’ (Levitt, 2000; Beasley et al., 2009). An AC, also known as a board’s sub-committee, aims to guarantee the reliability of the accounting information provided by the management. The Sarbanes-Oxley Act (SOX 2002), section (2) defines AC as:

A committee (or equivalent body) established by and amongst the BoDs of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer.

The aim of this chapter is therefore, to review the literature on the different aspects and roles of ACs. Following this introduction, Section 4.2 looks at the purposes of establishing the ACs. The advantages and disadvantages of having ACs in practice are discussed in Sections 4.3 and 4.4, respectively. Section 4.5 presents some widely accepted international guidelines on ACs; Section 4.6 evaluates the literature on AC attributes, while Section 4.7 outlines the roles of ACs. The concept of AC effectiveness is discussed in Section 4.8 and the significance of an effective AC is discussed in Section 4.9. A model of AC effectiveness is presented in Section 4.10 whilst Section 4.11 presents the developments of AC around the world. Finally, Section 4.12 summarises the chapter.

4.2 Purposes of Audit Committees

The need of auditing evolves mainly to ensure transparency and accountability in corporate affairs, where owners appoint a professional management to look after the

business on their behalf. Normanton (1966) noted that: “*Without audit, no accountability; without accountability, no control; and if there is no control, where is the seat of power?*” This famous quotation crystallises the idea that the audit is a necessary independent attestation of the accountability to the stakeholders by the stewards of the enterprise; that is, by the Board of Directors (BoDs). However, where the principal stakeholders and the stewards are the same (as with an owner-managed firm), there is arguably less need for the audit (Chambers, 2005). The developments of ACs in the U.K. and the U.S.A. have been driven by concerns about the credibility of financial reporting, particularly in relation to the issue of auditor independence. The report of the Cadbury Committee (1992) provided an outline of AC structure and membership, terms of reference, and a range of duties for the AC, but it offered no explicit statement as to its purpose. Given the nature of the recommendations, from the Cadbury perspective the AC would appear to represent the means by which the conformance role of the board might be more effectively achieved (Tricker, 1994). Ezzamel and Watson (1997) observed:

The Cadbury Report does not spell out precisely what the new subcommittees are meant to achieve... and how, other than by simply attending meetings, the non-executives are to hold executives more accountable through these new committees.

The key purpose of establishing an AC is to focus on issues of control and accountability on the corporate affairs. This view of the AC role is confirmed by commentators such as Demb and Neubauer (1992), who described an AC as ‘*the personification of the board's stewardship responsibility*’. Cobb (1993) identified four main purposes of establishing ACs, namely:

- (i) Reduction of board liability;
- (ii) Establishing a link between the external auditor and the board;
- (iii) The reduction of illegal activity; and
- (iv) The prevention of fraudulent financial reporting.

The Treadway Report (Treadway Commission, 1987) firmly emphasised that the primary role of the AC is to oversee the financial reporting process of the company.

Pomeranz (1997) noted: *“Audit committees and their perceived roles can be seen as vaguely unsuccessful, yet meritorious, endeavours to create a more level playing field for external and internal auditors”*. Bradbury's study on AC formation in New Zealand (Bradbury, 1990) suggested that ACs are established mainly to increase the credibility of financial statements. Porter and Gendall (1993) discussed AC development in Canada, the U.S.A., the U.K., Australia and New Zealand. They identified corporate failure as the primary stimulus in the development of ACs, and traced their changing role and duties over time. They concluded with a warning that too much may be expected of an AC, leading to ‘unfulfilled expectations and in undermining confidence in ACs’. Teoh and Lim (1996) explained the establishment of ACs in Malaysia as a response to corporate scandals.

However, in considering the purpose for which the ACs are established, Bradbury's cautionary remarks on the impact of institutional arrangements which vary between countries are important, as confirmed by Guthrie and Turnbull (1995) who suggested that in Australia, the ACs as currently conceived are unable to meet their objectives, which are defined as: *“Although many currently believe that audit committees were developed to protect investors...audit committees, in fact, were developed to protect non-executive directors ... from being misled by management”*. Turnbull (1994) explained that all hierarchical management systems must condense information. The study also noted:

It is not in the self-interest of subordinates to provide information about shortcomings for which they are accountable. The result is that boards with outside directors, and even those with executive directors, are at risk of being kept in the dark. Historically, this is why outside directors developed audit committees. Investor interests are incidental to the purpose of audit committees in protecting directors as becomes evident from reading the publications of the leading audit firms on this topic.

Some commentators (for example, Marrian, 1988) have observed that less explicit reasons for AC establishment may exist. Eichenseher and Shields (1985) linked the incidence of AC formation in the U.S.A. to the appointment of leading (‘Big-Eight’)

auditing firms, suggesting that this was a response to increased directors' liability. However, their study did not identify this as an explicitly articulated reason for AC formation, but instead inferred it from company behaviour. The importance of implicit reasons for AC establishment is further emphasised by Harrison's discussion of the strategic use of board committees to enhance and maintain corporate legitimacy (Harrison, 1987). Collier (1996) also offered a detailed analysis of the rise of ACs in the U.K., examining the literature on AC effectiveness, and concluded that evidence of their effectiveness was very limited and certainly insufficient to support their rapid increase in popularity.

The academic literature on ACs is thus inconclusive on the matter of their purpose. Nevertheless, the most extensive focus in this literature is on the effectiveness of ACs and how this may be achieved. The literature on CG has generally supported the notion that the presence of an effective AC complements good governance. Therefore, ACs should be formed in all organisations, in addition to having proper internal control systems in place, in order to ensure transparency and accountability in these organisations.

4.3 Advantages of Audit Committees

Several advantages of ACs are put forward by different researchers, such as: Kunitake (1983); McDonald Report (1988); Pincus et al. (1989); Haka and Chalos (1990); Luecke and Westfall (1990); DeFond and Jiambalvo (1991); Cadbury Committee (1992); Porter and Gendall (1993); Guthrie and Turnbull (1995); Wolnizer (1995); Adams (1997); Spira (1999a); Archambeault and DeZoort (2001); Osman and Nogueer (2007); Sori et al., (2007); Chen et al. (2008); Sarens et al. (2009); and FRC (2010). Their arguments can be summarised as saying that an AC:

- Improves the quality of financial reporting, by reviewing the financial statements on behalf of the BoDs;
- Creates a climate of discipline and control which will reduce the opportunity for fraud;

- Enables the non-executive directors to contribute an independent judgement and play- a positive role;
- Strengthens the position of the external auditor by providing a channel of communication and forum for issues of concern to be raised;
- Provides a framework within which the external auditor can assert his independence in the event of a dispute with management;
- Strengthens the position of the internal audit function by providing a greater degree of independence from management; and,
- Increases public confidence in the credibility and objectivity of financial statements.

Guthrie and Turnbull (1995) argued that two general themes emerge concerning the advantages of ACs. The first theme is that ACs help the independence of non-executive directors, as well as that of the internal and external auditors. Secondly, ACs improve the quality of accounting financial reporting and auditing within the host organisation. An AC is also effective in minimising opportunistic accounting choice behaviour since its functions include a review of the firm's accounting methods and changes in accounting methods (Pincus et al, 1989). Caplan (1999) highlighted the significance of ACs in detecting errors, irregularities and fraudulent practices in the firm. Since an AC restricts management's choice of accounting methods that are not representational and faithful, extra protection is afforded to debt holders as well as shareholders (Pincus et al, 1989). By monitoring the financial reporting and auditing processes, ACs also reduce information asymmetries between a company's internal and external agents, and consequently they mitigate agency costs. An AC is as a delegate body of the BoDs which is charged with safeguarding and advancing the interests of shareholders (Wolnizer, 1995; Klein, 1998b; Garcia et al., 2003). An AC is thus viewed as a monitoring mechanism intended to reduce information asymmetries between insider and outsider (i.e. management and non-management) board members (Eichenseher and Shields, 1985; Pincus et al., 1989; cited in Pacheta-Martinez and De Fuentes, 2007). The significance of ACs in strengthening internal control has been noted in many studies; for example, Wolnizer (1995); DeZoort (1998); Tan and Kao (1999); and

Millichamp (2002). All of these studies have addressed the importance and implication of AC's role, and its credibility and reliability in case of firm's control mechanism, as well as investors' decision making process.

A great deal of research [for example, Public Oversight Board (POB), 1993; Turpin and DeZoort, 1998; Blue Ribbon Committee (BRC), 1999; McDaniel et al., 2002] has addressed the importance of the ACs in ensuring credibility of financial reporting and auditing process. Vinten (2003) argued that most AC chairpersons commend the recommendations as having exerted a positive influence on corporate reporting and internal controls. Verschoor (1992) claimed that the establishment of standing ACs of the BoDs in public corporations, followed by their assumption of greater oversight responsibilities for matters of internal control, financial reporting, and auditing, has been recognized as the most significant development affecting CG.

4.4 Disadvantages of the Audit Committees

Despite having numerous advantages, the ACs and their roles have been criticised by some researchers; for example, Rainsbury et al. (2008) noted that the AC sometimes limits the growth opportunity of a firm. McMullen (1996) claimed that ACs are considered as: *'The creatures of the company's management rather than the watchdogs over shareholders' interests'*. Critics also argue that many ACs hesitate to stop management misdeeds because they fear rocking the boat and lack access to knowledgeable lower level employees. The theoretical arguments against ACs were pointed out by: Marrian (1988); Bradbury (1990); Cadbury Committee (1992); Porter and Gendall (1993); Guthrie and Turnbull (1995); Collier (1992); Collier (1996); Pomeranz (1997); Barker (2002); and, Rainsbury et al. (2008). The disadvantages as highlighted in these studies can be summarised as follows:

- The AC sometimes may cause encroachment on the functions of the executive and dilution of executive authority, or may pre-empt management responsibility;
- The AC may cause the diversion of non-executive directors from their strategic and other roles into the routine matters of audit and financial reporting;

- The AC might reduce contact between the auditors and the board;
- Sometimes, the AC is used only as a rubber stamp to confirm management decisions; and,
- AC meetings sometimes simply become a waste of their members' time.

However, these disadvantages support the idea that establishing an AC is one thing, but establishing an effective AC is another. Sommer (1991) noted that: "*A corporation having an AC as part of its governance structure and having an effective AC are, of course, different matters*". It is an accepted truth that an AC is not, and cannot be, a panacea (Macdonald Commission, 1988; Porter and Gendall, 1998). Kalbers and Fogarty (1993) claimed that any AC is more effective than no AC; however, the formation of an AC does not provide evidence about the actual levels of monitoring that will be performed. Rittenberg and Nair (1994), and Mendez and Garcia (2007) noted that the existence of an AC alone does not provide sufficient control, nor does it ensure that the company will maintain a high standard of financial reporting integrity. Further, Porter and Gendall (1993) claimed that while such procedures can reduce the potential problems, the benefits of having an AC can be realised only if it is composed of suitably qualified members. Therefore, the drawbacks of ACs that have been pointed out are not always caused by the AC itself but because of its weak practice in the company. In fact, establishing an effective AC can minimise (if not eliminate) these short comings and contribute to ensure better governance of corporate affairs.

4.5 International Guidelines on Audit Committee

There are some international guidelines that recommend different aspects of an AC (including its composition, process, roles and functions). Among these, the U.K. Combined Code on CG (2003), the Treadway Report (1987), the BRC Report (1999), and the Sarbanes-Oxley Act (2002) are well recognised. A summary of these guidelines is presented in the following sub-sections.

4.5.1 Combined Code on Corporate Governance for the U.K.

The Combined Code on CG (Combined Code) is a set of principles of GCG and provides a code of best practice which is aimed at companies listed on the London Stock Exchange (LSE). It is essentially a consolidation and refinement of a number of different reports and codes concerning opinions on GCG, including: the Cadbury Committee (1992), the Greenbury Committee (1995); the Hampel Committee (1998) and the Turnbull Committee (1999). As already stated in *Chapter Three*, the Combined Code was issued in 2003 in order to provide guidance on some key aspects of CG, namely: directors, remuneration, accounting and auditing, and relations with shareholders. The Code is reviewed and updated on a regular basis by Financial Reporting Council (FRC). Section C(3) of the Code outlines that the board should establish formal and transparent arrangements in the name of AC for considering how they should apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors. A comprehensive guideline on AC practices has been given in the following six subsections (Combined Code, 2003; FRC, 2008):

(i) The board should establish an AC of at least three, or in the case of smaller companies, two independent non-executive directors. In smaller companies the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman. The board should satisfy itself that at least one member of the AC has recent and relevant financial experience.

(ii) The main role and responsibilities of the AC should be set out in written terms of reference and should include:

- Monitoring the integrity of the financial statements of the company, and any formal announcements relating to the company's financial performance;
- Reviewing significant financial reporting judgements contained in them;
- Reviewing company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;

- Monitoring and review the effectiveness of the company's internal audit function;
- Making recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;
- Reviewing and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant U.K. professional and regulatory requirements; and
- Developing and implementing policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed.

(iii) The terms of reference of the AC, including its role and the authority delegated to it by the board, should be made available. A separate section of the annual report should describe the work of the committee in discharging those responsibilities.

(iv) The AC should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

(v) The AC should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the AC should consider whether there is a need for an internal audit function and make a recommendation to the board. The reasons for the absence of such a function should be explained in the relevant section of the annual report.

(vi) The AC should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. If the board does not accept the AC's recommendation, it should include in the annual report (and in any papers recommending appointment or re-appointment) a statement from the AC explaining the recommendation and should set out reasons why the board has taken a different position.

4.5.2 The Treadway Report

In 1987, the Treadway Report in the U.S.A. (known as the Report of the National Commission of Fraudulent Financial Reporting), offered the following eleven recommendations to enhance the effectiveness of ACs, which were to be the foundation of corporate financial governance (Vanasco, 1994; Vinten, 2003; and Alleyne, 2006):

- The AC should have adequate resources and authority to discharge its responsibilities;
- The AC should be informed, vigilant, and effective overseers of the company's financial reporting process and its internal control system;
- The AC should review management's evaluation of the independence of the company's public accountants;
- The AC should oversee the quarterly as well as the annual reporting process;
- The SEC should mandate the establishment of an AC composed solely of independent directors in all public companies;
- The SEC should require the ACs to issue a report describing their responsibilities and activities during the year in the company's annual report to shareholders;
- A written charter for the AC should be developed. The BoDs should approve, review, and revise it when necessary;
- Before the beginning of each financial year, the AC should review management's plans to engage the company's independent public accountant to perform management advisory services;
- Management should inform the AC of second opinions sought on significant accounting issues;
- Together with top management, the AC should ensure that internal auditing involvement in the entire financial reporting process is appropriate and properly co-ordinated with the independent public accountant; and,
- Annually, the AC should review the programme that management establishes to monitor compliance with the company's code of ethics.

4.5.3 The Blue Ribbon Committee

The Blue Ribbon Committee (BRC), co-chaired by John Whitehead and Ira Millstein, was set up on 6 October 1998 by the Security and Exchange Commission (SEC), the New York Stock Exchange (NYSE), and the National Association of Securities Dealers (NASD) in response to the concern expressed by Arthur Levitt, the chairman of the SEC, about the financial reporting process. In February 1999 the committee issued its report with some recommendations designed to:

- (i) Strengthen the independence of ACs;
- (ii) Increase the effectiveness of audit committees; and,
- (iii) Improve the relationship between boards and their audit committees, the activities of auditors, and management.

In December 1999, the SEC approved changes to its rules to implement several of the BRC's recommendations with respect to AC composition and practices. The seven board areas of AC on which the committee recommended are:

- (i) Independence of the AC;
- (ii) Financial literacy of AC members;
- (iii) AC structure and process;
- (iv) AC relationship with management including the internal auditor and with the outside auditor;
- (v) Practical improvements to AC oversight and enhancing the external auditors' interaction with the AC;
- (vi) Instituting AC disclosure; and,
- (vii) Mandatory audit of the interim financial reporting.

4.5.4 The Sarbanes-Oxley Act

The Sarbanes-Oxley Act of 2002 (the Act) was approved by the U.S. House of Representatives by a vote of 423:3, and by the U.S. Senate by a vote of 99:0. It was signed into law on 30 July 2002 by the then president George W. Bush. The main purpose of the Act was to protect investors by improving the accuracy and reliability of

corporate disclosures made pursuant to the securities laws, and for other purposes. The Act, more commonly referred to as SOX, was named after its sponsors, Senator Paul Sarbanes and Representative Michael Oxley. The fundamental groundwork of the Act is to provide investors and the public with increased trust in accounting and financial reporting. Throughout this review various components of the Sarbanes-Oxley Act of 2002 are explored in greater detail, predominantly those dealing with CG and internal controls. Discussions with practising certified public accountants, along with opinions from other professionals in the business community, helps to assess the effectiveness and ultimate usefulness of the Act's fundamental objectives.

The Sarbanes-Oxley Act was created to protect investors' interests by improving the accuracy and reliability of corporate disclosures. The Act requires companies to make new disclosures on internal controls, ethics codes and the composition of their ACs on annual reports. Thus, these stringent requirements force companies to be more thorough about ensuring the validity of their financial reporting process. Under the Act, a five member board will oversee auditors, accounting firms are not allowed to provide other services to companies whose accounts they audit, and independent directors must sit on the ACs. The Act states that an AC is a committee established by, and amongst, the BoDs of a company, for the purpose of overseeing the accounting, financial reporting process and audits of the financial statements. Rezaee et al. (2003; cited in Alleyne et al., 2006) stated that the Sarbanes-Oxley Act enacted the following six requirements for the ACs:

- The AC should be composed entirely of independent members of the BoDs;
- The AC should be directly responsible for the appointment, compensation and oversight of the work of external auditors;
- The AC should have authority to engage advisors;
- The AC should be properly funded to effectively carry out its duties;
- The auditors must report to the AC on all 'critical accounting policies and practices' used by the client; and
- The SEC should issue rules to require public companies to disclose whether at least one member of their AC is a 'financial expert'.

4.6 Audit Committee Attributes

There is empirical evidence (for example, Scarborough et al., 1998; and Raghunandan et al., 2001) to suggest that the composition of an AC greatly improves the level of interaction and reporting access of internal audit. Scarborough et al. (1998) examined the relationship between the AC and internal audit. They found that AC composition¹⁶ does influence the extent of interaction between the AC and internal audit. While limited to the examination of the AC role in internal control assessment, this study provided evidence that AC composition influences the effectiveness of the AC in relation to internal controls. Raghunandan et al. (2001) examined the association between AC composition and the committee's interaction with internal auditing. They found that AC composition influences the extent of committee interaction with internal auditing.

There is a growing number of studies on the attributes of ACs, mainly focusing on the significance of committee members' knowledge, experience, diligence, and independence. For example, Bedard and Gendron (2010) highlighted that AC members should possess certain personal characteristics in terms of qualification and competence. Hoitash et al. (2009) described positive association between AC attributes and internal control quality of the firm. Raghunandan et al. (2001; cited in Myers and Ziegenfuss, 2006) defined AC quality as independent and financially literate AC members. An AC cannot be effective if it does not have the 'right people' as members (Sabia and Goodfellow, 2005). Sharma et al. (2009) noted that AC members' diligence is a key factor for an effective AC. Regulators recognise that some attributes are important for AC membership, among which independence and financial competency are vital (Bedard et al., 2008). Much of the research on ACs examines the relation between: AC inputs (e.g. independence, expertise, or diligence) and financial reporting outputs (e.g. abnormal accruals) (Klein 2002; Bedard et al., 2004, 2008); restatements (Abbott et al., 2004; Agrawal and Chadha 2005); fraudulent financial reporting (Beasley et al., 2000); going-concern reports (Carcello and Neal, 2000); auditor changes (Carcello and Neal

¹⁶ In terms of all members being independent/external and at least one members having financial and accounting background (Scarborough et al., 1998).

2003); and stock price reaction (DeFond et al., 2005). These studies generally conclude that independence, expertise, diligence, meeting, and the size of AC are positively associated with higher quality financial reporting and auditing. The relevant literature on these attributes of ACs is discussed below.

4.6.1 Audit Committee Independence

The existence of an independent AC is a sign of the firm's commitment to good corporate governance (GCG) practice (Sommer, 1991). Many prior studies (for example, Bedard and Gendron, 2010 and Abbott et al., 2007) have pinpointed that AC composition is a vital factor and the committee's independence has been described as a pre-requisite of its effectiveness. The utility of the auditing function depends upon the quality of the audit, which is determined by the independence and expertise of the auditors (DeAngelo, 1981; Watkins et al., 2004). Therefore, ACs should be independent of the organisation's management in order to perform an oversight role and so protect the shareholders' interests. It may be argued that if the members of an AC are independent from management and owners of the organisation, then they should be able to deter management from manipulating financial results. Beasley (1996) noted that the incidence of financial fraud is negatively associated with the independence of the BoDs. However, the persistence of accounting scandals has led to a profound reconsideration of the workings of ACs, with special attention being paid to their composition and independence from managerial teams. The Treadway Commission (1987), the Cadbury Report (1992), the American Law Institute (1994), and the BRC Report (1999) have all recommended that independent directors should be included in the ACs. Carcello and Neal (2000) concluded that the scope of demonstrating impartial view and fair judgement has a significant impact on the effectiveness of the AC. This scope varies depending on how the committee is composed and structured. The primary duty of an AC is to protect stakeholders' interest and in doing so it requires a conducive environment in the firm (Lee et al., 2004). Bedard et al. (2004) argued that more objective oversight of financial reporting process can be ensured if the AC includes the more independent members.

Furthermore, Garcia-Meca and Sanchez-Ballesta (2009) argued that an independent AC can potentially improve the quality and credibility of financial reporting. Cohen and Hanno (2000) highlighted the importance of AC independence for evaluating management actions in respect of risk assessment. The highly regarded BRC (1999) recommends that an AC should be composed only of directors who have no relationship with the firm that may interfere with its independence. The AC members should not have any sort of relation or connection with the firm that may hamper their professionalism and fairness. The three main categories of relationships that can hinder the independence of ACs as identified in the regulatory literature are: employment, personal relationship, and business relationship (Bedard and Gendron, 2010). The committee can be valuable informers to shareholders as its focus is on ensuring supply of reliable, sufficient and trustworthy information about business operation, control and management activities. The presence of inside executive directors in the committee may jeopardise the prime objective of forming the committee. If the majority of AC members are appointed from the internal management team, then it is obvious that the committee cannot achieve this objective independently. Studies by Dechow et al. (1996) and Klein (2002b) have noted that the inclusion of more independent members in AC minimises the likelihood of financial fraudulent activities. Gendron et al. (2004) mentioned that members who are willing to be active and effective in the AC should have a probing attitude which helps them assess the management's various decisions. However, this attitude is reflected, and can be demonstrated if, the majority of committee members are independent directors (McMullen and Raghunandan, 1996).

The independence of an AC is important for carrying out its monitoring responsibilities which delegated by the board. Chan and Li (2008) noted that the inclusion of expert independent directors in board and AC enhances the firm value significantly. Many stock markets already include independent members in the ACs in their listing requirements; for example, under the new listing requirements of NYSE and NASDAQ no AC member is to have any relationship with the company which may interfere in carrying out responsibilities for the company independently. The independence of ACs is also important for ensuring quality financial reporting. Independent members'

dominance in the AC advertises problems in financial reporting, ensures fair assessment of reporting and auditing process, and facilitates the firm in effective decision making (Abbott et al., 2004). Independent members are ideally appointed in the AC because of their reputation and exposure in this area. Therefore, they tend to be sincere in carrying out their duties. The involvement of independent directors in the AC of a firm that experiences failure in their financial reporting process is likely to ruin their reputation and career (Srinivasan, 2005). The independence of an AC is also reflected in adherence to accounting principles. For example, Carcello and Neal (2003) found a positive relation between the ratio of independent directors in the AC and the optimism of company's going concern disclosure. Roles of AC ultimately lead to positive impact in terms firm's earning, value creation and goodwill. Pucheta-Martinez and Fuentes (2007) revealed that the inclusion of independent members in AC has a positive impact in improving the reporting quality. The establishment of an AC aims to delegate the responsibilities of hiring external auditors, and to facilitate and supervise their work and the AC should be composed of a majority of independent members (Olivencia Report, 1998 cited in Osma and Noguer, 2007).

The leadership (i.e. the chairmanship) of an AC is another important factor for its effective functioning. Even if all members are not independent directors in the committee, the chairman should be elected from amongst the independent directors. In some firms, the Chief Executive Officers (CEOs) hold the chairman positions of the ACs. This not only hampers the independence of the committee but also may keep the committee away from serving its assigned duties. Beasley and Salterio (2001) reported that an independent AC is more likely to be associated with a larger proportion of non-employee directors on the board, and is less likely to be associated with CEO duality. Chan and Li (2008) commented that holding the position of AC chairman and CEO by the same individual hampers AC independence and is negatively associated with the value of a firm.

4.6.2 Committee Members' Knowledge and Experience

Researchers (such as: Beasley and Salterio, 2001; DeZoort and Salterio, 2001; McDaniels et al., 2002; Bedard et al., 2004; Bedard and Gendron, 2010) argue that members' knowledge/expertise or experience is directly associated with the effective functioning of an AC. Since the main task of an AC is to oversee corporate financial reporting and the auditing process, its members should possess sufficient expertise to understand the issues to be investigated or discussed by the committee (Lin et al, 2008). Positive relationship between members' financial knowledge and AC effectiveness has been found in many studies; for example, Treadway Commission (1987); DeZoort et al., (2001); Felo et al. (2003); and Defond et al. (2005). Furthermore, POB (1993) mentioned that the lack of adequate knowledge and relevant experience causes an inability and failure of AC members to understand their roles and responsibilities in the firm. The absence of these qualities also affects the technical aspects of some of the committee's roles, particularly in case of internal control evaluation (Abdolmohammadi and Levy, 1992; DeZoort, 1998; Tan and Kao, 1999; Gendrol et al., 2004; Haron et al., 2005). Knapp (1987) highlighted that there occurs frequent disputes between external auditors and management about accounting estimations. The ACs are responsible to resolve these disputes and to do so the committee members have to have adequate knowledge and expertise in a related area. DeZoort (1998) also described the necessity of auditing and internal control experience for AC members, particularly in detecting fraudulent activities and internal control weaknesses. The AC members who have accounting and auditing experience can play a leading role in the committee by providing valuable views, justification, and comments, which can increase a committee's productivity (Bonner and Lewis, 1990).

Furthermore, Pomeroy (2010) noted that the AC members with accounting experience are particularly thorough in their investigation and review of accounting decisions made in the company. Kirk (2000) concluded that a decision made without engaging competent members may impair the judgement made by an AC. Libby and Luft (1993) emphasised on the necessity of discrete measures which focus the effect of accounting related decisions making in the firm. This decision making sometimes becomes

complex and requires special knowledge and skills. In this respect, the argument made by Kalbers and Fogarty (1993) is notable, that is, depending on the nature of their complexity, accounting tasks may require a certain level of ability, knowledge, and skills. In deciding on some of the complex accounting related issues, data and their literal interpretations alone are not enough; rather they require technical knowledge and wider experience. Relevant experience provides a wide range of broader concepts for solving of accounting problems, instead confining the problem solved by a data driven approach (Moeckel, 1990). Tan and Kao (1999) pointed to the essence of an individual's competence in performing assigned responsibilities. People who have relevant experience and knowledge can demonstrate better performance and prove their competence. McMullen and Raghunandan (1996) identified members' expertise in accounting reporting, internal control, and auditing as important inputs in an effective AC. To some extent, the goal of AC and independent auditors is very similar (i.e. fair practice in financial reporting and better judgement about firm's financial matters). DeZoort (1998) found that an AC which has members with prior experience in auditing has greater credibility and less conflict of opinion with the external auditor. However, accounting financial experts may make them less willing to join firms with poor CG (Langan 2003, and Engel 2005). Krishnan et al. (2009) found that the accounting financial expertise of AC members complements strong CG; which is consistent with the results of Choi et al. (2004), DeFond et al. (2005), and Dhaliwal et al. (2006).

Because the responsibilities of an AC include the assessment and evaluation of the corporate ethical environment, financial information, regulatory compliance, internal control and information systems; AC members should have the requisite qualification and expertise to discharge these responsibilities. Policy makers believe that financial expertise on ACs would '*enhance its effectiveness in carrying out its financial oversight responsibilities*' (SEC, 1999; cited in Krishnan and Lee, 2009). The BRC (1999) recommends that at least one member should have accounting or related financial management expertise. The Federal Deposit Insurance Corporation Improvement Act (FDICIA) of 1991, which was passed by the U.S. Congress in response to the then savings and loan scandals, requires that ACs in banking institutions should include

members with banking or related financial management expertise and have access to outside legal counsel (McMullen, 1996 cited in Alleyne, 2006). Archambeault and DeZoort (2001) found that companies that had suspicious switches of external auditors were those who had fewer AC members with experience in accounting, auditing, or finance. This might happen because external auditors feel comfortable to deal with someone who has experience or expertise in a similar area, and so they are more motivated in their works.

The level of financial knowledge and skill of AC members has obvious consequences in dealing with different financial issues. For example, Corcello et al. (2006) conducted a study on the impact of certain types of financial expert groups, including accountants and financial brokers performing AC's financial oversight duties. Their study argued that the first group (i.e. accountants) is effective in evaluating a firm's compliance with accounting standards and treatments, while the second group is crucial in reviewing a firm's investment project plans. This implies that the members' background in terms of education and experience influences their focus in the committee's activities. Therefore, it is wise to include members in ACs who have expertise and knowledge in accounting and auditing because most of the responsibilities of an AC are related to these areas. Kinney (2000) described the impact of financial knowledge on the welfare of all stakeholders. This knowledge is particularly required when the committee deals with external auditors to ensure the fulfilment of their statutory tasks (Beasley, 2000). This expertise is needed especially when the AC interacts with the internal auditors on a regular basis and maintains a cooperative relationship between external auditors, management, and internal auditors (McMullen and Raghunandan, 1996). Knowledge and expertise on accounting of the members of an AC is obvious and desired because an AC's monitoring role includes reviewing financial statements and assessing the degree of aggressiveness and conservatism of the accounting policies and accounting estimates (Rainsbury et al., 2008). An AC member having financial expertise possesses the ability to provide a professional evaluation on the financial estimates, and the appropriateness of accounting principles and disclosure practices of the firm. Because of the inclusion of reputed financial experts in the AC, a company is supposed to be transparent in quality

financial reporting and can gain a positive impression in the market. In light of this, DeFond et al. (2005) found a more positive market reaction by the announcement of inclusion of financial experts in the AC of a firm when compared to that of a non-financial expert.

Although Kalbers and Fogarty (1993) argued that appointing AC members from a wide variety of backgrounds may create a feeling of inadequacy and inefficiency in terms of accounting related technical knowledge, the benefits of AC members' financial or accounting expertise is acknowledged by a significant number of researchers. The significance of an AC members' background is also evidenced in IPO pricing and earnings management. The AC members who have a financial expertise are also effective in minimising under-pricing in the case of an IPO, and they are also effective in preventing unwanted earnings management. An AC at the time of the IPO has no effect on under-pricing, unless its members are independent and have expertise in financial matters, in which case the AC decreases significantly the level of under-pricing of the IPO (Bedard et al., 2008). Dhaliwal et al. (2006) found that the firms with accounting financial experts are less likely to engage in earnings management, and that this is more pronounced for the firms with GCG in practice. Xie et al. (2003) also noted that firms having AC members with financial expertise limit management in engaging unauthorised earnings management. Thus, a firm with a strong CG may also push for the appointment of an accounting financial expert for its AC. Also, from the perspective of a potential AC appointee, a firm with strong CG may be an attractive prospect because it may alleviate concerns about added scrutiny from regulators and added litigation risk. Similarly, Krishnan and Lee (2009) documented a strong negative association between litigation risk and AC members with accounting financial expertise.

The above discussion explicitly argues that AC members should have relevant expertise for performing the committee's roles effectively. But which type of expertise is required for the committee members is not clearly defined. Expertise is defined in the BRC (1999) as:

Past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a CEO or other senior officer with financial oversight responsibilities.

Some researchers have highlighted the need for relevant qualification, while others have emphasised on the need for relevant work experience. Again, many studies have argued that the AC members should have mixture of both qualification and work experience in this area. BRC (1999) defined financial experts as those who have work experience in the top level of accounting and finance and/or a CPA, or equivalent, qualification. They include CEOs and top level managers with financial oversight responsibilities. The 'accounting' financial expertise in Defond et al. (2005) is defined as directors with work experience as public accountants, auditors, principal accounting officers, and controllers. The 'non-accounting' financial expertise includes all CEOs or presidents of for-profit corporations. Lee et al. (2004) defined financial experts as having a CPA qualification and/or work experience as any or more of the position of: investment bankers, venture capitalists, CEOs, Chief Financial Officers (CFOs), Vice President (VP) of Finance, controller, or treasurer. DeZoort et al. (2001) found that AC members with CG experience and/or financial reporting and audit expertise, can deliver credible, reliable, and effective judgement when any dispute relating to a financial decision arises. McDaniel et al. (2002) examined the difference in quality judgement between two groups, namely financial literates and financial experts, and found the latter to be more effective in performing the responsibilities of an AC member. Both technical knowledge and work experience are found to have an impact on a committee's performance. McDaniel et al. (2002) also argued that the inclusion of financial experts in AC improves the quality of overall financial reporting.

There are a growing number of studies that address the benefits of inclusion of financial experts in the ACs. Using an event study methodology, Defond et al., (2005) found significant positive abnormal returns around the appointment of 'accounting' financial experts to the AC, but not around the appointment of non-accounting financial experts and directors without any financial expertise. The firms with AC members who have

financial expertise, are less likely to be subject to censure for poor financial reporting (Agrawal and Chadha, 2004; Farber, 2005; McMullen and Raghunandan, 1996), are more likely to have higher quality earnings (Qin, 2007), and also are more likely to reduce earnings management for firms with weaker CG mechanisms (Carcello et al., 2006). Further, the ACs with financial experts, are more likely to promote more conservative financial reporting when there exists strong CG practice (Krishnan and Visvanathan, 2008).

4.6.3 The Size of the Committee

Some researchers (e.g. Pincus et al., 1989) reported that the size of an AC is an influential factor for its effective functioning. Pucheta-Martinez and Fuentes (2007) documented a positive relationship between the size of an AC and the quality of financial reporting, which is also consistent with the findings of Felo et al. (2003). Although AC size is affected by the size of the BoDs and the company, a large AC may not necessarily result in more effective functioning because more members in an AC may lead to unnecessary debates and delay the decisions (Kalbers and Fogarty, 1996; Yermack, 1996; Scarbrough et al., 1998 cited in Lin et al., 2008). Therefore, the current requirement on AC size as laid down by the market regulators in the U.S.A. and the U.K. is a minimum of three members (NACD, 2002; ICAEW, 2001), while some empirical studies have found that the normal AC size in the U.S.A. and the U.K. is three to five (Carcello and Neal, 2000; Raghunandan et al., 2001; Spira, 2002; Davidson et al., 2004). As per the new requirements, every firm listed under NYSE and NASDAQ must have an AC with a minimum of three members. Furthermore, the best practices suggest that the AC should include at least three members to provide the necessary expertise for the oversight function (Cadbury Committee, 1992; the BRC, 1999). However, some researchers (for example, Yermack, 1996; Scarbrough et al., 1998; Lin et al., 2008; and Bedard and Gendron, 2010) have argued that a large AC may not necessarily result in more effective functioning as more members in the AC may lead to unnecessary debates in the meeting and delay in taking decisions.

4.6.4 The Authority and Resources of the Committee

Authority and resource are two vital factors for an effective AC. Most AC guidelines (for example, the Treadway Report, 1987; the Cadbury Committee, 1992; the BRC, 1999; the Sarbanes-Oxley Act, 2002; and, the Combined Code, 1999, 2003) recommend that the AC should be provided with sufficient authorities and resources for its effective functioning. The AC requires significant resources to perform effectively because of the wide scope of responsibilities (PricewaterhouseCoopers, 2005). Arthur Anderson (1994) noted that it is deemed extremely important that the ACs have unrestricted access to all relevant internal and external information to fulfil their oversight responsibilities. Recommendations made in AC related guidelines and studies can be summarised as:

- The AC should delegated adequate authority to carry out their responsibilities;
- The AC should have ready access to relevant information if required;
- The AC should get prompt responses from management while carrying out its duties;
- The AC should be provided with sufficient resources including secretarial support to carry out its responsibilities; and,
- AC members are paid adequate remunerations and benefits for giving their time and effort to the company.

4.6.5 Diligence of the Committee

Members' diligence is very important in performing the responsibilities of an AC effectively and with integrity (Sharma et al., 2009). Kalbers and Fogarty (1993) also reported that AC members' diligence is one of the main components of its effectiveness. Diligence simply means conscientiousness in paying proper attention to a task, giving the degree of care required in a given situation. The success of any committee largely depends on its members' sense of responsibilities and willingness to devote adequate time for the committee's activities. The responsibilities of the AC should be specified in a charter, which should be reviewed from time to time (Mohamad and Sori, 2001). Lee and Stone (1997) explained 'diligence' as 'willing to be effective'. Members' diligence is reflected by their willingness to undertake responsibilities and the time devoted for

them. Gendron et al. (2004) mentioned that members who are willing to be active and effective in the AC should have a probing attitude in mind which helps in assessing various management decisions. Because diligence is extremely subjective when observed directly, many researchers have used AC meeting frequency as a proxy of diligence (Raghunandan and Rama, 2007). The highlights regarding AC diligence noted in the above mentioned studies are summarised below:

- There should have a charter (terms of reference) for the AC stating its objectives, duties and responsibilities;
- The AC charter should be reviewed annually;
- AC members should have a clear understanding of their responsibilities;
- Members of the AC should wilfully assume their responsibilities; and,
- AC members should give sufficient time to devote in committee's affairs.

4.6.6 Meetings of the Committee

The importance of AC meeting frequency has been recognised by many researchers including Spira (2002) and Anderson et al. (2004). The meetings are not mere rituals devoid of interest to managers and auditors (Gendron et al., 2004; Gendron and Bedard, 2006) instead meaningful and substantive meetings are consistent with an agency perspective (Beasley et al., 2009). In studying the collapse of Andersen, Chen and Zhou (2008) noted that the number AC meetings is an important mechanism of CG. However, authoritative statements on CG are silent on meeting frequency and length of meeting, and this absence of regulatory guidelines affords ACs considerable discretion in this area (Sharma et al., 2009). A few studies (for example, McMullen, 1996; Collier and Gregory, 1998; ICAEW, 2001) have reported that ACs in companies in the U.S.A. and the U.K. held meetings on an average of four to six times per year, with an average duration of three to four hours per meeting. Menon and Williams (1994) suggested for a minimum of two meetings in a year. Furthermore, Abbott et al. (2007) noted that an effective AC should meet at least four times annually. However, Sharma et al. (2009) noted that there was an average of 3.75 AC meetings annually in New Zealand, while R

and R (2007) reported that the ACs of the U.S. S&P SmallCap 600¹⁷ companies meet around seven times in a year. Interestingly, a negative association between AC independence and meeting frequency was found by Sharma et al. (2009). This might happen because an independent AC can perform freely as per its plan, and it does not have to meet for discussion frequently. The study further revealed that financial literacy of AC members, size of the AC, and board independence are all positively associated with AC meeting frequency. Bedard and Gendron (2010) noted that the number of meetings is not frequently associated with AC effectiveness; instead the AC should meet as often as its responsibilities require.

Nevertheless, the recommendations of a minimum number of meetings to guarantee effective AC control are supported by the empirical evidence of a positive relationship between meeting frequency and the quality of a firm's accounting information (Xie et al., 2003; Abbot et al., 2004). It is argued that effective control is unlikely to occur if an AC holds a single yearly meeting, or none at all (Menon and Williams, 1994; Klein, 1998a; Collier and Gregory, 1998; Deli and Gillan, 2000). The process of AC meetings is important for better outcomes from the meetings (Bedard and Gendron, 2010). Conducive environment in the meetings depends on the role of chairman, and he can make the meeting effective ensuring all participants can express their fair concerns freely (Raghunandan et al., 1998; the BRC, 1999; Sabia and Goodfellow, 2005). This requires an independent and congenial AC environment where members can discuss issues freely. Kirk and Siegel (1996) also mentioned that if members of the AC meet the chairman in advance of the meeting to talk about any issue in less pressured environment, it is beneficial for the members to clarify their objectives and also for the chairman to have the opportunity be prepared for a fruitful discussion.

Current best practices suggest that a meeting agenda is one of the key factors that make the ACs more effective and, therefore, the agenda of the meeting should also be

¹⁷ The S&P (SmallCap) 600 is an equity index representing 600 small-sized companies in various industries. Being launched in 1994 by the Standard & Poors Corp., the S&P 600 Index is considered as a benchmark for evaluating the investment potential of profitable small companies.

carefully chosen (Sabia and Goodfellow, 2005). Most proponents of AC reform argue that effective ACs should set their own agendas and determine the types of information that they want to review before meetings (NACD, 2000). In fact, some (for example, Batson, 2003; Breeden, 2003) have noted that the usurpation of these responsibilities by senior management at Enron and WorldCom contributed to the financial frauds at those entities. A similar concern was noted at Hollinger International Inc. (Paris et al., 2004). Furthermore, Gendron and Bedard (2006) and Spira (2002) noted that management can influence the agenda or information flow to its interest. Beasley et al (2009) found that agendas are typically set well in advance of the meeting, and the AC chair often sets the agenda, with input from the CFO and other committee members, consistent with Spira's (2002) finding that the agenda is driven by the finance director and the AC chairperson.

The above discussion on AC attributes clearly states that the effective functioning of an AC is greatly influenced by some of its attributes, including: composition, diligent, authority and meeting process. While an AC is regarded as a key element in the CG process of companies, its attributes in fostering effective CG has been the subject of much debate (Sommer, 1991; Wolnizer, 1995; Chen et al., 2008). For example, scholars have argued that many AC members lack critical attributes including independence and expertise in oversight (Vicknair et al., 1993), and that whether ACs are discharging their important responsibilities is not sufficiently understood (Kalbers and Fogarty, 1993). Some studies (for example, Kalbers and Fogarty, 1998) have also argued that the adoption of an AC may be primarily symbolic and that the benefits associated with them are more rhetorical than substantive. Independent AC members with significant relevant knowledge and experience have been found to have a positive impact on AC diligence (Scarborough et al., 1998; Raghunandan et al., 2001, and Zain and Subramaniam, 2007). The Sarbanes-Oxley Act (2002) not only imposes the independence of members of ACs, but it also stipulates that at least one member of an AC should have far reaching experience in the field of finance. McHugh and Raghunandan (1994), Scarborough et al. (1998), Yeo (2001) and Christopher et al., (2009) went one step further to indicate that AC independence is further enhanced if the members, in addition to being independent, have the technical expertise to understand the work of the internal audit function.

4.7 Roles of Audit Committees

Although the ACs existed in practice for a long time, the perceptions on AC's role have evolved continuously (Lin et al., 2008). Before the 2000s there were varied views on the roles of ACs in the Western literature, but a relative consensus has emerged in recent years following the promotion of AC function in CG by market regulators and professional bodies. The early advocates argued that an AC mainly reviews the financial statements prepared by the management before being they are given to BoDs. The roles of ACs have expanded substantially in the last two decades. For instance, as required by the Treadway Commission (1987), the ACs should oversee companies' internal control and co-ordinate the work of internal and external auditors (IIA, 1993; Guthrie and Turnbull, 1995; the BRC, 1999). Later, AC's roles were further expanded to include monitoring of the management's financial performance or accountability, and the internal controls, as well as to be a means to enable non-executive directors to oversee the ethical behaviours of the management in respect of compliance with regulations and the company's codes of conduct (DeZoort, 1997, DeZoort et al., 2002; ICAEW, 1997, 2001; Spira, 2002). The role of an AC was extended to enhance auditor independence, or to ensure the quality of financial reporting and auditing process (Mautz and Neumann, 1970b; CICA, 1981; the Bradbury, 1990; Abdolmohammadi and Levy, 1992; ICAEW, 1997; the BRC, 1999). In other words, the AC serves as a link between BoDs and the external auditor, and it mediates potential conflicts or disputes between the management and auditors, all of which ultimately facilitates auditors to perform their job more independently (KPMG Peat Marwick Thorne, 1991; Collier, 1993; Vinten, 1995; Carcello and Neal, 2000).

The ACs are traditionally responsible for oversight of auditing matters relating to the company's financial reporting (Brown et al., 2009). Lin et al. (2008) noted AC oversight roles and responsibilities for improving internal control, rules compliance, sound corporate financial reporting, and auditing processes. The key elements of an AC's oversight roles as mentioned in the BRC (1999) include:

Ensuring that quality accounting policies, internal controls, and independent and objective outside auditors are in place to accurate, high quality and timely disclosure of financial and other material information to the board, to the public markets, and to shareholders.

This monitoring function is normally delegated to the AC as an entrusted body of the board. *“The audit committee monitors the financial reporting process, the effectiveness of the company’s internal controls, its internal audits where applicable, and its risk management systems”* (European Parliament and Council of the European Union, 2006 cited in Sarens et al., 2009). AC’s role has been widened to look not only at the financial reporting process, but also to assess the risks faced by companies (which includes competition, environmental, financial, legal, operational, regulatory, strategic and technological responses) (Pomeranz, 1997; NACD, 2000; KPMG, 1999, 2008).

The following list is an attempt to summarise the key roles of ACs as noted in a number of studies (for example, Baruch, 1980; Marsh and Powell, 1989; Vanasco, 1994; Chambers, 2005; Lambe, 2005; Daly and Bocchino, 2006; Mir and Seboui, 2008; Chen et al., 2008; and Laux and Laux, 2009) and recommended by the AC guidelines (such as: the Cadbury Report, 1992; the Olivencia Report, 1998; the BRC, 1999; AICPA, 2004):

- To review the integrity of the company’s financial statements;
- To advise the board on the reliability of financial and perhaps other information to be published in the name of the board;
- To oversee the financial reporting and disclosure process;
- To monitor the choice of accounting policies and principles;
- To provide recommendations to the BoDs on the appointment of the external auditors, the audit fee, and any matters of resignation or dismissal;
- To discuss the nature and scope of the audit with the external auditor;
- To review the management letter from the external auditor;
- To monitor the independent auditors’ qualification and independence;
- To monitor the effectiveness of internal control process of the company;
- To review any significant findings of internal investigations;

- To review and advise on company's risk management strategies; and
- To oversee of regulatory compliance, ethics, and whistleblower hotlines.

Therefore, it is quite clear that in recent years the AC has become one of the main pillars of CG system in companies around the world. An AC is critical to the success of an organization, with the responsibilities to monitor the effectiveness of the internal audit function, and the internal control system, and review the financial statements and thereby have a more efficient vigilant internal control in the organization. Verschoor (1993) identified responsibilities in overseeing the systems of financial reporting, external auditing, and internal control. The roles of an AC in overseeing and monitoring financial reporting process, internal controls, and external auditing are also noted by Sori et al. (2007) and Sharma et al. (2009). Although an AC performs different types of responsibilities, the key areas where an AC plays significant roles are discussed below.

4.7.1 Role in Financial Reporting

Ensuring reliable financial information is one of the most important functions of the AC (Rezaee and Farmer, 1994). There is pressure from the oversight role for the AC to get more involved to ensure the integrity of the financial reporting process. The establishment of AC improves the quality and accuracy of financial information (DeFond and Jiambalvo, 1991; McMullen, 1996), ensuring that the officers responsible for reporting and disclosure are more closely monitored and controlled. The role of an AC in overseeing financial reporting has been studied by a huge number of researchers (such as: Mautz and Neumann, 1970a; Braiotta, 1986; Luecke and Westfall, 1990; Rittenberg and Nair, 1994; Rezaee and Farmer, 1994; Wolnizer, 1995; Lee and Stone, 1997; Porter and Gendall, 1998; Spira, 2002; Smith, 2003; Gendron et al., 2004; Gendron and Bedard, 2006; Turley and Zaman, 2007; Cohen et al., 2007a; Laux and Laux, 2009; Bedard and Gendron, 2010). These studies have generally noted that ACs are expected to:

- Review all financial statements, whether interim or annual, before they are approved by the BoDs and publicly disseminated to ensure their objectiveness,

accuracy, and timeliness;

- Review all existing accounting policies, and concentrate on the impact on the financial statements of any changes in accounting policies including the likely impact of any contemplated changes;
- Appraise key management estimates, judgements, and valuations where they are thought to be material to the financial statements;
- Evaluate the adequacy of financial statement disclosures;
- Review adequacy of organisation's structure, including management's implementation of internal controls; and,
- Review all significant transactions, especially those that are non-routine and those that might be illegal, questionable, or unethical.

4.7.2 Role in Internal Auditing

Spira (1999a) mentioned that AC members should be able to comprehend the firm's total internal control process so that they can effectively prevent and/or mitigate financial reporting failure and potential management frauds. The AC is responsible for monitoring the integrity and performance of a firm's internal audit functions (Laux and Laux, 2009). The role of an AC in monitoring and overseeing internal auditing activities has also been clearly discussed in EACLN (2008)¹⁸. The AC can strengthen the entity's internal audit function by ensuring that management has established, and is maintaining, an adequate and effective internal audit structure (Beasley et al. 2009; Turley and Zaman, 2007; Rezaee and Farmer, 1994). Beasley et al. (2009), studying AC oversight process within forty-two U.S. public companies, found that AC members largely depend on internal auditors in evaluating the effectiveness of internal control over financial reporting. The study also reported the necessity of frequent meetings between AC members and internal auditors, which supports the view of Braiotta (1990; 1999). Private meetings between the AC and the head of internal audit division serve the purpose of enhancing and protecting the independence of the internal audit function

¹⁸ The European Audit Committee Leadership Network (EACLN) is a group of audit committee chairs, drawn from Europe's leading companies, who are committed to improving the performance of audit committees and enhancing trust in financial markets.

(Braiotta, 1999 cited in Christopher et al., 2009). Oliverio and Newman (1993 identified the interaction between the internal auditors and the AC is likely to enhance the effectiveness and objectivity of internal audit functions. Sharma et al. (2009) noted that the internal audit division acts as a comfort provider for the AC. A summary of the above studies in relation to AC's role in internal auditing can be found in Wolnizer (1995), who stated that ACs are expected to:

- Evaluate the independence and competence of internal audit function;
- Discuss with the chief of internal auditors about internal audit reports, effectiveness of internal controls and problems in performing the internal audit.
- Review the scope of internal audits planned for the year;
- Review management's response to internal auditors' recommendations;
- Review and approve the internal audit budget;
- Review the relationship between internal and external auditors and coordination of their work; and,
- Appoint and dismiss the head of internal audit.

4.7.3 Role in External Auditing

The involvement of ACs in dealing with external auditor has been the subject of many studies (for example, Rezaee and Farmer, 1994; Wolnizer, 1995; Kirk and Siegel, 1996; Lennox and Park, 2007; and Beasley et al., 2009; Bedard and Gendron, 2010). The AC is a valuable instrument for initiating direct contact with the independent (external) auditor, participating in the selection of the external auditor, and promoting effective communication between the independent auditor and corporate directors (Rezaee and Farmer, 1994; Beasley et al. 2009). Lennox and Park (2007) claimed that the AC is responsible for hiring the external auditor and overseeing audit quality. Meanwhile, Kirk and Siegel (1996) argued that external auditors need support of the BoDs in performing their duties objectively and with integrity. To work independently, the external auditors need to have access to some relevant resources of the firm. At the same time, their activities need to be monitored and evaluated in order to ensure their accountability. Beasley et al. (2009) also found AC members dependency on external

auditors in performing their oversight responsibilities. Bedard and Gendron (2010) mentioned that one of the main responsibilities of ACs is to oversee the external audit function, including the selection, compensation, work, and independence of the external auditors. In respect of the effective functioning of AC, Zain and Subramaniam (2007) emphasised the need for a good relationship between external auditors and AC through private meetings and informal communication. Therefore, an AC can play a significant role in dealing with external auditors in terms of their appointment, resources, independence, monitoring and evaluation. In the case of annual audit and external auditors, Wolnizer (1995) mentioned that the ACs are expected to:

- Review the findings of the external audit;
- Determine the completeness and appropriateness of management's response to audit findings;
- Evaluate independence of external audit function;
- Review the reasonableness of the external audit fees;
- Arbitrate in disputes between management and auditors;
- Nominate external auditors; and
- Review the engagement letter prepared for the independent auditors.

4.7.4 Other (Miscellaneous) Roles

Apart from the above three broad roles, an AC performs some other various roles for the company; including advising on risk management strategies, overseeing the compliances of regulatory and ethical issues, and bridging the gap between board, management, internal auditors and external auditors. Carcello et al. (2002) described the AC as a 'communication bridge' between management, and the internal and external auditor. Similarly, Mallin (2010) stated that the AC provides a useful 'bridge' between both internal and external auditors, and the board; helping to ensure that the board is fully aware of all relevant issues related to the audit. The committee regularly meets with outside auditors and internal financial managers to review the internal control process, financial reporting system, and external audit process and they then report the updates to the BoDs (Klein, 2002a). A similar issue was addressed by Williams (2007)

who argued that the practice of holding separate sessions for meetings between independent AC members, and external and internal auditors without the presence of executive directors brings an open, useful and dynamic forum, especially on issues that may be sensitive to the executives. AICPA (2004) described an AC's roles in the risk management of the company. Chambers (2005) also highlighted AC's role in advising management on risk management policies, and in overseeing the regulatory compliance, ethics and whistleblower hotlines.

Although risk management has been noted as an essential part of CG to be overseen by AC (Chambers, 2005; Sarens et al, 2009; Mallin, 2010), several studies have proposed a separate risk management committee to assist the board in this regard; for example, Brown et al. (2009) argued for the necessity of the creation of a separate risk management committee to interface with and assist the board and AC. Similarly, De Lacy (2005) recommended the separation of the risk management committee from the AC. However, the establishment of a strong internal audit section in the firm also helps the AC in risk management where a separate risk management committee is not in place. The NYSE requires all listed companies to establish and maintain an internal audit function in order to provide management and the AC with continuous assessment of the company's risk management frameworks and its internal controls (Pforsigh, et al. 2006). In Canada, the Toronto Stock Exchange (TSE) has published similar requirements (Kleffner, et al., 2003).

Therefore, it is quite clear from the above discussion that the AC is established with the aim of enhancing confidence in the integrity of an organisation's processes and procedures relating to internal control and corporate reporting. An AC provides an 'independent' reassurance to the board through its oversight and monitoring role. Among the many responsibilities that the boards entrust the AC with are the transparency and accuracy of financial reporting and disclosures, the effectiveness of external audit functions, the robustness of the systems of internal audit and internal controls, the effectiveness of anti-fraud, the ethics and compliance systems, and the review of the functioning of the whistleblower mechanism.

4.8 Audit Committee Effectiveness

The mere existence of an AC alone does not provide sufficient control, nor does it ensure that the company will maintain a high standard of financial reporting integrity (Rittenberg and Nair, 1994; Mendez and Garcia, 2007). It needs to perform effectively and care must be taken to structure, staff, and support the AC to ensure its effectiveness. With a number of recent high-profile financial fraud cases at the start of the new millennium, academic and industry now seek for effective ACs in order to provide sound monitoring (Chan and Li, 2008). Some questions remain about the effectiveness of these regulations (Romano, 2005). The AC is one of the key mechanisms of CG (Chen et al, 2008) and its effectiveness is crucial for sound CG practices in the organisation. Campbell (1990) and Vicknair et al. (1993) reported that the lack of effective AC practice is a significant factor behind rigorous financial problems of companies. Effectiveness is an elusive concept that can be approached through several models, none of which is appropriate in all circumstances (Cameron, 1981). Furthermore, Spira (1998a) considered that: "*there is no discussion of the meaning of effectiveness, resources, or independence within the literature and this assertion is unsupported*". Similar limitations were identified by Cameron (1986) when he surveyed studies of organisational effectiveness. He observed that evaluations of effectiveness are problematic with regard to arbitrary selection of criteria, and confusion between determinants and indicators. Lewin and Minton (1986) noted that the multiplicity of means and the plethora of ends, as well as the many management philosophies and associated organisation designs extant, have made the measurement of effectiveness into a very complex problem. It is complex because of the problems inherent in specifying some joint preference function, or in attempting to specify the weights in some multi-attribute effectiveness measures.

Lee and Stone (1997), in explaining the purpose of their study, noted that: "*actual effectiveness is impossible to observe*". Spira (1998b; 1999a) added that "*the lack of clarity in the definition of audit committee purpose and the differences of emphasis observed internationally make the assessment of audit committee effectiveness problematic*". Cameron (1981) claimed that organisational effectiveness has become 'an

enigma' and, therefore, the meaning of effectiveness in academic research is unclear. The author was probably very cautious about the exact measure of AC effectiveness because different researchers have explained the concept differently. Baugher (1981) suggested that there is often no single model for defining effectiveness in any given situation. The investigator may focus on a particular type of effectiveness; however, an operation can look at effectiveness from one perspective and ineffectiveness from another perspective. Baugher's (1981) study concluded that: *"The investigator should determine which type of effectiveness is of the greatest concern to the constituency or constituencies to which he or she must report"*. Cameron (1986) agreed with the above statement, and also added that: *"There cannot be a single theory about effectiveness and the primary task facing any investigator of effectiveness lies in determining the appropriate indicators and standards"*. For this reason, the selection of data by which to measure effectiveness is valuable because an organisation may be judged effective on the basis of bias. According to Lewin and Minton (1986), *"organisations are effective if relevant constraints can be satisfied and if organisational results approximate or exceed a set of referents for multiple goals"*.

Cameron (1981) noted that the words effectiveness and efficiency are often confused. A large number of studies (for example, Jenkins and Robinson, 1985; Kalbers, 1992a; Kalbers and Fogarty, 1993; Rittenberg and Nair, 1994; Porter and Gendall, 1998; Millstein, 1999; Raghunandan et al., 2001; Smith, 2003) focused on AC effectiveness have used the word 'effectiveness' to mean the 'carrying out or fulfilling its specific oversight responsibilities or duties'. Various studies (for example: Braiotta, 1986; Verschoor, 1989; Lee and Stone, 1997; Turley and Zaman, 2002; Watts, 2002; Zain and Subramaniam, 2007) have used 'discharging their oversight responsibilities' for the definition of AC effectiveness. DeZoort (1998) defined effectiveness as: *"a committee's collective ability to meet its oversight objectives"*. In addition, Baugher (1981) noted that: *"The investigator should determine which type of effectiveness is of the greatest concern to the constituency or constituencies to which he or she must report"*. The definition of an effective AC given by DeZoort et al. (2002) included its comprehensive roles and responsibilities, that is: *"An effective audit committee has qualified members*

with the authority and resources to protect shareholders' interests by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts". Woodlock and Claypool (2001) found that once the AC is made aware of its current practices, a comparison needs to be made between current practices and those that constitute best practices so that the AC, the CEO, the CFO, and the external auditor are better able to assess where to commit resources to close the gap between current and best practices. Moreover, Rowland (2002) claimed that the monitoring model is manifest in actual corporate practice when compared with best practice guidelines. A strong internal control function is a necessary criterion for an effective AC (Zain and Subramaniam, 2007) because the AC members especially rely on the work of the internal auditor in order to develop their own appreciation of the controls' effectiveness (Spira, 1999a).

A well functioning AC should have a greater likelihood of detecting problems than an inactive one (Choi et al., 2004). Finally, AC related disclosure and report in the annual report is a necessary element for assessing the effectiveness of AC function (Spira, 1998a; ICAEW, 2001; Ng and Tan, 2003; Lee et al., 2004). Relevant disclosures include a written charter or terms of reference specifying the AC responsibilities that have been endorsed or approved by BoDs, they also include AC reports demonstrating how an AC has fulfilled the described responsibilities during the year. The effectiveness of ACs depends, to a large extent, upon their diligence or activities; such as, the frequency, duration, and content of AC meetings (Teoh and Lim, 1996; Collier and Gregory, 1998; Beasley and Salterio, 2001; Ng and Tan, 2003; Abbott et al., 2004). In addition, some studies (for example, DeZoort, 1998; Scarbrough et al., 1998; Beattie et al., 2000; Goodwin and Yeo, 2001; Braiotta, 2003; Song and Windram, 2004) contended that an effective AC should hold meetings with the management, and the internal and external auditors separately in order to exercise an effective oversight or monitoring role over the financial reporting and auditing processes.

It is clear from the above discussion that previous studies have discussed two different frameworks of AC effectiveness. For example, DeZoort et al. (2002) reviewed 37

empirical studies published between 1987 and 2002, and provided a framework with four fundamental determinants of AC effectiveness, namely: composition, authority, resources, and diligence. On the other hand, instead of focusing on the determinants of AC effectiveness, Turley and Zaman (2004) and Kalbers and Fogarty (1993) analysed the effectiveness of ACs using a framework which focused on successfully performing AC's roles. However, while having the 'right people' as AC members and providing them with concrete responsibilities and resources are important inputs to AC effectiveness, they are not sufficient to ensure effectiveness (Bedard and Gendron, 2010). Instead the process by which AC members assess information and oversee activities is important in this respect. In fact, process is a very important mechanism of an AC that explains how characteristics are translated into organisational outcomes. Gendron et al. (2004) noted that the AC process is an important factor in developing a better understanding of AC effectiveness. Bedard and Gendron (2010) explained that the dimensions of an AC process include: AC meeting, meeting agenda, questioning and leadership. However, performing AC roles successfully depends on the input factors (i.e. composition, authority, resource and diligence) and the processes by which an AC functions (e.g. meeting process) Therefore, it would be more comprehensive and accepted if AC effectiveness is evaluated considering its input (e.g AC composition), process (e.g. AC meeting) and output (e.g. AC roles) dimensions. The current study aims to investigate AC effectiveness in Bangladesh considering all of these three dimensions as AC effectiveness criteria.

4.9 Significance of Audit Committee Effectiveness

An effective AC is critical in enhancing the effective oversight of the financial reporting process and ensuring high quality financial reporting (Chen and Zhou, 2007). Empirical studies have revealed that the existence of effective AC is positively associated with the quality of financial reporting. For example, McMullen (1996) found that the presence of AC is negatively associated with financial restatements and sanctions by the U.S. SEC. Chambers (2005) noted that poor standards of CG (for instance, ineffective or non-existent ACs) facilitate abuses (such as, fraudulent financial reporting). The significance

of AC effectiveness in preventing misstatement in financial reporting has been highlighted in many studies including Magee and Tseng (1990) and Dye (1991). An effective AC is now treated as a principal player in ensuring GCG and rebuilding public confidence in the financial reporting of a firm. A well functioning AC leads to the improvement of corporate financial reporting and the decrease of earnings management or financial frauds, as well as the increase of unqualified auditor reports (Wild, 1996; Carcello and Neal, 2000; DeZoort and Salterio, 2001; Klein, 2002b; Sharma, 2004; Bedard et al., 2004). In their study, Bryan et al. (2004) found positive association between the AC effectiveness and firm's earning. An effective AC serves as important CG mechanism to boost investors' confidence in GCG, to improve the trust in financial reporting processes, and it lends more credibility to the audited financial statements (McMullen, 1996; Urbancic, 1996; Spira, 1999b; the SEC, 1999, 2003; Rezaee et al., 2003). The significance of an effective AC is visible in enhancing the quality of statutory auditing, which ultimately leads to better financial reporting. For example, Kunitake (1983) studied 580 AMEX listed firms and concluded that the firms without ACs in place change external auditors more frequently than those firms with ACs. Garcia-Meca and Sanchez-Ballesta (2009) noted that the existence of AC reduces errors and irregularities in financial statements, and enhances the credibility of financial reporting; this result was consistent with the view of McMullen (1996).

In contrast, there are a number of studies which have found opposite results; for example, Beasley (1996) found that there was no significant relationship between presence of AC and the likelihood of fraud or error. Furthermore, Pucheta-Martinez and Fuentes (2007) revealed that presence of AC has little or no impact on quality of financial reporting. However, it is widely accepted that an AC plays an important role in assuring the quality of financial reporting and corporate accountability. As a liaison between the external auditor and the board, the AC minimises information asymmetry between them, facilitates the monitoring process (Klein 1998b; Sori et al., 2007), and enhances the independence of the auditor (Mautz and Neumann, 1977).

An effective AC also significantly contributes to the establishment of a rigorous internal control function in the company, which ultimately reduces irregularities and fraudulent activities in the company's affairs. Zain and Subramaniam (2007) highlighted the leadership role of AC in supporting and guiding internal auditors. They also argued that an AC is perceived to hold an authoritative position which helps it to question the decisions made by management. As already discussed, independence is a pre-requisite for an effective AC. Klein (2002b) examined whether the magnitude of abnormal accruals has any relationship with AC independence and found a negative relation between AC independence and abnormal accruals, the impact of which is more pronounced when independent members in the AC are not a majority. Klein's (2002b) study concluded that independent ACs can monitor firms' earning processes more objectively. Xie et al. (2003) and Laux and Laux (2009) explained the role of AC in preventing earnings management. An independent AC is considered to be an effective mechanism in limiting earnings management (Garcia-Meca and Sanchez-Ballesta, 2009). Furthermore, Lin and Liu (2009) added that an effective auditing function can detect and disclose earnings management and other types of misconduct by business managers or controlling shareholders. Klein (2002b) and Bedard et al. (2004) found that AC's independence and financial expertise are negatively associated with earnings management, as measured by discretionary accruals. Chen et al. (2008) noted that an effective AC can play a significant role in resolving an agency problem (i.e. owner-management problem) in the company. The study also found the influence of an effective AC in the higher earnings and returns of the company which is also consistent with the findings of Wild (1996).

Therefore, it is clear from the above discussion that an effective AC contributes significantly in ensuring fair and sound practice of financial reporting, establishing rigorous internal control, and thus safeguarding stakeholders' interest. This ultimately leads to minimum irregularities, increased investors' trust, higher returns, and maximum wealth of the stakeholders.

4.10 Audit Committee Effectiveness Model

The literature discussed in this chapter indicates that although the effectiveness of an AC is reflected by its roles and performance, it is still dependent on a number of factors (e.g. composition, authority, and independence). The empirical evidence also supports the positive impact of AC effectiveness in minimising agency conflict and maximising stakeholders' wealth. The following model of AC effectiveness (Figure 4.1) proposed by the researcher depicts the different factors that influence AC effectiveness as well as the significance of an effective AC.

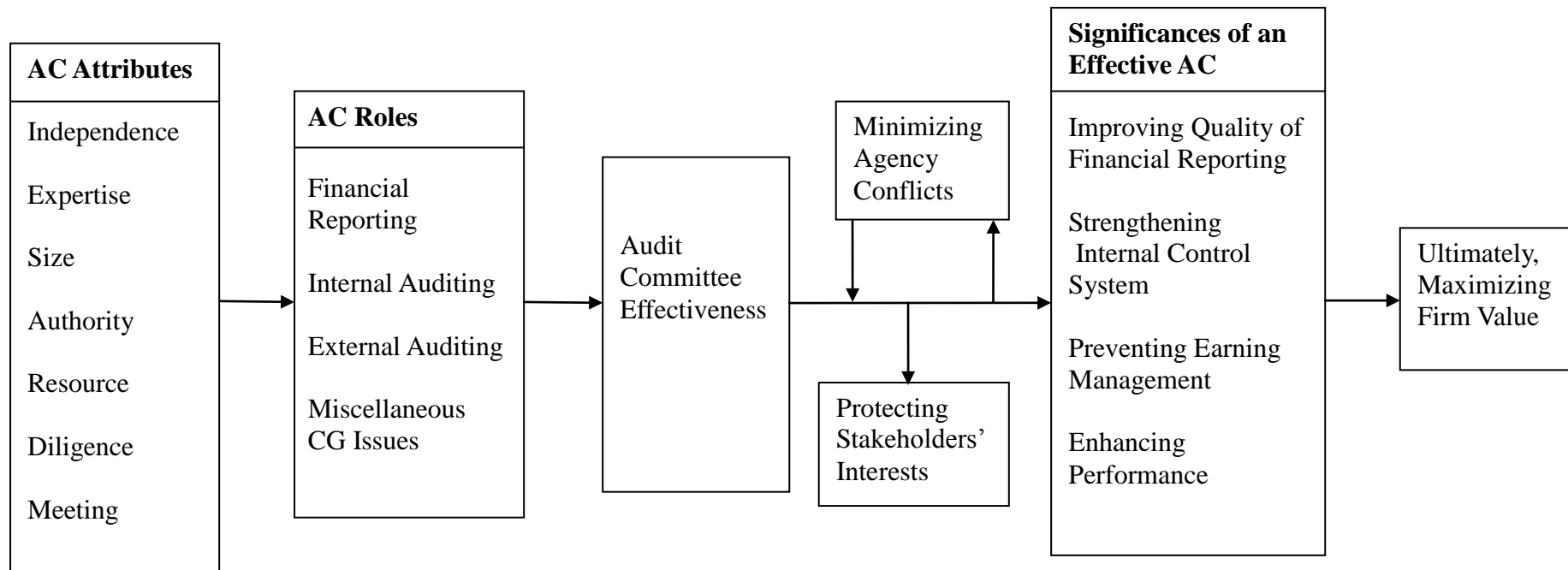


Figure 4.1: Audit Committee Effectiveness Model

Figure 4.1 shows that the effectiveness of an AC mainly depends on the ability and scope of performance of its oversight roles, and on its responsibilities as delegated by the BoDs. The key functional areas where AC contributes are: financial reporting, internal auditing, external auditing, and a firm's compliance issues. The attributes of an AC (i.e. composition, members' expertise, independence, authority and diligence, and the size of the committee) and its decision making process (i.e. meeting) have obvious impacts in whether or not it carries out these roles successfully. This means that the effectiveness of an AC is heavily influenced by the input factors (e.g. composition, members' expertise, independence, authority and diligence, and size). An effective AC minimises the agency problem by reducing the information asymmetry between owners and management and also acts as a safeguard of all stakeholders' interests. The main outcomes of an effective AC are in: (i) producing more credible financial information; (ii) establishing rigorous internal control; (iii) preventing frauds and earnings management in the firm; and (iv) increasing firm's earnings and profit. All of these benefits ultimately lead to maximizing the long term wealth of a firm which is the ultimate goal of any business entity. The model has guided the development of the survey questionnaire and interview checklist which are used in this study. More specifically, the survey instruments cover all of the AC attributes and roles that are included in the model. In addition, the AC effectiveness model has been used in analysing regression statistics obtained from the questionnaire survey data. The variables of multiple regression models have been chosen and categorised as per the AC effectiveness model.

4.11 Developments of Audit Committees

The concept of the AC is not new. For example, in 1872 a report was published on the AC of the Great Western Railway Co.¹⁹ (Dafinone, 2001). However, the recent global financial crisis has seen the collapse of several large international businesses (e.g. Enron), which illustrates the point that no industry or jurisdiction is immune from

¹⁹ Created by an Act of Parliament on the 31st August 1835, the Great Western Railway (GWR) was one of the largest British railway companies, linking South West England and South Wales with London.

misstatement in financial reporting. After these notorious corporate scandals, the AC has increasingly come to be considered as a useful mechanism of CG (NACD, 2002; Spira, 2002; Cohen et al., 2002; FRC, 2008; Sarens et al., 2009). In particular, the roles and functions of AC have been closely reviewed after 2001 (Rezaee et al., 2003; Alleyne et al., 2006). The AC is now considered as an effective mechanism to enhance board's oversight of management performance. It is also considered to be able to strengthen the financial reporting processes. Consequently, it is able to provide additional protection to shareholders, and public investors or creditors (DeZoort et al., 2002; Hemraj, 2003; Abbott et al., 2004; Pergola, 2005). Although the NYSE first endorsed the AC concept in 1938 (KPMG, 2006), it was virtually unheard of in the international arena before 1970s (Canadian Institute of Chartered Accountants, 1981).

However, within less than three decades the number of large capital markets that require a public company to have an AC has increased considerably. For example, the U.S.A., Australia, Canada, Hong Kong, Malaysia, Singapore and Thailand all now mandate that public companies have an AC as part of their corporate structure. Likewise, the U.K. and Germany impose an AC requirement on a 'comply or explain' basis. In France, Japan, China and Taiwan, however, the formation of an AC is still voluntary (Tafara, 2006). Although the AC has become a more common mechanism for ensuring GCG in some countries, they are still far from being universal. The inconsistency in the regulatory framework for the ACs around the world may pose a challenge to companies without ACs who want to list on foreign exchanges (e.g. NASDAQ in the U.S.A.) where establishing an AC is a regulatory requirement to comply for the companies. It could also have an impact on stock exchanges in the design and enforcement of regulatory requirements. Historically, ACs have always been associated with the roles of overseeing and monitoring the management as well as the external auditor. They also have a role in achieving proper CG and accountability in companies. However, the majority of AC studies have been done in the context of developed countries including, the U.S.A. and the U.K. (Bedard and Gendron, 2010).

In 1976, the NYSE made it compulsory for all listed companies to set up ACs which are comprised solely of outside directors. In the U.K., the Cadbury Committee (1992) made a strong recommendation that all listed companies should establish an AC. In Canada, it is now legally compulsory for most publicly held companies to have ACs. In view of the importance of an AC, this section briefly reviews the history of the AC with a focus on its formation and sustenance since its inception. Some notable landmarks in respect of AC international development are presented in the following tables.

Table 4.1: Requirement to Establish an AC in Selected Countries

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

Table 4.2: Recommendation of Formation of an AC in Selected Countries

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

Although it is seen that the listing requirements and Business Act required the formation of AC in the U.S.A. and Canada, respectively, in the 1970s, there is documentation that that some committees resembling to the AC were formed before 1870 in the USA

(McKee, 1979), and in early 1870s in England (Tricker, 1978). The importance of the AC, and the need for publicly owned firms to form the committee, is well documented in many reports, for example: the Report of the National Commission on Fraudulent Financial Reporting by the Treadway Commission (1987) in the U.S.A.; the Draft Report of the Committee on the Financial Aspects of CG by the Cadbury Committee (1992; 1995) in the U.K.; the Report of the Commission to Study the Public's Expectations of Audits by the Macdonald Commission (1988) in Canada; ACs by the South African Institute of Chartered Accountants (1991); and, Corporate Practices and Conduct by the Bosch Working Group (1991) in Australia. The development of the AC which is considered in these reports mainly draws upon the experiences of companies in the U.K., U.S.A., and Canada. The following subsections discuss the development of AC in some developed and developing economies across the world.

4.11.1 Development of the Audit Committees in the U.S.A.

The development of ACs in the U.S.A. can be traced back to 1940 when both the SEC and the NYSE recommended setting up ACs for all listed companies on the NYSE following the case of Mc Kesson-Robbins in the late-1930s. However, the idea of an AC did not become popular until 1967 when the American Institute of Certified Public Accountants issued a statement recommending that publicly-owned corporations appoint ACs composed of independent directors as part of the CG process to protect public interest and preserve the integrity of the nation's capital and financial markets. During the 1970s the NYSE actively encouraged the establishment of ACs by listed companies. In 1973 the NYSE recommended that each listed company form an AC comprising three to five independent directors. Since the 1970s, politicians in the U.S. have hotly debated the issue of AC, and the Moss Committee (a Congressional Sub-committee) and the Metcalf Committee (a Senate Sub-committee) have recommended that the AC be made a listing requirement. In 1977 this recommendation became a listing requirement; it became effective on 30 June 1978. In the same year, the AICPA's BoDs reaffirmed this position, urging AICPA members to encourage corporate clients and employers to establish ACs. In 1978, the AICPA's Special Committee on the ACs

concluded that ACs were necessary for both corporate directors and independent auditors to fulfil their respective responsibilities. Furthermore, it endorsed the efforts of the stock exchanges, the NASD, and other bodies to require ACs.

The movement towards a regulatory requirement for public companies to establish ACs gained momentum from the National Commission on Fraudulent Financial Reporting (the Treadway Commission, 1987). This Commission was formed with the aim of identifying the conditions that may lead to fraudulent financial reporting and the necessary steps to reduce the frequency of occurrence. In its report (1987), the Commission recommended that: *“All public companies should be required by SEC rule to establish ACs composed solely of independent directors” so as to reduce the possibility of fraudulent financial reporting*”.

In 1994, the POB Advisory Panel on Auditor Independence (the Kirk Panel) issued its findings on ‘Strengthening the Professionalism of the Independent Auditor’, which identified the need for a strong relationship between ACs and the independent auditor in order to improve the overall financial reporting process. Finally, in 1999 the NYSE, the NASD and the Blue Ribbon Committee on ‘improving the effectiveness of corporate ACs’ (established in September 1998 by the NYSE and the NASD) released its report announcing a few key recommendations to improve the quality of corporate financial reporting. In 2002, the Sarbanes-Oxley Act was passed in order to protect investors by improving the accuracy and reliability of corporate disclosures. The Sarbanes-Oxley Act, therefore, was created to protect investors’ interests by improving the accuracy and reliability of corporate disclosures. The Act requires companies to make new disclosures on internal controls, ethics codes and the composition of their ACs on annual reports.

4.11.2 The Development of Audit Committees in the U.K.

Tricker (1978) provided evidence that some committees resembling the current AC were in operation in England in the early 1870s. However, the development of ACs in the U.K. was slower than in other countries. The first public sector initiatives in respect of

ACs are in evidence from as early as 1973. The internal audit report on Civil Service in 1973 noted the advantages of having an AC, which included the discussion of audit plans and results as one of its primary roles (Dafinone, 2001). In the U.K., private sector initiatives have been most active in the last three decades. It was only in 1987, after evidence of increasing failures and incidents of corporate fraud in Britain, that the Bank of England and an organisation called PRO-NED²⁰ urged public companies to adopt ACs. In 1992 the Cadbury Report gave a boost to the idea of the AC. Their report made recommendations on the financial aspects of CG, with emphasis on the importance of properly constituted ACs in raising standards of CG. They recommended that all public listed companies in U.K. should establish ACs within the two years following May 1992. The Hampel Report (1998) restated the recommendations with respect to the establishment, structure, role and duties of ACs in the U.K. Later, the Turnbull Report (1999) considered the role of the AC, and it highlighted that the annual review of the effectiveness of internal control should be delegated to the AC.

In fact, there is neither a firm legal, nor a regulatory requirement for U.K. listed companies to have ACs, and they are still only quasi-mandatory across much of the U.K. government sector. For example, there is some discretion in the UK public sector:

Because of the benefits outlined above there must be clear and strong reasons, which should be documented, for a decision not to establish an audit committee. In such a case, consideration should be given to making the fact that the audit committee does not accord with this control. (Treasury, 2003)

Provision 4.3 of the Cadbury Code (1992) recommended that boards should have ACs, but the listing rules gave only a ‘comply or explain’ status to the Cadbury provisions. The U.K.’s Combined Code (1998) introduced apparently mandatory principles, while also continuing with discretionary provisions, but there was no mention of ACs in any of these principles. The Combined Code (2003) is even more complex, with main as well as supporting principles (both of which have the same apparent mandatory status)

²⁰ The objective of the formation of PRO-NED was to promote the appointment of non-executives to Boards of Directors.

as well as ‘comply or explain’ provisions; however, there continues to be no reference to audit committees in the apparently mandatory principles of the code. There is now much more extensive coverage of ACs within the discretionary ‘comply or explain’ provisions of the Combined Code (2003).

4.11.3 The Development of Audit Committees in India

Although ACs evolved in 1940s as an effective CG mechanism in the U.S.A., it was not much heard of in India before the 1980s. In recent years the idea of ACs is gaining popularity in India, particularly in the country’s banks and insurance companies. The first formal development of ACs in India was in 1991 during the economic reforms that placed substantial emphasis on the role of the external auditor and the AC. The 1992 stock market scam and liberalisation of the economy contributed to the introduction of AC requirements. In 1998 the Confederation of Indian Industries (CII) in its Code of Corporate Governance recommended companies to constitute ACs. The CII Code was the first, and probably a unique instance, where an industry association took the lead in prescribing AC standards for listed companies.

Further, in October 1999 the Reserve Bank of India (the central bank) issued an order requiring all listed banks to establish an AC as a committee of Board of Directors, generally consisting of non-executive directors, of a company. The specified roles of the committee were to act as a liaison between the auditors, both internal and external, and the board of directors. Furthermore, the Companies (Amendment) Act (2000), among other things, provides for the formation and functioning of ACs (section 292A). Similar requirements for audit committees are prescribed under clause 49 of the Listing Agreement issued by Securities and Exchange Board of India (SEBI), which required every listed company to have an AC generally consisting of non-executive directors of a company. In 2004 the clause was amended and the revised Clause 49 removed the non-executive director requirement and instead specified that the ACs should have a minimum of three members with two-thirds of them being independent. Under this amended clause, all companies listed on the stock exchanges have to establish ACs in

their companies. In a recent study, Sarkar and Sarkar (2010) found that a majority of companies have constituted their audit committees with the minimum size (three) required under the regulations.

4.11.4 The Development of Audit Committees in Bangladesh

AC is a relatively new phenomenon in Bangladesh, and its establishment has not been made mandatory. Despite the significant importance of ACs, few boards in Bangladesh have effective ACs and almost none have nomination or remuneration committees [Bangladesh Enterprise Institute (BEI), 2003]. BEI (2005) further studied 57 companies of different business segments, and reported that 62% of the organizations in Bangladesh have ACs. In 2006, the Security and Exchange Commission (SEC) issued some guidelines regarding AC practices for the listed firms in Bangladesh. It is true that like other emerging economies, there is shortage of competent AC members in Bangladesh to work for around 250 listed companies and thousands of private limited companies. According to the SEC's record (as of January 31, 2010), a total of 185 (out of total 241 listed companies on the DSE) companies had an AC in place. In an emerging capital market there is a smaller pool of experienced AC members and, therefore, many AC members may be busy serving on numerous committees and boards and have less time to develop informal communication channels (Zain and Subramaniam, 2007). Haque et al. (2006) argued that in Bangladesh the practice of AC is more visible than that of the other subcommittees. Furthermore, ACs are more visible in financial institutions when compared to other sectors (possibly because of the tight regulations imposed on this sector by Bangladesh Bank along with the SEC and Ministry of Finance). To ensure better governance in all sectors and not just the banking sector, Ahmed and Yusuf (2005) suggested that establishing an independent AC should be made compulsory for all listed companies in Bangladesh.

4.12 Conclusion

In recent years, the AC has become a more common mechanism for ensuring GCG in firms (Chen et al, 2008). An AC, acting as an independent governing body, improves

CG practice in these firms (DeZoort and Salterio, 2001). With the support from the board, along with the co-operation of employees and management team of the firm, the AC can perform its assigned duties duly (Haron et al., 2005). The main attributes of an AC may be abridged as: selection and nomination process, knowledge and expertise of AC members, independence from management; access to information; resources, diligence and meetings. The AC is responsible to perform multiple roles in the firm, and its effectiveness requires the ability of members to perform these roles properly. The activities of an effective AC are summarised in the definition by Marrian (1988):

A committee of board comprising three to five directors with no operating responsibility in financial management. Its primary tasks are to review the financial statements, the effectiveness of company's accounting and internal control system, and the findings of the auditors and to make recommendation on the appointment and remuneration of external auditors.

This chapter commenced with a description of the evolution of AC and ended with its developments around the world. The purposes, advantages, disadvantages and significances of ACs have been discussed with reference to the related literature. This chapter also discussed the attributes and activities of an effective AC, and then presented a conceptual framework of AC effectiveness. The next chapter discusses the details of the data collection and research methodology used for this study.

CHAPTER FIVE: RESEARCH METHODOLOGY

5.1 Introduction

Research methodology is the roadmap that deals with the manners in which data will be collected, analysed and interpreted in order to achieve research objectives. This chapter therefore, presents the research design and methods used to address the research problem, as outlined in *Chapter One*. It is structured as follows: Section 5.2 outlines the research objective, and Section 5.3 states the research questions. Section 5.4 offers a description of the research design and methods of the study. Details of data collection methods employed in this study (i.e. questionnaire and interview surveys) are discussed in Sections 5.5 and 5.6, respectively. Section 5.7 describes the statistical tools used for analysing questionnaire survey data while Section 5.8 discusses how the responses of interview survey have been analysed. Finally, Section 5.9 summarises the chapter.

5.2 Research Objective

As stated in *Chapter One*, the main objective of this research is to contribute to the understanding of the AC practices from the perspective of an emerging economy by undertaking an empirical investigation into the AC practices in companies listed on the Dhaka Stock Exchange (DSE).

5.3 Research Questions

The research questions which follow are derived from the above stated objective, and from the comprehensive literature review which is presented in *Chapter Three and Chapter Four*. The literature review included relevant studies such as: Verschoor (1993); Collier (1993); Menon and Williams (1994); Green (1994); DeZoort (1997); Rezaee (1997); Klein, (1998a,b; 2002a); ICAEW (2001); Jennings (2002); DeZoort et al. (2002); Al-Moataz (2003); Chambers (2005); Carcello et al. (2006); Alleyne and Greenidge (2006); Dhaliwal et al. (2006); Farooque et al. (2007); Pucheta-Martinez and

De Fuentes (2007); Raghunandan and Rama (2007); Sori et al. (2007); and Zain and Subramaniam (2007)Abbott et al. (2007); Chen and Zhou (2007); Chan and Li (2008); Lin et al. (2008); Bhagat and Bolton (2008); Brown et al. (2009); Sarens et al. (2009); Sharma (2009); and Siddiqui (2010).

5.3.1 Principal Research Questions

This study addresses the following four main questions:

- What is the current state of the AC practices in Bangladesh?
- What are the main factors that affect the AC practices in Bangladesh?
- What major steps can be undertaken to enhance the effectiveness of ACs in Bangladesh?
- Is there any significant difference in the perception of different respondent groups in respect of the current state of AC practices in Bangladesh?

5.3.2 Subsidiary Research Questions

From the main research questions, a set of subsidiary questions are derived:

- How are the AC members appointed?
- To what extent do the AC members have required expertise in accounting/auditing area?
- To what extent do the AC members have sufficient experience?
- To what extent do the ACs include independent/external directors?
- To what extent is the size of ACs appropriate in performing their responsibilities?
- To what extent are the ACs provided with sufficient resource?
- To what extent are the ACs delegated required authority by the BoDs?
- To what extent do the ACs have ready access to relevant information?
- To what extent are the AC members willing to undertake (assume) their responsibilities?
- To what extent do the AC members devote sufficient time to the committee

activities?

- How is the agenda of AC meetings chosen?
- How often are AC meetings held?
- To what extent can the AC members talk freely in AC meetings?
- To what extent do the ACs play a role in financial reporting?
- To what extent do the ACs play a role in external auditing?
- To what extent do the ACs play a role in internal auditing?
- To what extent do the ACs interact with external auditors/internal auditors/management of the company?
- To what extent are the ACs independent?
- To what extent are the ACs effective?
- To what extent does the background of AC members affect AC effectiveness in Bangladesh?
- To what extent does independence affect AC effectiveness in Bangladesh?
- Are the existing regulations in Bangladesh sufficient for effective AC practices?
- What other measures can be taken to improve the effectiveness of ACs in Bangladesh?

5.4 Research Design

Research design is the next step that researchers undertake following the formulation of the research objectives and questions (Frankfort-Nachmias and Nachmias, 2008). A research design specifies the structure of research, and its function is to ensure that the evidence obtained would enable the researcher to answer the research questions as unambiguously as possible. Blalock and Blalock (1982) argued that the research design consists of a general set of operating guidelines within which the research is carried out. Furthermore, Punch (2005) noted that it is important to establish the research method after setting out the research questions. According to Ghauri and Gronhaug (2005), *"research methods refer to systematic, focussed and orderly collection of data for the purpose of obtaining information from them, to solve/answer a particular research problem or question"*. Researchers around the world typically employ three main

different types of research methods, namely: the quantitative method, the qualitative method, and the mixed method.

5.4.1 Quantitative Research

Quantitative research incorporates some statistical elements which are designed to quantify the extent to which a target group is aware of, thinks, believes, or is inclined to behave in a certain way. The quantitative approach employs quantitative measurement and uses different statistical analyses (Hussey and Hussey, 1997; Gillham, 2000). Holland and Campbell (2005) argued that quantitative research has the advantage of generating standardised numerical data, along with describing and predicting a relationship for a large population with a high degree of confidence. Quantitative research can provide stronger forms of measurement, and establish more reliability, causality, and generalisation capability of the study findings (Bryman, 2001). The quantitative approach can deal with a large number of samples within a relatively short period of time, which helps to augment the method's generalisation capacity (Berg, 2001).

However, there are some disadvantages which stem from the point that quantitative methods attempt to neutralise the researcher, or to reduce or eliminate the researcher's influence on the research, to the extent that researchers become 'disembodied abstractions' and depersonalised (Collins, 1992; Lamnek, 1988). Quantitative analysis of the relationships between variables creates a static view of social life or social processes (Cicourel, 1982). Further, Robson (2002) pointed out several disadvantages of quantitative research, referring to it as: *"a field where it is not at all difficult to carry out an analysis which is simply wrong, or inappropriate for your purposes. And the negative side of readily available analysis software is that it becomes that much easier to generate elegantly presented rubbish"*. Furthermore, Maxwell (2005) regarded quantitative research as a structured approach that helps to ensure the comparability and generalisation ability of data across individuals, times, settings and researchers.

5.4.2 Qualitative Research

Qualitative research is concerned with individuals' descriptive accounts of their perceptions, attitudes, beliefs, views and feelings etc. It displays how these are put together into a framework which connects attitudes, behaviours and the discontinuities, or even contradictions, between attitudes and behaviour (Hakim, 1997). Qualitative research is broadly defined as any kind of research that produces findings not arrived at by any statistical procedure or other methods of quantification (Corbin and Strauss, 1990). Qualitative methodology takes a descriptive, non-numerical approach to collect and interpret information, aiming at understanding the phenomenon. Many different opportunities present themselves for collecting qualitative data, such as: case studies, personal experiences, interviews, observations, and historical and visual texts (Denzin and Lincoln, 1994, 1998; Morse and Field, 1995; Symon and Cassell, 1998).

Kvale (1996) noted that the qualitative approach entails alternative conceptions of social knowledge of meaning, reality, and truth in social science research. Researchers attribute various advantages in using a qualitative approach. Berg (2001) argued that it provides a greater depth of understanding of an issue. The author claimed that this procedure provides a means of accessing unquantifiable facts and seeks answers to questions by examining various social settings and those individuals who inhabit the settings. Furthermore, Babbie (2009) argued in favour of the qualitative method and highlighted that this method is an effective strategy for studying subtle nuances in attitudes and behaviour, and for examining social processes over time. The author also noted that flexibility and greater validity are vital advantages of qualitative methods. However, the qualitative approach also has some inherent shortcomings. For example, this type of study generally uses small samples, which are not always representative or typical and, therefore, valid generalisations cannot be made (Hakim, 1987). Reliability and transparency also remain low for qualitative methods (Berg, 2001; Bryman, 2001). Berg (2001) suggested that qualitative research is very time-consuming and leads to weaker forms of measurement.

5.4.3 Mixed Method

In social science research, a mixed method (i.e. a combination of both qualitative and quantitative methods) is an approach which provides the opportunity for 'triangulation'²¹ (Flick, 1992; Jick, 1979; Hammersley and Atkinson, 1995; Maxwell, 1998; Leedy, 1997; Roe, 1998; Scandura and Williams, 2000; Smith, 1991), since it effectively incorporates 'multiple research strategies' (Burgess, 1982). A mixed method can also help in bridging the schism between quantitative and qualitative research (Onwuegbuzie and Leech, 2004). Methodological works on this research paradigm have been supported by several authors; for example, Brewer and Hunter (1989); Creswell (2003); Greene et al. (1989); Johnson and Christensen (2004); Newman and Benz (1998); Reichardt and Rallis (1994); Tashakkori and Teddlie (1998, 2003). Hence, the mixed method approach combines qualitative and quantitative approaches of data collection and/or analysis, concurrently or sequentially, in order to best understand the research issue.

There are some unique advantages of employing the mixed method approach in research. For example, it enables triangulation, which theoretically should highlight if there is any inherent biasness in the data sources; and allows for its neutralisation when that data is used in conjunction with other data sources, and methods (Jick, 1979). When various methods reach the same conclusion, the results become more robust and this enhances the reliability of the findings. The combination of methods helps to capitalise the strengths of the two approaches, and compensate for the weaknesses of each approach (Punch 2005). Greene et al. (2005) mentioned that a mixed method strategy offers:

- (i) More comprehensive understanding from multiple perspectives and lenses;
- (ii) More insightful understanding from fresh and creative perspectives;
- (iii) Greater validity; and,
- (iv) Greater value consciousness and diversity of values.

Despite these obvious merits, the use of mixed method as a research strategy has been

²¹ Triangulation refers to the process of using multiple data collection techniques within one study to check the validity of the data derived (Denzin, 1978).

criticised by some authors. For example, Fielding and Fielding (1986) disagreed with Denzin's views that the mixed method reduces bias and improves validity, and Mason (2002) argued that adopting multiple methods may simply result in the derivation of data as they relate to different aspects of the same phenomenon. However, the derivation of data relating to varying aspects of the same phenomenon is not only helpful, but it can also be necessary in some cases.

5.4.4 Choosing the Method for the Current Study

There is no absolute data collection method which is always suitable for similar types of research. Choosing the appropriate method(s) for any study mainly depends on the nature of the research, the data to be collected, and the research purposes. The research methods are determined by the nature of the research question(s) (Field and Morse, 1995). Both Punch (2005) and Shulman (1988) insisted that different questions require different methods to answer them. According to De Vaus (2002),

It is impossible to decide which method is the best. The relative strengths and weaknesses vary according to the characteristics of the survey. There are many factors affecting which method is the most suitable for a survey such as the purpose of the study, sample size and distribution, the time available and the environment and conditions under which the study is conducted.

The main objective of this study is to state the scenario of prevailing AC practices in Bangladesh by eliciting the opinions of various groups, namely: the AC chairpersons, the company secretaries, the heads of finance, and the external auditors. Access to Bangladeshi firms for data collection is not always easy; it becomes even more difficult when the issue is company governance related like the current research issue (i.e. AC practices). Moreover, if the interview method alone is used, it would take up a lot of the valuable time of the participants. In addition, the purpose of this study is to obtain the views of as many participants as possible, so it did not seem to be practical to use the interview method alone. Apart from the review of literature on AC (as discussed in *Chapter Four*), discussions were held with several Bangladeshi auditing and accounting practitioners and regulators. These discussions were conducted in an informal manner

and in the form of unstructured interview to facilitate the choice of modes for collecting data for this study. Following the feedback of these discussions, two stages of data collection process were considered appropriate to achieve the objectives of the study.

The study has, therefore, used both the quantitative method (in the form of a questionnaire survey) and the qualitative method (in the form of an interview survey) in gathering opinions on the research issues. Creswell (2003) regarded survey design as a numeric description of the trends, attitudes or opinions of the population. The qualitative part of this study is aimed at complementing the findings of quantitative method in order to make the findings more robust. Moreover, in the context of the research questions of the study, the interview method remains as an obvious option in order to capture a deeper understanding of the current state of AC practices prevailing in Bangladesh, and in suggesting ways of enhancing its effectiveness in Bangladesh. Considering the overall context of this study, both quantitative and qualitative research methodologies have been considered to be very useful and this also facilitated the study to take the advantage of triangulation in making the study findings more robust and reliable. Therefore, the researcher has decided to utilise both questionnaire survey and interview survey methods in collecting data for the current study. These two instruments of data collections are discussed in more detail in the next sections.

5.5 Questionnaire Survey

Questionnaire survey is the most frequently used method in the social science field (Easterby-Smith et al, 2001; 2008). In this method, all respondents are asked almost the same questions in the same circumstance (Easterby-Smith et al., 2001; Li et al., 2000; Merriam, 1988; Payne, 1980). The questionnaire survey is particularly useful in describing the characteristics of a large population (Babbie, 2009). Oppenheim (1992) noted the following advantages of questionnaire survey method.

- The most obvious appeal of the mail questionnaire is the low cost. The mail questionnaire does not require a trained staff of interviewers; the processing and analysis of data are usually cost effective. The lower cost is particularly evident when the sample number is large.

- This method gives respondents the opportunity to think freely or consult other people rather than give immediate answers as in the case of interviews. Thus, it is useful in avoiding error arising from interviewer bias.
- Through this method, researchers can reach the respondents who live at widely dispersed addresses or abroad.
- The mail questionnaire provides greater anonymity for respondents.
- The questionnaire method is also preferable when a question demands a considered answer, or if answers require respondents to consult personal documents or other people.

Therefore, a questionnaire survey allows the collection of large volume of data from a sizeable population in a highly economical way (Saunders, et. al., 2007). The current study includes a sizeable population and a large volume of data needs to be collected. A self-explanatory questionnaire was designed to obtain information from the listed firms on AC practices. In designing the questionnaire, the study has also consulted previous similar studies (such as, Al-Maotaz, 2003, Sori, 2005) that dealt with AC practices in different countries.

5.5.1 Study Population and Sample

In sample based studies, it is necessary to clearly define the population being surveyed and to ensure that the sample selected provides an accurate representation of the population (Thomas, 1996). The population of the current study consists of all Bangladeshi joint stock companies listed on the Dhaka Stock Exchange (DSE). As per the SEC record as of 31 January 2010, a total of 185 companies had AC in place (out of a total 241 companies listed on the DSE). In the current study, the AC chairpersons, the company secretaries, the finance heads and the external auditors of these 185 companies are the key participants. Those companies who do not have ACs are excluded from the current study sample for three reasons, namely: (i) the objective of the study is to investigate the current AC practices in Bangladesh and the respondents were requested to offer their perception towards the existing practice (not the ideal practice) of ACs in

their own company or their client company(s) (in case of external auditors) having AC; (ii) one of the four survey respondent groups is the chairpersons of ACs; and (iii) as of 31 January 2010, the number of DSE listed companies without ACs was only 56, which were only 23.24% of the total companies listed on the DSE.

Choosing these four sample groups as survey participants is deemed appropriate because of their involvement with and knowledge about the ACs in Bangladesh. In case of the first group, the AC chairpersons, it is obvious to elicit opinions of the AC chairpersons because they know the AC practices perhaps more than any other group. The reasons of choosing company secretaries as one of the four respondent groups are: firstly, they provide secretarial supports to the ACs and keep all records of the ACs; and secondly, in most of the cases company secretaries act as the member secretaries of the ACs. This implies that they closely observe how ACs are actually functioning and, consequently, their views on the issue are considered to be very important in stating the current picture of AC practices. In this regard, Stiles (2001) noted that the company secretaries are the most suitable respondents to any Corporate Governance (CG) related survey because of the legal requirement attached to their positions and due to their responsibilities in administering company processes. Company secretary's involvement with the AC affairs is also noted in Smith Guidelines (2003) on AC practices. A few recent studies conducted on CG issues have included company secretaries as survey respondents. For example, Haque (2007) included company secretaries as survey respondents in his study on CG practices in Bangladesh. Furthermore, Annuar (2008) conducted a questionnaire survey on company secretaries in undertaking a research on CG in Malaysia. In respect of finance heads and external auditors, these two groups are more knowledgeable on the issue and, in almost every case they are not included in the ACs. That is why these two groups are considered as more suitable choices in obtaining objective and independent opinions regarding the AC practices. The choice of these two sample groups is also supported by Woodlock and Claypool (2001) who mentioned that the CFO (finance head) and the external auditor are better to assess AC practices of a firm.

The survey questionnaires were distributed to all AC chairpersons, company secretaries and finance heads of the 185 companies having ACs in place. Out of these 185 companies, 25 finance heads were also in charge of company secretary’s responsibilities and 10 company secretaries were in charge of finance head’s responsibilities. This resulted that a total of 520 questionnaires (185 AC chairpersons, 160 company secretaries and 175 finance heads) were sent to these three sample groups. In respect of external auditors, the study included the partners of auditing firms that conducted the statutory audit of the companies listed on the DSE in the most recent five years. It should be mentioned that the SEC has imposed some qualification for audit firms who can perform statutory audit of the listed companies. One of the criteria is that the audit firm must be a partnership or joint venture entity, but most of the audit firms in Bangladesh are owned by sole proprietor. Although there are a total of 210 registered audit firms in Bangladesh, only 29 firms (as per ICAB record) were engaged in performing external auditing task for companies listed on the DSE within the last 5 years and the study included all 105 partners of these 29 firms. Therefore, the total sample of the questionnaire survey is 625 to whom questionnaires were distributed. The following table summarizes the sample size of the survey.

Table 5.1: Analysis Showing the Sample of Questionnaire Survey

Sample Group	Sample Size	Percentage
AC Chairperson	185	30%
Company Secretary	160	25%
Finance Head	175	28%
External Auditor	105	17%
Total	625	100.00

Since this study has included all 185 companies having ACs in place (which corresponds to the total population) then the sampling strategy does not seem to be a critical issue except for taking into consideration the non-response bias or missing information for the sample firms, as argued by Tuma (2004). The problem of non-response bias was mitigated through extensive and repetitive efforts including follow up

reminder and/or call-backs as suggested by Thompson (2002). A statistical test was also run in order to detect if there were any such biasness, and this will be explained in a later part (subsection 5.5.8.2) of this chapter.

5.5.2 Questionnaire Design

Conducting a questionnaire survey is the process of translating concepts into measurable variables (Saunders et al, 2007). In respect of designing questionnaires, Bourque and Fielder (1995) suggested that in order to help potential respondents fill out the questionnaire without need for assistance, questions should be as easy as possible, short, and precise.

5.5.2.1 Questionnaire Length

Researchers should be aware that long questionnaires discourage the target respondents from completing the instrument and, consequently, it is either not fully completed or not returned at all (Al-Moataz, 2003). In both cases, the study's validity is seriously jeopardised. Therefore, the current researcher has tried to make the questionnaires as short and concise as possible, keeping in mind that all important aspects are covered.

5.5.2.2 Form of the Questions

According to Hussey and Hussey (1997), researchers sometimes disagree over the extent to which the form of questions should be structured. The questionnaire may include open-ended and/or close-ended questions, having taken into due consideration their advantages and disadvantages. Open-ended questions allow the participants to give answers in their own words, like an essay examination question (Weisberg et al, 1996; Peterson, 2000). Open questions offer the advantages that the respondents are able to give their opinions as precisely as possible in their own words. Academic researchers, who can take years to analyse interview data, use open-ended questions more often, but sometimes it becomes difficult to analyse these data. Dillman (1978; 2000) claimed that open-ended questions are likely to be used in two distinctly different situations: firstly,

when the respondents can express themselves freely; and secondly, when there are a very large number of possible answers, listing all of the options would increase the difficulty of answering to the questions.

On the contrary, closed-ended questions offer a series of alternative choices of answers among which the respondents choose one, like a multiple-choice examination question (Weisberg et al, 1996). Closed questions are very convenient for collecting factual data and analysing responses since the range of potential answers is limited. It is also easy and inexpensive to work with the resulting data. If the closed-ended format is chosen, much care should be taken in writing the answer choices so that all possible options are included and none of these overlap (Weisberg et al, 1996). Dillman (1978; 2000) further pointed out that closed-ended questions are often used to establish priorities among issues and decide among alternative policies. Similarly, closed-ended questions are indispensable for exploratory studies in which the researcher's main purpose is to find the most salient aspects of a topic. The most frequent criticism of open ended questions is that the preferred options of all respondents are not stated (Hussey and Hussey, 1997). The appropriateness of either closed-ended or open-ended questions depends on the objective of the questionnaire, the respondents' level of information about the topic in question, the extent to which the topic has been thought through by respondents, the extent to which respondents are motivated to communicate on the topic, and the sample size of the study population (Hussey and Hussey, 1997).

The aim of the questionnaire survey in this study is to obtain opinions on the current practices of ACs in Bangladeshi corporations. Hence, it requires constructing the questionnaire (see Appendix 3) in such way so that it is specific enough to reveal answers to the questions, yet general enough to allow respondents not to reveal any sensitive information. A closed-ended question, as mentioned earlier, offers a selection of answers from which the respondent is asked to select one. Therefore, all questions in this instrument are close ended and have been constructed according to the Likert Scale, as advocated by Bryman and Bell (2003), Hussey and Hussey (1997) and Zikmund (2000) for cases similar to the current study. It has used Five-Point Likert Scale with a value of

‘1’ indicating that the respondent strongly disagrees to any particular factor/statement and the highest number ‘5’ indicating that the respondent strongly agrees to the particular factor/statement in the actual practices in the corporation. The Five-Point Likert Scale has been used in case of this instrument in preference of the Seven-Point Likert scale since the target respondents seem to be uncomfortable with a complex scale of six or seven points.

5.5.2.3 Structure of the Questionnaire

The questionnaire (see Appendix 3) developed for the study is divided into four broad parts. Part I is for respondent’s background information and includes his/her education, experience, and qualification. Part II, the main part of the questionnaire, aims to gather respondents’ opinions on 50 statements regarding current practices of ACs in Bangladesh. These statements have been grouped according to eight different aspects of ACs, namely:

- (A) Composition;
- (B) Authority and Resources;
- (C) Diligence;
- (D) Meeting;
- (E) Role in Financial Reporting;
- (F) Role in External Auditing;
- (G) Role in Internal Auditing; and,
- (H) Overall practices.

In Part III of the questionnaire, nine factors that are deemed to affect the AC practices in Bangladesh, have been listed, while Part IV lists ten possible steps to be taken for enhancing the effectiveness of ACs. As already mentioned, a 5 point Likert Scale (1= highly disagreed and 5= highly agreed) has been used in Parts II, III, and IV. The four sample groups were distributed the same set questionnaire, except for a few wording changes in the case of the external auditor group (for example, it is meaningless to ask an external auditor whether he/she has CA qualification).

The reason of grouping the statements into such small sections in the questionnaire was to reduce the possibility of boredom, which might induce the respondent to give up while responding to the questionnaire. The sub-division of the questionnaire has also been helpful in constructing the research hypotheses. The questionnaire was also designed to ensure that the respondents followed precise and specified instructions. As discussed earlier, the main objective of this study is to state the current practices of ACs in Bangladesh and this is covered in Part II, the key part of the questionnaire. Statements under eight different sections of this part have been discussed as follows.

Section A: Composition

The first section contains eight statements (S1-S8) to investigate the AC members' qualification, expertise, knowledge and independence because these are very influential elements for AC practices. Windram and Song (2000) indicated that financial literacy is a very significant determinant of AC effectiveness. Similarly, Bedard et al. (2004; 2008); Raghunandan et al. (2001) and Pachuta-Martinez (2007) also focused on the importance of financial literacy and the independence of AC members.

Furthermore, Defond et al. (2005); Dhaliwal et al. (2006); Lin et al. (2008); Krishnan et al. (2009); and Krishnan and Lee (2009) have noted the significance of accounting and financial expertise of AC members. Rainsbury et al. (2008) pointed out the necessity of accounting knowledge of AC members. In respect of AC size, NACD (2002) and ICAEW (2001) suggested that an AC should have a minimum of three members. Lin et al. (2008), however, argued that if an AC is too large then it can sometimes lead to unnecessary and meaningless debates in the committee's meetings. Guidelines on the composition of ACs in terms of members' attributes, its independence and size have also been given in the Treadway Report (1987); the BRC (1999); the Sarbanes-Oxley Act (2002); and the Combined Code (2003). Therefore, the statements included in this section are:

- S1: The AC members are appointed in consultation with the AC chairperson.
- S2: The AC members have sufficient knowledge on the entity's business.
- S3: The AC members have sufficient knowledge on Accounting and/or Auditing

practices.

S4: The AC members have sufficient experience in Accounting and/or Auditing.

S5: The AC members are capable of mediating problems in performing their duties.

S6: The majority of AC members are independent /non-executive directors.

S7: The Chairperson of the AC is an independent/non-executive director.

S8: The size of the AC is appropriate for carrying out its duties properly.

The null hypothesis for this group is:

Ho (1): Differences observed in the mean scales of responses within four sample groups (AC Chairperson, Company Secretary, Finance Head and External Auditor) with respect to composition of the ACs are statistically insignificant.

Section B: Authority and Resources of the AC

Section B consists of five statements (S9-S13) to obtain opinions on the authority and resources provided with the ACs. Arthur Anderson (1994) noted that it is deemed extremely important that ACs have unrestricted access to all relevant internal and external information to fulfil their oversight responsibilities. Clear guidelines on adequate authority and resources of AC have been provided in the Treadway Report (1987) and the Sarbanes-Oxley Act (2002). Therefore, statements included in this section are:

S9: The AC has adequate authority in order to carry out its responsibilities.

S10: The AC has ready access to relevant information if required.

S11: The AC receives prompt responses from the management in carrying out its duties.

S12: The AC is provided with sufficient resources including secretarial support to carry out its duties.

S13: The non-executive AC members are adequately paid for their time and efforts.

The null hypothesis for this group is as following:

Ho (2): Differences observed in the mean scales of responses within four sample groups with respect to authority and resources provided to the ACs are statistically insignificant.

Section C: Diligence of the AC

This section consists of five statements (S14-S18) that focus on diligence of the AC members. Kalbers and Fogarty (1993) and Sharma et al. (2009) reported that AC members' diligence is one of the main components of its effectiveness. Lee and Stone (1997) explained the 'diligence' as 'willing to be effective'. The statements included in this section are:

S14: The AC has a charter which outlines its objectives, duties and responsibilities.

S15: The AC charter is reviewed annually.

S16: AC The AC members have a clear understanding of their responsibilities.

S17: Members of the AC readily assume their responsibilities.

S18: The AC members devote sufficient time to the committee's affairs.

The null hypothesis for this group is:

Ho (3): Differences observed in the mean scales of responses within four sample groups with respect to diligence of the ACs are statistically insignificant.

Section D: Meetings of the AC

The proper functioning of any committee largely depends on its effective meetings. Section D includes eight statements (S19-S26) on the process of AC meetings. Importance of AC meeting frequency has been discussed by Chen and Zhou (2008); Anderson (2004) and Spira (2002). Abbot et al. (2004) and Sharma et al. (2009) suggested holding three to four AC meetings in a year as a good practice. In respect of agenda of AC meetings, NACD (1996) suggested that the agenda should be decided by AC itself without interfere from management and the agenda should be circulated among the members beforehand. Similarly, Beasley et al. (2009) suggested that AC

chairman should set the agenda taking input from the finance director and AC members. The statements included in this section are:

S19: The agendas of the AC meetings are finalized by the chairperson.

S20: The chairperson cooperates with other committee members before finalizing the agenda of the meetings.

S21: The agenda and related materials are provided to members fairly ahead of the meetings.

S22: All members can express their views freely and independently in the meetings.

S23: The frequency of the AC meetings is sufficient to carry out its responsibilities.

S24: The duration of the AC meetings is sufficient for a full discussion of important issues.

S25: Non-members attend the AC meetings if required.

S26: The minutes of the AC meetings are circulated to all members of the Board of Directors (BODs).

The null hypothesis for this group is:

Ho (4): Differences observed in the mean scales of responses within four sample groups with respect to the effectiveness of AC meetings are statistically insignificant.

Section E: Role in Financial Reporting

Section E consists of six statements (S27-S32), which focus on the roles of AC in financial reporting process. The AC is primarily responsible for monitoring the integrity of firm's financial statements (Laux and Laux, 2009). The Combined Code (2003); the Treadway Report (1987); the BRC (1999) and the Sarbanes-Oxley Act (2002) have discussed about AC's roles in financial reporting process of the company. Similarly, Gendron and Bedard (2006); Turley and Zaman (2007) and Cohen et al. (2007a) highlighted AC's roles in financial reporting of the company. Hence, the statements included in this section are:

S27: The AC reviews the integrity of companies' financial statements.

S28: The AC reviews accounting policies and any changes made therein.

S29: The AC reviews accounting estimates and judgments done in preparing financial statements.

S30: The AC reviews the compliance of the Accounting Standards (e.g. IAS, BAS etc.) in preparing financial statements.

S31: The AC reviews the clarity and completeness of disclosures in financial statements.

S32: The AC reviews other information (e.g. the auditors' report, financial highlights etc.) presented in the annual report.

The null hypothesis for this group is:

Ho (5): Differences observed in the mean scales of responses within four sample groups with respect to AC's role in financial reporting are statistically insignificant.

Section F: Role in External Auditing

This section contains eight statements (S33-S40) focusing on the role of AC with the external auditors because the AC is a valuable instrument for initiating direct contact with external auditor, participating in the selection of external auditor, and promoting effective communication between the external auditor and company management. Klein (2002a) argued for the importance of AC members' meeting with external auditors. The Treadway Report (1987); the BRC (1999); the Sarbanes-Oxley Act (2002); and the Combined Code (2003); have guided AC's roles in external auditing process of the company. Rezaee and Farmer (1994); Wolnizer (1995); and Beasley et al. (2009) also argued that the ACs can play important roles in this respect. The statements included in this section are:

S33: External auditors are appointed and/or removed upon the recommendation of the AC.

S34: The AC assesses and reviews the expertise and resources of the external auditors.

S35: The AC reviews and approves the terms of the Engagement Letter (EL)²² prepared for the external auditors.

S36: The AC monitors the external audit firm's compliance with the existing ethical and regulatory requirements in Bangladesh.

S37: The AC reviews the findings of the annual audit obtained by the external auditors.

S38: The AC reviews the management's responsiveness to the external auditors' findings.

S39: The AC meets with the external auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit.

S40: The AC reviews and monitors the independence and effectiveness of the external auditing process.

The null hypothesis for this group is as following:

Ho (6): Differences observed in the mean scales of responses within four sample groups in relation to AC's role in internal auditing are statistically insignificant.

Section G: Role in Internal Auditing

In this section, eight statements (S41-S48) have been directed to the respondents to investigate the roles of AC in internal auditing process of the company. The Combined Code (2003); the Treadway Report (1987); the BRC (1999) and the Sarbanes-Oxley Act (2002) have discussed the role of an AC in internal auditing process of the company. Internal auditing is one of the critical resources of the AC in carrying out its responsibilities (Rezaee and Farmer, 1994; Montondon, 1995). Sarens et al. (2009) noted that internal audit section is a comfort provider for the AC. In addition, Apostilou and Strawser (1990) pointed out that in fulfilling the oversight responsibilities, the AC should rely on internal auditors for much of its information concerning corporate

²² An engagement letter (EL) defines the legal relationship (or engagement) between a professional firm (e.g., law, investment banking, consulting, advisory or accountancy firm) and its client(s). This letter states the terms and conditions of the engagement, principally addressing the scope of the engagement and the terms of compensation for the firm

activities. Rezaee and Farmer (1994); Turley and Zaman (2007); Lennox and Park (2007); Laux and Laux (2009); and Beasley et al. (2009) also argued for AC's roles in this respect. Therefore, the statements included in this section are:

S41: The AC recommends and approves the appointment or termination of the heads of the internal audit division.

S42: The AC approves and reviews the charter of the internal auditors.

S43: The AC assesses and reviews the annual internal audit work plan.

S44: The AC reviews the annual internal audit reports, budget and other findings.

S45: The AC reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.

S46: The AC meets with the head of the internal audit function without the presence of the management.

S47: The AC enhances the independence of the internal auditors of the company.

S48: The AC monitors and evaluates the effectiveness of internal audit function.

The null hypothesis for this group is as following:

Ho (7): Differences observed in the mean scales of responses within four sample groups in relation to AC's role in external auditing are statistically insignificant.

Section H: Overall Independence and Effectiveness of ACs

This section consists of two (S49-S50) statements that attempt to explore the perception of participants about the overall effectiveness of AC in the company. It was difficult to classify these statements into any of the previous seven groups because of their generic nature. The two statements included in this section are:

S49: The AC can work independently.

S50: The AC is effective.

The null hypothesis for this group is as following:

Ho (8): Differences observed in the mean scales of responses within four sample groups with respect to overall perception on independence and effectiveness of the ACs are statistically insignificant.

5.5.3 Pre Testing and the Pilot Study

In the case of questionnaire survey, the success largely depends on the quality of questionnaire itself. Oppenheim (1992) indicated that the main factor in questionnaire design is clarity and, therefore, complex and confused wording should be avoided. Therefore, it is absolutely essential that a pilot study should be conducted to establish that the proposed questionnaire is intelligible and clear to members of the target population. Also, researchers must ensure that the questionnaire is unambiguous, reliable and valid for the purpose for which it is to be used (Oppenheim, 1992; Easterby-Smith et al., 2008).

In social science research much emphasis is given to piloting the questionnaire before its final distribution. The aim of the pilot survey is to establish that the proposed questionnaire is understandable and clear to the members of the target population. It is useful to pilot the questionnaire with a small sample of respondents to check its suitability for achieving the research aims and objectives (Hussey and Hussey, 1997). Salant and Dillman (1994) mentioned that pre-testing a questionnaire is like ‘test-driving’ which may be a bit time-consuming but absolutely essential. Sinclair (1975) strongly recommended the pre-testing of a draft questionnaire to avoid ambiguity in question wordings so that all respondents understand the questions in the same way. Oppenheim (1992) commented: *"pilot work can be of the greatest help in devising the actual wording of questions, and it operates as a healthy check"*. Sometimes, the pretesting of the questionnaire reveals very serious errors, oversights, or problems that would have spelled disaster if they had not been detected and corrected before going into the field or the mail. As well, Stebbins (2001) claimed: *"the rise of quantitative research brought with it the need to pre-test measuring instruments and conduct pilot studies to iron out kink in procedures and sharpen precision so the main study could proceed as flawlessly as possible"*. Pre-testing a questionnaire instrument is an important step in ensuring its reliability and validity (Thomas, 1996). Corbetta (2003) also stressed that spotting any need for changes in advance is essential and can only be afforded through pilot testing because when the actual fieldworks have begun it will be costly and time consuming to modify the questionnaire.

The questionnaire in this research went through a number of developmental stages before final distribution. In the first stage, a draft of the questionnaire was produced by writing down and grouping all questions and issues which had resulted from the literature review. This draft was then distributed among some PhD students of Accounting Section in Cardiff Business School and few faculty members of IBA, Dhaka University to elicit their comments (mainly on the wording, sequence and structure of the questionnaire). Babbie (2009) suggested that a pilot test should use the same class of people who are intended to answer the final questionnaire and that these people should complete the questionnaire themselves rather than having the researcher read through it. Following the comments obtained from them, the revised questionnaire was further sent to five academics in Bangladesh having a PhD in accounting/auditing, five AC chairpersons, five company secretaries, five finance heads and five external auditors. The aim of this stage was to assess whether the research instrument is valid for the task or not. Hussey and Hussey (1997) mentioned that validity is the extent to which the research findings accurately represent the real picture of the issue being studied. An effect or test is valid if it demonstrates or measures what the researcher thinks or claims it does. In other words, in a validity assessment the basic question that the researcher tried to answer is: *“Are we in fact measuring what we think we are measuring?”* (Diamantopoulos and Schlegelmilch, 2000). In addition, another objective of piloting is to detect the validity and reliability of the questionnaire. According to Diamantopoulos and Schlegelmilch (2000), a measure that is valid is also reliable but the reverse is not necessarily true.

Along with the revised questionnaire, a cover letter explaining the nature, and objectives of research was also sent to each participants of the pilot survey. The reviewers were requested to note their observations, and then make recommendations to the questionnaire and comment on the ways to develop it, as well as making suggestions that could facilitate the analysis of data. Most of the pilot survey participants opined that an anonymous questionnaire survey should be undertaken for this study and the researcher followed this suggestion. The following table presents the response rate of the pilot study.

Table 5.2: Analysis Showing the Response Rate of Pilot Study

Piloting Groups	Sent	Response	Response Rate (%)
Academics	5	5	100%
AC Chairpersons	5	2	40%
Company Secretaries	5	3	60%
Finance Heads	5	4	80%
External Auditors	5	5	100%
Total	25	19	76%

Table 5.2 indicates that a total of 25 individuals from five different groups were approached for formal pre-testing, and that the overall response rate was 76% (i.e. a total of 19 out of 25). It is noticeable that all academic and external auditors responded the survey while only two out of five AC chairpersons responded.

The pre-testing of the survey questionnaire for this study obtained some valuable comments and ideas about the questionnaire's content, wording, and sequence; and hence, some modifications were required regarding the wording and scaling of certain questions, but not on any key content of the questionnaire. The pre-testing and piloting process took place in March and April 2010.

5.5.4 Administration of the Questionnaire Survey

The questionnaire was mailed to the sample participants in May 2010 after the subsequent amendments which were suggested in the pilot survey were made. The questionnaire pack included a set of questionnaires, two cover letters, an envelope with stamp (freepost) and return address. A cover letter is helpful in obtaining higher response rate because it explains the target respondents about the purpose, importance, and sponsors of the study. The first cover letter (see Appendix 1) was issued from the researcher explaining the nature and importance of the study, requesting to complete the questionnaire, assuring the strict confidentiality of their responses. The second letter (see Appendix 2) was from the supervisor to inform the purpose of the survey and the

importance of their responses. A reminder letter was sent to the sample participants who had not replied within four weeks of the first mailing. A final follow-up letter, including a questionnaire pack, was then sent registered by mail to all of the organisations that have not replied by the end of eighth week of the first mailing. In order to increase the response rate, the researcher followed up the survey with his best efforts. For example, the researcher also carried out field visits and used telephone, fax and e-mail communications to communicate with as many of the target respondents as possible. To motivate the respondents, in the questionnaire there was an offer of receiving a copy of research findings which was made to the respondents.

5.5.5 Questionnaire Survey Responses

Out of 625 mailed questionnaires, a total of 150 questionnaires were finally received in different stages, and 140 out of them were considered usable for the survey. A detailed breakdown of the questionnaire survey responses is presented in Table 5.3.

Table 5.3: Analysis Showing the Response Rate of Questionnaire Survey

Description	Total Mailed	Received within 4 th week	Received between 5 th - 8 th week	Received after 8 th week	Total Received	Response Rate	Total Usable
AC Chairpersons	195	13	8	11	32	16%	30
Company Secretaries	160	18	9	13	40	25%	37
Finance Heads	175	22	10	14	46	26%	44
External Auditors	105	16	8	8	32	31%	29
Total	625	69	36	46	150	24%	140

The above table shows that the overall response rate is 24% (or 150 out of 625). Because of the missing response in the case of the majority of statements, a total of 10 received questionnaires could not be used and, therefore, responses from 140 participants were used for analysis. Sample-group response rates were: 16% (AC chairpersons); 25% (company secretaries); 26% (finance heads); and 31% (external

auditors). One of the possible reasons for the relatively lower response rate in case of AC chairperson group might be that most of them do not have any permanent office in the company and that they are not regularly in the company. The possible explanation for comparatively higher response rate in the case of external auditors is that they are externals of the companies and, therefore, they are willing to share their views. However, considering the sensitivity of the research issue and Bangladeshi corporate environment, the overall response rate is found to be satisfactory.

5.5.6 Profile of Respondents

Although detailed characteristics of the survey respondents will be discussed in the next chapter, a brief profile (education, qualification and experience) of the survey respondents is presented in the following table:

Table 5.4: Profile of Questionnaire Survey Respondents

Description	Education-Last Degree		Education-Last Subject		Professional Qualification		Years of Experience	
	Below Bachelor's	Bachelor's & above	Accounting	Other	Yes	No	Below 10 years	10 years & above
Number	5	135	66	74	89	51	67	73
Total	140		140		140		140	

It can be seen from Table 5.4 that almost all (96%) respondents had a bachelor's degree or higher level of education, while only 5 respondents finished their education at below bachelor's level. Regarding the major area of last education, 66 (47%) respondents have an accounting background and the other 74 respondents are from Finance, Economics, Management or other areas. Again, 89 respondents (64%) have one or more professional qualification (i.e. CA, ACCA, CMA, CFA, CS etc.) while 51 respondents do not hold any such qualification. Regarding the length of work experience, 73 respondents (52%) have previous work experience in related area for 10 or more years and the rest 48% respondents have less than 10 years work experience in related field. It is relevant to

mention here that the average length of experiences in related area of the respondents was 10.89 years (as presented in the Table 6.5 of *Chapter Six*).

Therefore, Table 5.4 divides all respondents into two groups, categorised according to each of four characteristics, namely: education, subject, professional qualification and years of experience. This division has opened up a scope to investigate whether there is any significant difference in responses between these groups. However, two groups of respondents divided based on last education vary extremely in numbers (5 versus 135) and, hence, the researcher feels that comparison between these two groups will fail to draw any statistical inference. Therefore, there have been comparisons of three pairs divided on the other three characteristics. The mean scored of the responses towards 50 statements of the questionnaire have been compared in form of the following three null hypotheses.

Ho (9): Difference observed in the mean scales of responses between respondents having accounting subject and respondents having other subjects in last education is statistically insignificant.

Ho (10): Difference observed in the mean scales of responses between respondents having professional qualification and respondents without professional qualification is statistically insignificant.

Ho (11): Difference observed in the mean scales of responses between respondents having 10 and more years experience and respondents having below 10 years experience in related field is statistically insignificant.

5.5.7 Validity

Spector (1994) highlighted the importance of validating the research instrument. There are two types of validity of measurement that are of concern for most researchers, they are: content validity and construct validity (Churchill and Iacobucci, 2002).

5.5.7.1 Content Validity

The content validity of an instrument is the extent to which it provides adequate coverage of the topic under study. To evaluate the content validity of an instrument, researchers must first agree on what elements constitute adequate coverage of the problem. The content validity of the instrument of this study was established through the pilot study, as discussed earlier. Furthermore, the duration taken to complete the questionnaire by the pilot survey respondents was checked and timed to ensure that it was not so long that it made the participants shy away from completing it and answering all the questions. The questionnaire covers all the important aspects identified within the literature discussed in *Chapter Three* and *Chapter Four* of this thesis. However, comments obtained from pilot survey were incorporated before finally being used the questionnaire in the main study.

5.5.7.2 Construct Validity

This deals with the degree to which the scale represents the concept being measured (Tull and Hawkins, 1993). This validation situation is much more difficult; researchers still want assurance that their measurement has an acceptable degree of validity. The questionnaire used in this study contains clear and direct questions; this was reflected from the piloting tests, indicating that the construct validity is acceptable. Moreover, using the interviews as additional data gathering techniques contributes positively to the construct validity. Finally, the use of a Five Point Likert scale in the questionnaire has also contributed to improving the construct validity.

5.5.8 Reliability

Assessing the reliability of the data is important before making any statistical analysis. Reliability is concerned with the accuracy and precision of a measurement procedure (Sekaran, 2003). While validity is represented in the agreement between two attempts to measure the same trait through maximally different methods, reliability is the agreement between two efforts to measure the same trait through maximally similar methods (Churchill and Iacobucci, 2002). Similarly, Oppenheim (1992) described reliability as

‘consistency’ between methods. More specifically, reliability refers to the degree to which an instrument or technique generates the same results each time it is used. The consistency of the results refers to similar observations being undertaken by different researchers on different occasions (Saunders et al., 2007). Reliable instruments are refined to the degree that they are useful enough at different times and under different conditions.

5.5.8.1 Test of Reliability

There are three common methods of estimating reliability (Frankfort-Frankfort-Nachmias and Nachmias, 2008) which are: the test-retest, the parallel-forms, and the split-half. Again, Saunders et al. (2007) and Hussey and Hussey (1997) noted three approaches to assess the reliability of the data, which are: the test-retest method, the split half method, and the alpha coefficient.

The *test-retest* method is used to administer the instrument to the same group at two different times, and to compute the correlation in the two sets of scores. With this method, error is defined as anything that leads a person to get different scores from the two different measurements (Alreck and Settle, 1995; Oppenheim, 1992; Smith, 2003). In *the parallel-forms method*, the researcher develops two parallel versions of a measuring instrument. These two versions are administered to the same group of people, and then the two sets of results must be correlated in order to obtain an estimate of reliability. *The split-half method* estimates reliability by treating each of two or more parts of a measuring instrument as a separate scale. Each of the two parts is treated separately and scored accordingly. The two parts are then correlated (Frankfort-Nachmias and Nachmias, 2008). *The coefficient alpha method* provides a summary measure of the inter-correlations that exists among a set of items. Coakes and Steed (1999) argued that the alpha coefficient is the reliability test that is most commonly used by researchers to check internal consistency. Coefficient alpha should be routinely calculated to assess the quality of measure. If alpha is low then this outcome suggests that some items do not share equally in the common core and should be eliminated

(Churchill and Iacobucci, 2002). The alpha coefficient ranges from 0 to 1, and it is common practice to take 0.60 as the minimum acceptable value of alpha. Smith et al (2008) and Robinson et al (1994), as quoted in Al-Mushayt (2000), claimed that the reliability coefficient in the order of 0.60 is acceptable, while De Vaues (1996) and Smith (2003) suggested a minimum alpha value of 0.70 and 0.80, respectively, for reliability purposes. The alpha value is calculated based on the average correlation of items within a test if the items are standardised.

The equivalence measure of reliability for this study was done to focus on the internal consistence or internal homogeneity of the set of statements, which formed the statements in the questionnaire into groups as mentioned above. In this study, because of practical difficulties in adopting the other three methods, the researcher has decided to use the co-efficient alpha score to measure the reliability the survey questionnaire. Reliability tests were carried out on all groups of data (i. e. (A) Composition; (B) Authority and Resources; (C) Diligence; (D) Meeting; (E) Role in Financial Reporting; (F) Role in External Auditing; (G) Role in Internal Auditing; and (H) overall AC Practices). The test results are summarised in the following table.

Table 5.5: The Reliability Analysis-Scale (ALPHA)

Groups	Coefficient Alpha Value				
	AC Members	Company Secretaries	Finance Heads	External Auditors	Combined
A	0.701	0.715	0.821	0.884	0.813
B	0.908	0.875	0.847	0.895	0.887
C	0.821	0.834	0.849	0.696	0.832
D	0.766	0.776	0.766	0.889	0.843
E	0.931	0.918	0.942	0.92	0.945
F	0.906	0.892	0.781	0.89	0.884
G	0.959	0.935	0.884	0.932	0.934
H	0.813	0.826	0.702	0.743	0.752

Table 5.5 shows that the alpha coefficients in all cases are more than 0.70. These results indicate that the data obtained from questionnaire survey are reliable and suitable for further analysis.

5.5.8.2 Investigating Non-Response Bias

The possibility of occurrence of non-response bias arises when a significant part of the survey samples fails to return the questionnaire, and the data may consequently turn out to be invalid. It is well recognised in the literature that responses to mail questionnaires are generally poor, and it is a common phenomenon to see low return percentages. Hence, in order to ensure the reliability of the data, an attempt to diagnose the presence of non-response bias is essential (Bartlett and Chandler, 1997; Ku Ismail, 2003). Oppenheim (1966) and Wallace and Mellor (1988) put forward a technique to diagnose non-response bias by comparing the answers to the questionnaire provided by early respondents to those of late respondents. The rationale to this argument is that 'late' responders are reasonable 'surrogates' for non-respondents (Wallace and Mellor, 1988). Therefore, in this study, the first 20 questionnaires (5 from each sample groups) received from respondents were categorised as 'early' and the last 20 questionnaires (5 from each sample groups) as 'late'. The early and late responses were then compared with the aim of observing whether significant differences exist between the two groups. The Mann-Whitney Test result ($p > .05$) implies there was no significant difference between these two groups' response. Therefore, it can be inferred that the study findings are free from non-response bias.

5.5.8.3 Investigating Self Selection Bias

Another source of bias in survey-type studies is the self-selection bias (Whitehead, 1991; Oppenheim, 1992; Eysenbach and Wyatt, 2002). This bias might arise from the fact that 'people are more likely to respond to a questionnaire if they see items which interest them' (Eysenbach and Wyatt, 2002) and they may try to 'respond' extra-well (Oppenheim, 1992) to the questions. Indeed, self-selection bias is a result of a pre-existing interest factor, and it is more serious than the non-representative nature of the

population due to the existence of many unknown factors (Eysenbach and Wyatt, 2002; Oppenheim, 1992). In the current study, much effort was given to diagnose the existence of self-selection bias. The current study deals with the practices of AC and to some extent it requires specialised expertise to respond to the survey. Although expertise in respect of AC has been explained in terms of educational background and experience, previous researchers (for example, McMullen, 1996; DeZoort, 1998; and Pomeroy, 2010) have placed more emphasis on experience. Hence, this researcher believes that people having more experience in the relevant area might find more interest in participating in the survey. Therefore, experience has been chosen as a criterion to test the self-selection bias. In the study, two groups of control and experimental respondents have been developed (Oppenheim, 1992). The control group consists of respondents with more than 10 years experience, while the experimental group comprised of respondents with less than 10 years experience. To investigate self-selection bias the Mann-Whitney U Test was used; and no such type of bias was found ($p > .05$, please see Table 6.14, p. 247).

5.6 Interview Survey

One of the most persistent criticisms of closed-ended questions, as used in the questionnaire survey, is that pre-set response options are likely to cause the respondents to give answers that they would not have given if they had the flexibility to answer for themselves. This short-coming of questionnaire survey necessitates the use of interview survey in research. Interviewing is defined as a conversation between two or more parties with a purpose to gather information (Marshall and Rossman, 1999). Interviews can elicit what a person knows, perceives, likes and thinks (Cohen et al., 2007c). This method allows the researcher to control the interview situation, results in a higher response rate than the mail questionnaire, and the interviewer can probe for additional and detailed data. Finally, interviews are preferable when asking for longer, difficult, and open-ended questions (Warwick and Lininger 1975; Moser and Kalton, 1985; Frey and Oishi, 1995; DeVaus, 1996; and Frankfort- Nachmias and Nachmias, 2008).

5.6.1 Types of Interview

In general, there are four types of personal interviews: structured, semi-structured, unstructured, and focus group interviews (Field and Morse, 1995) which are briefly discussed as following.

In *structured interviews*, the questions are closed-ended and the sequence in which they are asked is also same in every interview. This type of interviews is more objective and easy to analyse, but less flexible. Sekaran (1992) described these as: "*structured interviews are those conducted by the interviewer when he or she knows exactly what information is needed and has a predetermined list of questions that will be posed to respondents*".

The *semi-structured interviews* follow a less rigid format. Although still using standardised questions (covering socio-biographical details like age, sex, and educational qualification), there are also open-ended questions designed to elicit more qualitative information (Clarke, 1999). The strength of semi-structured interviews arises in the process of 'open discovery', when the matters explored change from one interview to the next as different aspects of the topic are revealed (Hussey and Hussey, 1997). In the semi-structured interview method, the researcher can enjoy the flexibility in terms of sequence of questions, response options, and probing questions, although there is a clear list of questions which is used as an interview checklist.

The *unstructured interview* method, also known as 'informal conversational interview', is the most open-ended approach to interviewing (Fontana and Frey, 2000). The unstructured interview provides maximum flexibility to pursue information in whatever direction appears to be appropriate, as well as enabling interviewees to answer questions within their own frame of reference. Furthermore, it gives the interviewee the opportunity to choose to talk at length about an issue. Sekaran (1992) stated:

The type and nature of the questions asked of the individuals might vary according to the job level and type of work done by respondents. For instance, managers at top and mid levels might be asked more direct questions about their

perceptions of the problem and the situation. Employees at lower levels may have to be approached differently.

The *focus group interview* is an interview with a small group of people on a specific topic. It allows researchers to focus upon group norms and dynamics around issues they wish to investigate. The extent of control of the group discussion determines the nature of the data produced by this method. According to Sekaran (1992), "*focus groups typically consist of eight to twelve members randomly chosen, with a moderator leading discussions regarding a particular topic, item, or product*".

5.6.2 Interview Method Used in the Study

The main objective of conducting interview survey in this study was to allow the respondents to further develop their views since the closed questions of a questionnaire locked respondents into arbitrarily limited alternatives (Foddy, 1999). Structured interview method which is very much similar to questionnaire survey, does not seem suitable because this might not be able to elicit the insight of the issue. On the other hand, unstructured interview method is not considered to be suitable for this research because it takes too much time and would have been impractical from the interviewee's point of view. Also, the researcher feels that the main focus of the issue might have been lost if unstructured interviews were conducted. Furthermore, focused group interviews would have also been unsuitable because it would be difficult to interview groups of AC chairpersons or external auditors in Bangladesh due to their geographical dispersal and busy work schedules. The researcher also believes that using a semi structured interview method would facilitate more control over the time, content and the sequence of the interview. In addition, it allows the interviewer to ask probing or supplementary questions which might bring out more insight of the research issue. Therefore, in the second phase of data collection, semi-structured interviews were conducted to confirm the results obtained from the questionnaire survey and to obtain a better understanding of the findings. Weller (1998) argued that semi-structured interviews play an important role in developing of an exploratory models and the preparation for a systematic form of investigation. The semi-structured interview is claimed to frequently yield a high

percentage of return (Miller, 1991). In addition, it provides a way of generating empirical data about the social world by asking people to talk about their opinions. Adams and Schvaneveldt (1985) also noted several advantages of using semi-structured interviews over other forms of interview.

5.6.3 Administration of the Interview Survey

The interview participants were chosen from those respondents who had indicated in the questionnaire survey that they would be willing to participate in any further stage of the study. The interviewees were selected on a random basis, and the twenty participants consisted of: five AC chairpersons, five company secretaries, five finance heads, and five external auditors. The survey was undertaken in June and July 2010. The participants were contacted first to seek their appointments for an interview. Once an interviewee gave a date and time, they were sent the interview checklist so that they knew what would be discussed beforehand. Prior to undertaking the interviews, the researcher tried to collect some information about the companies in order to be fully prepared and able to conduct the interviews smoothly. In addition, each interviewee who had agreed to participate in the survey was contacted by telephone by the researcher on the working day before the scheduled interview as a final courtesy reminder and confirmation.

An interview consent form (see Appendix 4) ensuring the confidentiality and anonymity of the responses was signed by each interviewee before starting the interview. At the beginning, the researcher introduced himself, described the study purpose and ensured the confidentiality of the interview responses. The duration of each interview was 60 to 90 minutes. To facilitate smooth progress of interviews, a checklist (see Appendix 5) was also used in this regard. Before finalising the interview checklist, the researcher discussed the questions with an AC chairperson, a finance head and two external auditors so that no key point is missing from the list. The first section of the checklist highlights interviewee background for example, name, education, experience etc. The second section covers several questions on the current state of AC practices (including

importance of the AC, its composition, authority, diligence, various roles and overall effectiveness in Bangladesh). The third section dealt with the factors affecting AC practices in Bangladesh. The last section solicited interviewee's suggestion to enhance AC effectiveness in Bangladesh. The researcher tried to take as many hand-written notes as possible to record all the major contents of the interview responses because many of the participants did not want their responses to be tape-recorded. However, some interviewees were tape recorded and the responses were translated immediately. At the end, the researcher thanked the interviewees for their time and also offered a copy of the findings of the research.

5.6.4 Profile of the Interviewees

A brief profile of 20 interview participants is presented in Table 5.6, where 'I' denotes interview which has been presented as per their sequences of taking place. In the table the external auditors' firms have been classified into two groups namely, Big 4²³ and Non-Big 4. It should also be mentioned that the size of companies (to which the other participants namely, company secretaries, AC chairpersons and finance heads are attached) has been measured in terms of the amount of paid up capital of the company as following: Large (more than 2,000 million BDT); Medium (1,000 to 2,000 million BDT); and Small (less than 1,000 million BDT).

²³ Four local audit firms in Bangladesh are affiliates of the Big 4 auditors i.e. Rahman Rahman Huq (RRH), Hoda Vasi Chowdhury, A Qasem & Co., and S F Ahmed are associated with KPMG International, Deloitte Touche Tohmatsu, PriceWaterhouseCoopers, and Ernst & Young, respectively (Kabir et al., 2011).

Table 5.6: Analysis Showing the Profile of Interviewees

Interview	Position	Academic Qualification	Background	Professional Qualification	Years of Experience	Size of the Company	Industry Sector
I1	External Auditor	Master's	Accounting	CA	8	Big 4	-
I2	Head of Finance	Master's	Accounting	No	12	Small	Real Estate
I3	External Auditor	Master's	Accounting	CA	17	Non-Big 4	-
I4	Company Secretary	Master's	Management	CS	7	Small	Leasing
I5	External Auditor	Bachelor's	Accounting	CA	10	Big 4	-
I6	AC Chairperson	Bachelor's	Finance	No	6	Medium	Textile
I7	Head of Finance	Master's	Finance	No	13	Large	Bank
I8	Company Secretary	Master's	Economics	No	16	Small	Power
I9	AC Chairperson	PhD	Engineering	No	16	Large	Bank
I10	External Auditor	Master's	Accounting	CA & CMA	14	Non-Big 4	-
I11	Company Secretary	Master's	Commerce	CS	18	Large	Real Estate
I12	Head of Finance	Master's	Accounting	CA	15	Small	Pharmaceutical
I13	External Auditor	Master's	Accounting	CA	12	Non-Big 4	-
I14	AC Chairperson	Bachelor's	Accounting	No	18	Medium	Pharmaceutical
I15	Company Secretary	Master's	Accounting	CS & CA	8	Large	Bank
I16	Head of Finance	Master's	Accounting	CA	15	Medium	Power
I17	AC Chairperson	Master's	Accounting	CMA	12	Small	Insurance
I18	Head of Finance	Master's	Accounting	CA	14	Large	Bank
I19	AC Chairperson	Master's	Economics	No	9	Small	Cement
I20	Company Secretary	Master's	Finance	CS	8	Medium	Pharmaceutical

Table 5.6 states that 6 respondents had between 6 to 9 years experience in the job of a similar nature, while 14 respondents had 10 or more years of experience. Regarding academic qualification, 1 (one) completed PhD degree, 16 had completed a master's degree, and the other 3 (three) respondents had finished their education after completing their bachelor's degree. Regarding academic disciplines, 12 respondents had 'accounting' as the last academic area of concentration, and 7 (seven) respondents came from 'other business or economics' disciplines. The majority (60% or 12 out of 20) of the interview respondents had obtained one or more professional qualification(s) (i.e. CA/CS/CMA). The profile of the interviewees clearly indicates that they were highly educated and experienced to make a significant contribution to the study by sharing their opinions, perceptions, and thoughts regarding AC practice in Bangladesh.

The last two columns of the table (5.6) present the size and industry of the companies to which the interviewees are attached. It can be seen that out of 5 (five) external auditors interviewed, 2 (two) were from the Big 4 firms. The other 15 interviewee participants were chosen from a wide variety of sectors, including banking, textiles, leasing, the pharmaceutical industry, real estate, power, cement and insurance and these companies varied in terms of their size (i.e. large, medium and small).

5.7 Analysis of Questionnaire Survey Data

Data obtained from any research needs to be analysed and interpreted for it to be useful in meeting research objectives and answering the research questions (Saunders et al., 2007). Kerlinger (1986) pointed out three different motives for the use of statistical analysis, namely: firstly, to reduce large quantities of data to a manageable and understandable form, secondly, to aid in the study of population and samples, and thirdly, to assist decision-making and to enable the deduction of reliable inferences. While the earlier sections of this chapter have illustrated various methods of data collection, this section states the statistical tests used to report the survey responses and to examine significant difference in responses within samples in respect of different aspect of AC practices in Bangladesh.

Although the data have been analysed after conducting the questionnaire survey, much thought has been given to the testing and analysis of results during the questionnaire design. The first step in analysis, especially in surveys, is the editing and coding of collected data. The researchers usually check the data to make sure it is as accurate as possible, consistent with other facts secured, uniformly entered, as complete as possible, and arranged to facilitate coding and tabulation. The statistical analysis of collected data can be used for two purposes, which are commonly referred to as descriptive and inferential (Pallant, 2001). The selection of statistical tests for analysing data depends on some factors (Siegel and Castellan, 1988) that include: the number of groups involved (independent variables), the number of subjects in each group, whether the groups were related or independent, and the measurement scale of the data values.

There are two broad classifications of statistical tests used in data analysis, namely: parametric and non-parametric. The use of parametric tests is said to be appropriate when the following assumptions are adhered to (see Kinnear and Gray, 2009; Siegel, 1995; Siegel and Castellan, 1988):

- The observations must be independent of error;
- The observations must have equal variance in the various treatment populations;
- The observations must be drawn from normally distributed scores in the treatment of population; and,
- The variables must have been measured in at least an interval scale.

Conversely, non-parametric tests in social science research are as equally important as their parametric counterparts. Siegel and Castellan (1988) argued that behavioural scientists rarely have data that satisfy the assumptions of the parametric test, which includes achieving the sort of measurement that permits meaningful interpretation of parametric tests. This technique is considered distribution-free due to the fact that it makes no assumption about the distribution of scores in the population. In fact, the non-parametric techniques do not necessitate measurement on an interval scale and do not require the data to fulfil the strict assumptions of the parametric methods, such as normality and homogeneity of variance. It is clear that the use of the non-parametric

techniques is more appropriate in this study, as the collected data is weaker than that of an interval scale. Moreover, the statistical test utilised is determined by the information in the scale. It is important to note that non-parametric techniques have been constructed to elude the requirement of numerous statistical assumptions as in the parametric techniques. Bereson and Levine (1992) and Siegel and Castellan (1988) documented a number of advantages of employing the non-parametric tests, namely:

- Non-parametric methods may be used on all types of data;
- Depending on the parametric procedures selected, non-parametric methods may be almost, or are even equally, as powerful as the classical procedures when the assumptions of the latter are met and may be quite a bit more powerful when the assumptions of the classical procedures are not met;
- Non-parametric methods are generally easy to apply when the sample sizes are small;
- Non-parametric methods make fewer, less stringent assumptions than the classical procedures;
- Non-parametric methods permeate the solution of the problem without testing the parameters of the population; and,
- Non-parametric methods may be more economical than classical procedures, since the researcher may increase power and yet save money, time and labour by collecting large samples of data which are more grossly measured and, therefore, solving the problem faster.

Having considered that the questionnaire survey responses of this study are of opinion type on a scale based options, it was decided that non-parametric tests would be used in the present study to facilitate statistical analyses. According to De Vaus (2001), a statistical analysis should involve both descriptive and inferential types of analysis. The statistical techniques used for the purpose of analysing the data relevant to this research are reviewed in the following section.

5.7.1 Descriptive Statistics

The descriptive statistical technique refers to transformation from raw data to a form that is organised and easy to interpret for descriptive information. This technique normally involves the calculation of mean, median, frequency distribution, percentage distributions, rank, skewness, kurtosis and standard deviation (SD) to help the researcher describe the characteristics or average scores and the variability of scores in the sample (Zikmund, 2000). The current study has used descriptive statistical measures (such as means, medians, frequency distribution, percentage, rank and standard deviation) to state current practices of ACs in Bangladesh.

5.7.2 Analytical Statistics

The analytical, or inferential, method is the process whereby conclusions and generalisations are derived from the raw data. The process starts from data collection, is followed by descriptive analysis, and completed by analysis of significance and differences. Therefore, the current study employs analytical statistics for two purposes: to examine the significance of responses, and to make inferences about the population parameters from the sample statistics through hypothesis testing.

5.7.2.1 Testing the Significance of Responses

The significance of the responses towards 50 statements of the questionnaire was examined by using the Wilcoxon Signed Rank Test. For non-parametric sets of data, the Wilcoxon Signed Rank Test can be used as substitute of one sample t-test in parametric statistics (Chan, 2003). The test computes the difference between the sample mean and the hypothesised value. Therefore, the mean score of responses was compared with 3 (the mid score of the 5 point scale) to examine the significance of agreement or disagreement using a Wilcoxon Signed Rank Test.

5.7.2.2 Testing the Hypotheses

Kerlinger (1986) mentioned four different reasons for using statistical analysis, which are:

- (i) To reduce a large quantity of data to a manageable and understandable form;
- (ii) To aid in the study of the population and samples;
- (iii) To assist decision making; and,
- (iv) To enable the deduction of reliable inference.

Many statistical tools could be used for analysing the data collected from the questionnaire survey. However, the main objective of the analyses was to investigate current practices of the ACs in Bangladesh. The idea was to generate an indicator to measure the variability of an individual response within a particular distribution. This study aimed to make inferences from sample statistics to the population parameters. Therefore, hypothesis testing was done to compare the opinions of respondents on the current practice of the ACs in Bangladeshi companies. In order to test the stated hypotheses, the researcher carried out two non-parametric tests, namely: the Kruskal-Wallis One- Way Analysis of Variance Test Score, and the Mann-Whitney U Test. The following discussions briefly introduce these two testing techniques.

A. The Kruskal-Wallis Test

The Kruskal-Wallis Test is the non-parametric version of the parametric ANOVA Test for calculating the difference in the population mean. It is a test of one-way, between-groups analysis of variance that allows a comparison of three or more groups (Pallant, 2001). Borg and Gall (1983) stated that the Kruskal-Wallis Test is: *"a statistical technique used to compare categorical data. It also gives a comparison of the distribution of individual variables from two or more different groups and produces a measure of relationship, called the contingency coefficient which is similar to the correlation coefficient"*. In addition, the conditions that should be met for the appropriateness of using the Kruskal-Wallis Test include: the data must be a random sample from a large population, the expected number in each category should not be too small, and the rule of thumb is to demand that at least five counts be expected in each

category (Siegel and Castellan, 1988). When the obtained value of Kruskal Wallis (H) test is significant, this indicates that at least one of the groups is different from at least one of the others. To identify the differing group, Kruskal Wallis pair-wise comparison (six pairs of four groups²⁴ i.e. 1 & 2; 1&3; 1&4; 2&3; 2&4; 3&4) has been conducted.

B. The Mann-Whitney U Test

It is used to investigate the differences between two independent groups. This test compares the medians of the two groups and subsequently evaluates whether the ranks for the two groups differ significantly. The Mann-Whitney U Test is used to test the difference between two independent groups on a continuous measure. In respect of this test, Pallant (2001) noted that it converts the scores on the continuous variable to ranks, across the two groups; and that it then evaluates whether the ranks for the two groups differ significantly. In addition, the Mann-Whitney U Test is more powerful than the median test since it uses the ranks of the cases and it requires an ordinal (ranked) level of measurement. The test has been used in this study to compare means of responses from two groups divided on the basis of educational background, professional qualification and length of experience of the respondents.

5.7.2.3 Regression Analysis

Regression analysis is used to identify the relationship between a dependent variable and one or more independent variable(s). More specifically, regression analysis helps us to understand how the typical value of the dependent variable changes when any one of the independent variables is varied while the other independent variables are held fixed (Allison, 1999). In order to investigate the AC effectiveness in Bangladesh, two multiple regression models have been derived using the questionnaire survey data. In the first model AC characteristics (i.e. composition, authority & resources, diligence, meeting) are independent variables and AC role (weighted average score of three key roles of an AC) is a dependent variable. In the second model, the three key roles (i.e. role in financial reporting, role in external auditing and role in internal auditing) are

²⁴ 1= AC chairpersons; 2=Company secretaries; 3=Finance heads; and 4=External auditors.

independent variables and AC effectiveness is a dependent variable. The correlations (Spearman) of the variables of the regression models have also been presented to facilitate in ascertaining the association between the variables. The multicollinearity of the regression models has been investigated using the Variance Inflation Factors (VIFs). It should be noted that there is no hard and fast rule regarding VIF value for determining presence of multicollinearity problem. For weaker models, the researchers paid note if the VIFs were of 4 (four) or more while for stronger models (if explains 50% or more) some researchers accepted VIFs up to 10 (Hair et. al, 1992). In this study, VIFs of 8 (eight) or less have been accepted in examining the multicollinearity problem, considering that the regression models are very strong.

5.7.2.4 Analysing the Significance of Test Results

To analyse the statistical test results in *Chapter Six*, the researcher has assumed a 5% level of significance (i.e. a probability or p level of 0.05 or five times out of a hundred has been considered). When the p-value of a statistics is less than the significance level, the value of the statistic is said to be significant. The conventional probability, or p-value, for deciding that a result is not due to chance has been set as equal to, or less than, 0.05 (i.e. five times out of a hundred). If we are willing to accept a 5% chance of making an error, we can construct a 95% confidence interval (Weisberg et al, 1996; Cramer, 1998). If the probability is less than 0.05, then it is thought unlikely to have been due to chance. If, on the other hand, the probability level of an outcome is above 0.05, then that result is statistically non-significant in the sense that it is considered likely that it could have been due to chance (Cramer, 1998). In other words, the p-value is the probability that the null hypothesis is true. If the p-value is less than 0.05, we would say that the result is significant at the 0.05 level (Weisberg et al, 1996). To sum up, Kinnear and Gray (2000) posited:

- (i) If the p-value is greater than 0.05, H is accepted and the result is not significant;
- (ii) If the p-value is equal or less than 0.05 but greater than 0.01, H is rejected and the result is significant beyond the 5 per cent level; and,

(iii) If the p-value is less than 0.01, H is rejected and the result is significant beyond the 1 per cent level.

5.8 Analysis of Interview Survey Responses

The responses obtained from the interview survey have been analyzed following a 'Grounded Theory' approach. Grounded theory is most accurately described as a research method in which the theory is developed from the data, rather than the other way around. That makes this an inductive approach, meaning that it moves from the specific to the more general. Strauss and Corbin (1990) defined grounded theory as:

"... a qualitative research method that uses a systematic set of procedures to develop and inductively derive grounded theory about a phenomenon".

Strauss and Corbin (1998) further defined grounded theory as:

"... the theory derived from data, systematically gathered and analysed through the research process. In this method, data collection, analysis and eventual theory stand in close relationship to one another".

The primary objective of grounded theory is to expand upon an explanation of a phenomenon by identifying the key elements of that phenomenon, and then categorising the relationships of those elements to the context and process of the research. The basic idea of the grounded theory is to read and re-read a textual database (for example, field notes) and discover or label variables called categories, concepts and properties, and their interrelationships. The ability to perceive variables and relationships is termed 'theoretical sensitivity' and is affected by a number of factors, including one's reading of the literature and one's use of techniques designed to enhance sensitivity (Strauss and Corbin, 1998). There are three methods of analysis involved in grounded theory from which sampling procedures are typically derived which are: open coding, axial coding and selective coding (Strauss and Corbin, 1998).

Open coding is the part of the analysis concerned with identifying, naming, categorising and describing phenomena found in the text, essentially, each line, sentence, and

paragraph. The process of naming or labelling things, categories, and properties is known as coding. Coding can be done very formally and systematically or quite informally. In grounded theory, it is normally done quite informally. For example, if, after coding much text, some new categories are invented; grounded theorists do not normally go back to the earlier text to code for that category. However, maintaining an inventory of codes with their descriptions (i. e. creating a codebook) is useful, along with pointers to the text that contain them (Parker and Roffey, 1997).

Axial coding is the process of relating codes (categories and properties) to each other, via a combination of inductive and deductive thinking. To simplify this process, the grounded theorists emphasise causal relationships, and fit things into a basic frame of generic relationships.

Selective coding is the process of choosing one category to be the core category, and relating all other categories to that category. The essential idea is to develop a single storyline around which all everything else is draped. There is a belief that such a core concept always exists (Strauss and Corbin, 1998). Selective coding is about finding the driver that propels the story forward.

In analyzing the interview responses in the study, the researcher followed the basic stages of grounded theory. Firstly, the ‘critical instances’ of the interview transcripts were highlighted. This stage excluded things like digressions, repetitions and other irrelevant material. Secondly, ‘open coding’ was done to assign the quotes to categories. A category is an abstract conceptual label which summarizes the key characteristics of a passage. This was a relatively more time-consuming stage which involved working through the transcripts in turn to collect numerous quotes and examples of each existing category and to identify new ones. Many categories were identified from the first transcript and then progressively fewer new categories from each successive transcript, as the proportion of new information decreases. The process of assigning quotes to categories was repeated for one transcript by a second, independent person to check the reproducibility of assigning quotes to categories. At the end of this stage, an initial list

of categories was produced to facilitate the next stages. Thirdly, the researcher performed 'axial coding' which involved refining this list by deleting or combining some categories, followed by making connections between the categories and defining properties, for instance context and preconditions. Finally, 'selective coding' was done and this involved the identification of a core category or broad themes from which the general findings were inferred. In this research, the researcher tried to attract interviewees by means of the prepared questions that let them tell a story about the scenario of AC practices in Bangladeshi companies.

5.9 Conclusion

The present chapter has explained the research approach adopted in this study. It presented the factors that have influenced the choice of these techniques and approaches. It also reported the procedures followed in the design and development of the close-ended questionnaire. This chapter has also explained how the pilot study was carried out to develop the questionnaire, how it was conducted, and the benefits that had been gained from parties of piloting. It has provided details of the questionnaire survey procedures followed in the study. Furthermore, the chapter discussed the second phase of data collection which consisted of twenty semi-structured interviews. In brief, the chapter has given an elaborate picture of the research methodological issues of the study and discussed how these have been addressed. The next chapter presents in more detail the descriptive and inferential analyses of data obtained through questionnaire survey.

CHAPTER SIX: ANALYSIS AND DISCUSSION OF THE QUESTIONNAIRE SURVEY FINDINGS

6.1 Introduction

The aim of this chapter is to present and discuss the findings of the questionnaire survey. The structure of this chapter is as follows: Section 6.2 presents the background of respondents; Section 6.3 highlights the descriptive statistics of the responses; and Section 6.4 discusses the statistical test results of the survey data. Finally, Section 6.5 summarises the chapter.

6.2 Background of the Respondents

It is important to introduce the background of respondents participating in the survey to understand the level of the respondents. Therefore, the education, qualification, and experience of the questionnaire survey respondents are discussed in this section in order to facilitate a better understanding on their background.

6.2.1 Education

Educational qualification is an important indicator about respondent's background. Therefore, the last educational degree of the four sample groups is presented in the following table.

Table 6.1: Analysis Showing the Educational Qualification of Respondents

Education (Degree)	AC Chairperson		Company Secretary		Finance Head		External Auditor		Total	
	No	%	No	%	No	%	No	%	No	%
Bachelor's	7	23	7	19	7	16	11	38	32	23
Master's	20	67	28	76	33	75	16	55	97	69
PhD	2	7	1	3	1	2	0	0	4	3
Other	1	3	1	2	3	7	2	7	7	5
Total	30	100	37	100	44	100	29	100	140	100

Table 6.1 shows that the majority (two-thirds) of AC chairpersons have obtained a master's degree, and 23% (or 7 out of 30) of the respondents in this group have a bachelor's degree. Similarly, 76% (or 28 out of 37) of the company secretaries had master's degree, and 7 (19%) company secretaries obtained bachelor's degree. The table also presents that 75% (or 33 out of the 44) of the finance heads have completed a master's degree, and 16% of the respondents in this group have a bachelor's degree. Like the other three sample groups, the majority (55%) of external auditors have a master's degree, while 11 (38%) external auditors completed bachelor's degree. Therefore, out of total 140 respondents, the majority (or 97 out of 140) of respondents have completed a master's degree, 32 respondents have obtained bachelor's degree, 4 respondents have a PhD and 7 respondents have another qualification (such as: M. Phil, PG Diploma, or below bachelor's degree). Overall, more than 90% of the respondents have completed bachelor's or above level of education. This reflects that the respondents who participated in the questionnaire survey are highly educated and, therefore, their participation in the survey has enriched the quality of survey findings in depicting the current states of AC practices in Bangladesh. The following sub-section gives more detail of the subject in their last education.

6.2.2 Academic Discipline

Concentration/subject of education is another important criterion in analysing the respondents' capabilities of expressing objective views on any issue. For example, the respondents who hold accounting, auditing, finance, economics, or other business subjects in their education are perceived to be more knowledgeable on the current research issue (i.e. AC practice). Therefore, discipline of the last education of the respondents is presented in the following table.

Table 6.2: Analysis Showing the Academic Background of Respondents

Discipline	AC Chairperson		Company Secretary		Finance Head		External Auditor		Total	
	No	%	No	%	No	%	No	%	No	%
Accounting	9	30	14	38	20	45	23	79	66	47
Finance	2	7	4	11	14	32	2	7	22	16
Economics	3	10	3	8	3	7	0	0	9	6
Management	5	17	5	13	2	5	1	3	13	9
Marketing	1	3	4	11	1	2	1	4	7	5
Others	10	33	7	19	4	9	2	7	23	17
Total	30	100	37	100	44	100	29	100	140	100

Table 6.2 shows that 30% (or 9 out of 30) of the AC chairpersons specialised in accounting, while 5 respondents are from management area. It is also notable that one-third (or 10 out of 30) of the AC chairpersons participating in the survey are from different disciplines (including engineering, law, political science, and social science) which are less related to their job as AC chairpersons. This reflects the finding that one out of every three AC chairpersons does not have a relevant educational qualification to be able to fulfil his or her duties properly. Regarding the second group of respondents i.e. the company secretaries, 38% (or 14 out of 37) of the respondents studied accounting, while 7 (19%) of the company secretaries are from different non-business disciplines (such as: engineering, law, political science, and social science). The table also shows that 45% (or 20 out of 44) of the finance heads have studied accounting area, while 14 respondents of this group are from a financial discipline. It is encouraging that 91% of the finance heads emanate from business (i.e. accounting, finance, management and marketing) or economics discipline which is related to their present occupation. In respect of external auditors, 79% (or 23 out of 29) of the respondents have studied accounting, and 2 were found to be from the finance area.

Overall, 47% (or 66 out of 140) of the respondents are from accounting, while 22 (16%) respondents are from finance. It should be noted that almost one-sixth (17%) of the

respondents are from other different disciplines which are less related to the research issue (i.e. the AC practices). Nevertheless, it is important to note that a vast majority (almost 85%) of respondents are from business or economics disciplines, and the researcher believes that their participation in the questionnaire survey has enhanced the quality of findings and also has significantly contributed in attaining the objective of the study.

6.2.3 Professional Qualification

Since the current research is mainly related to the auditing, accounting and similar functions of the company, either of the two main qualifications namely, Chartered Accountant (CA) and Cost and Management Accountant (CMA) are held by the experts in these areas. Furthermore, the company secretaries holding a Chartered Secretary (CS) qualification are generally perceived to be more qualified. The following table presents an analysis of the professional qualification held by the respondents.

Table 6.3: Analysis Showing the Professional Qualification of Respondents

Qualification	AC Chairperson		Company Secretary		Finance Head		External Auditor		Total	
	No	%	No	%	No	%	No	%	No	%
CA	5	17	9	24	19	43	29	100	62	44
CMA	1	3	1	3	4	9	3	10	9	6
CFA	0	0	0	0	2	5	0	0	2	1
CS	0	0	19	51	2	5	0	0	21	15
Other	0	0	2	5	1	2	0	0	3	2
None	24	80	10	27	17	39	0	0	51	36
Total	30	100	37*	100	44**	100	29***	100	140	100

*4 Company Secretaries have both CA and CS qualifications.

**1 Head of Finance has both CA and CMA qualifications.

***3 External Auditors have both CA and CMA qualifications.

Table 6.3 shows that out of 30 AC chairpersons, the majority (80%) of respondents do not have any professional qualification. This seems to be important in understanding the procedure of financial reporting and auditing issues. Only 5 (17%) AC chairpersons are qualified Chartered Accountants (CAs) and one is a qualified Cost and Management Accountant (CMA). This result is of concern because McMullen and Raghunandan (1996) found that the companies with no problem in financial reporting were more likely to have a CPA on the AC than those companies that had experienced reporting problems. Table 6.3 also indicates that 51% (or 19 out of 37) of the company secretaries have a certified CS qualification, and 24% of the company secretaries are qualified CAs. However, 27% (or 10 out of 37) of the company secretaries do not have any professional qualification. In respect of third sample group, finance heads, the table shows that 43% (or 19 out of 44) of the finance heads are qualified CAs, and 9% of the finance heads are qualified CMAs, while 39% of the respondents of this group do not have any professional qualification. Apart from a CA qualification, 3 external auditors are also CMA qualified. Overall, 44% (or 62 out of 140) of the respondents have a CA qualification, and 21 (15%) respondents have a CS qualification. This distribution is quite sensible because all external auditors are by default qualified CA, and the majority of company secretaries are expected to have a CS qualification due to the requirements of some organisations. It should be noted that 8 respondents have double qualifications (i.e. any two of the stated professional qualifications, namely: CA, CMA, CS, and CFA). Overall, the majority (64%) of respondents possess one or more professional qualification(s) and this means that they are highly qualified in their respective positions. The researcher believes that participation of such well qualified respondents has enhanced the objectivity and reliability of the study findings.

6.2.4 Experience

Previous work experience in a related job is important for the respondents in understanding the questions and responding to them properly. The experience of the respondents participating in the questionnaire survey is presented in the following two tables.

Table 6.4: Analysis Showing the Experience of Respondents

Experience	AC Chairperson		Company Secretary		Finance Head		External Auditor		Total	
	No	%	No	%	No	%	No	%	128	%
	Yes	21	70	34	92	44	100	29	100	128
No	9	30	3	8	0	0	0	0	12	9
Total	30	100	37	100	44	100	29	100	140	100

Table 6.4 states that 30% (or 9 out of 30) of the AC chairpersons and only 3 company secretaries (8%) had not had previous experience in a related job. All of the finance heads and external auditors who participated in the survey had previous experience working in similar jobs. Overall, the majority (91%) of respondents had experience in a similar area to their current job. This indicates that most of the respondents had previous working experience. The researcher believes that opinions of these experienced participants have significantly contributed to achieving the objectives of the study. The following table presents the years of experience of the participants.

Table 6.5: Analysis Showing the Length of Experience of Respondents

Description	AC Chairperson	Company Secretary	Finance Head	External Auditor	All Respondents
Holding Current Position	2.76	4.67	4.24	6.29	4.96
Experience in Related Field	12.36	11.09	11.24	9.41	10.89

Table 6.5 highlights that the mean of tenure at current position of the four sample groups are 2.76 years, 4.67 years, 4.24 years, and 6.29 years, respectively. Furthermore, the average years of work experience in related job are 12.36, 11.09, 11.24, and 9.41, respectively. Overall, the average tenure at current position of respondents is 4.96 years, and average experience in a relevant field is 10.89 years. With regard to the tenure in current position, the average tenure of AC chairperson group is 2.76 years, which is significantly lower than that of other three sample groups. This might happen because AC practice is a new issue in Bangladesh, and is being monitored by the SEC only from

2006. Furthermore, the average length of experience of the external auditors as partners in their respective firms is 6.29 years, which is higher than that of the other three sample groups. This happens because, unlike other sample groups, most external auditors are self-employed and therefore, they tend to be less likely to change their jobs or organizations. The distribution reflects that the respondents had many years of experience, which indicates their capabilities in responding to the issues included in the questionnaire.

6.3 Descriptive Statistics

Data description is typically the first step in analysing any set of information. Descriptive statistics are used to describe and summarise the basic features of the data in a study. It mainly includes graphical presentation, frequency table, mean, media, mode, ranking, skewness, kurtosis, and standard deviation of data. In the current study, the questionnaire survey data have been presented using some descriptive statistical tools including frequency table, mean, standard deviation and ranking. The following subsections present and analyse the descriptive statistics results of the questionnaire survey data.

6.3.1 Responses towards the Statements on Audit Committee Practices: Frequency Distribution

The following table presents the frequency of responses (in percentages) toward the statements included in the questionnaire. It should be noted that to facilitate the reporting and analysis, the ‘strongly disagree’ and the ‘disagree’ columns have been merged to ‘disagree’ and similarly, the ‘strongly agree’ and the ‘agree’ columns have been merged to ‘agree’ in the table.

Table 6.6: Frequency (in percentage) Distribution of Responses toward the Statements on Audit Committee Practices in Bangladesh

Statements	AC Chairperson (N= 30)			Company Secretary (N= 37)			Finance Head (N= 44)			External Auditor (N= 29)			All Four Samples (N= 140)		
	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree
A. Composition															
1. The AC members are appointed in consultation with the AC chairperson.	3	17	80	19	8	73	11	18	71	24	38	38	14	19	67
2. The AC members have sufficient knowledge on the entity's business.	3	23	74	3	14	83	7	27	66	34	38	28	11	25	64
3. The AC members have sufficient knowledge on Accounting and/or Auditing.	3	33	63	3	41	56	7	48	45	52	28	20	14	39	47
4. The AC members have sufficient experience in Accounting and/or Auditing.	3	20	77	11	49	40	7	50	43	55	21	24	17	37	46
5. The AC members are capable of mediating problems in performing their duties.	10	10	80	3	30	67	2	43	55	34	34	32	11	31	58
6. The majority of AC members are independent /non-executive directors.	60	33	7	70	27	3	73	23	4	72	21	7	69	26	5
7. The chairperson of the AC is an independent/non-executive director.	47	33	20	65	16	19	68	18	14	62	21	17	61	21	18
8. The size of the AC is appropriate for carrying out its duties properly.	7	13	80	3	8	89	5	16	79	7	21	72	5	14	81
B. Authority and Resources															
9. The AC has adequate authority in order to carry out its responsibilities.	3	10	87	5	5	90	2	2	96	7	31	62	4	11	85
10. The AC has ready access to relevant information if required.	3	10	87	3	8	89	7	41	52	10	17	73	4	10	86
11. The AC receives prompt responses from the management in carrying out its duties.	3	20	77	3	5	92	0	7	93	14	28	58	4	14	82

Statements	AC Chairperson (N= 30)			Company Secretary (N= 37)			Finance Head (N= 44)			External Auditor (N= 29)			All Four Samples (N= 140)			
	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	
12. The AC is provided with sufficient resources to carry out its duties.	3	17	80	8	3	89	7	9	84	7	28	65	6	13	81	
13. The non-executive AC members are adequately paid for their time and efforts.	17	37	46	19	24	57	20	39	41	24	41	35	22	34	44	
C. Diligence																
14. The AC has a charter which outlines its objectives, duties and responsibilities.	10	17	73	22	14	64	25	25	50	21	28	51	20	21	59	
15. The AC charter is reviewed annually.	13	33	54	30	41	29	32	39	29	45	38	17	31	37	32	
16. The AC members have a clear understanding of their responsibilities.	3	13	84	6	24	70	2	32	66	17	34	49	7	26	67	
17. Members of the AC readily assume their responsibilities.	13	7	80	3	27	70	9	23	68	3	31	66	7	22	71	
18. The AC members devote sufficient time to the committee's affairs.	13	13	74	3	41	56	14	45	41	41	21	38	17	34	49	
D. Meeting																
19. The agendas of the AC meetings are finalized by the chairperson.	7	7	86	5	8	87	5	5	90	10	17	73	6	9	85	
20. The chairperson cooperates with other committee members before finalizing the agenda of the meetings.	0	20	80	5	22	73	7	41	52	17	52	41	5	34	61	
21. The agenda and related materials are provided to members fairly ahead of the meetings.	0	0	100	0	5	95	0	7	93	3	24	73	1	9	90	
22. All members can express their views freely and independently in the meetings.	0	0	100	0	14	86	2	5	93	7	28	65	2	11	87	
23. The frequency of the AC meetings is sufficient to carry out its responsibilities.	0	7	93	3	16	81	5	14	81	17	14	69	6	13	81	

Statements	AC Chairperson (N= 30)			Company Secretary (N= 37)			Finance Head (N= 44)			External Auditor (N= 29)			All Four Samples (N= 140)		
	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree
24. The duration of the AC meetings is sufficient for a full discussion of the issues.	0	0	100	5	8	87	5	2	93	14	17	69	6	6	88
25. Non-members attend the AC meetings if required.	7	23	70	14	5	81	5	11	84	14	28	58	9	16	75
26. The minutes of the AC meetings are circulated to all members of the Board of Directors (BODs).	0	3	97	8	8	84	2	5	93	14	24	62	6	9	85
E. Role in Financial Reporting															
27. The AC reviews the integrity of companies' financial statements.	0	13	87	3	14	83	5	36	59	14	48	38	5	28	67
28. The AC reviews accounting policies and any changes made therein.	0	10	90	3	19	78	7	48	45	17	45	38	6	31	63
29. The AC reviews accounting estimates and judgments done in preparing financial statements.	3	17	80	3	32	65	11	43	46	17	48	35	9	36	55
30. The AC reviews the compliance of the Accounting Standards (e.g. IAS, BAS etc.) in preparing financial statements.	3	20	77	5	43	52	18	34	48	31	41	28	14	35	51
31. The AC reviews the clarity and completeness of disclosures in financial statements.	0	3	97	3	24	73	11	30	59	14	48	38	7	26	67
32. The AC reviews other information (e.g. the auditors' report, financial highlights etc.) presented in the annual report.	0	7	93	3	16	81	7	25	68	14	28	58	6	19	75
F. Role in External Auditing															
33. External auditors are appointed and/or removed upon recommendation of the AC.	10	37	53	19	32	49	27	39	34	21	58	21	20	41	39

Statements	AC Chairperson (N= 30)			Company Secretary (N= 37)			Finance Head (N= 44)			External Auditor (N= 29)			All Four Samples (N= 140)			
	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	
34. The AC assesses and reviews the expertise and resources of the external auditors.	10	50	40	19	41	40	23	48	29	14	55	31	17	48	35	
35. The AC reviews and approves the terms of the Engagement Letter (EL) prepared for the external auditors.	10	53	37	27	46	27	32	43	25	31	48	21	26	47	27	
36. The AC monitors the compliance of external audit firm's with the existing ethical and regulatory requirements in Bangladesh.	7	23	70	11	46	43	18	39	43	24	48	28	15	39	46	
37. The AC reviews the findings of the annual audit obtained by the external auditors.	3	3	94	5	22	73	2	34	64	7	31	62	4	24	72	
38. The AC reviews the management's responsiveness to the external auditors' findings.	3	20	77	8	32	60	2	55	43	10	48	42	6	40	54	
39. The AC meets with the external auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit.	7	23	70	16	38	46	18	57	25	21	55	24	16	44	40	
40. The AC reviews and monitors the independence and effectiveness of the external auditing process.	7	18	77	8	24	68	14	41	45	21	45	34	12	32	56	
G. Role in Internal Auditing																
41. The AC recommends and approves the appointment or termination of the heads of the internal audit division.	7	30	63	16	33	51	20	39	41	24	41	35	17	36	47	

Statements	AC Chairperson (N= 30)			Company Secretary (N= 37)			Finance Head (N= 44)			External Auditor (N= 29)			All Four Samples (N= 140)		
	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree	Disagree	Neutral	Agree
42. The AC approves and reviews the charter of the internal auditors.	7	27	66	22	27	51	11	50	39	21	45	34	15	38	47
43. The AC assesses and reviews the annual internal audit work plan.	3	20	77	22	11	67	9	32	59	14	31	55	12	24	64
44. The AC reviews the annual internal audit reports, budget and other findings.	3	7	90	11	22	67	5	27	68	10	28	62	7	21	72
45. The AC reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.	3	13	84	8	22	70	9	18	73	10	17	73	8	18	74
46. The AC meets with the head of the internal audit function without the presence of the management.	3	20	77	11	38	51	11	45	44	14	45	41	10	38	52
47. The AC enhances the independence of the internal auditors of the company.	3	7	90	11	32	57	5	32	63	10	34	56	7	27	66
48. The AC monitors and evaluates the effectiveness of the internal audit function.	3	7	90	8	14	78	9	23	68	14	52	34	9	16	75
H. Overall Practice															
49. The AC can work independently.	0	20	80	3	16	81	0	11	89	7	21	72	2	16	82
50. The AC is effective.	3	23	74	0	24	76	2	32	66	21	48	31	6	31	63

6.3.1.1 Composition

Table 6.6 shows that 80% (or 24 out of 30) of the AC chairpersons participating in the survey agreed with three statements on AC composition, namely:

- (i) The members are appointed after prior consultation with the AC chairman;
- (ii) The AC members are capable of mitigating problems; and,
- (iii) The size of the AC is appropriate.

The majority of respondents in this group also agreed on the sufficiency of the AC members' relevant literacy and experience, but only 7% of respondents agreed that the majority of AC members are independent/non-executive directors. Similarly, only 20% of the AC chairpersons agreed that the AC chairperson is an independent director. The results indicate that the ACs in Bangladesh tend to be dominated by executive directors, and that the AC chairpersons play an important role in selecting the other members of the committee.

The table also indicates that 73% (or 27 out of 37) of the company secretaries agreed that the AC members are appointed after prior discussion with the AC chairman, whilst 83% (or 31 out of 37) of respondents agreed that the AC members have sufficient knowledge about the entity's business. The majority of respondents also agreed on the sufficiency of AC members' qualification, the AC members' capabilities in mandating problems, and the appropriateness of AC size. However, only 41% of the respondents in this group agreed that the AC members have sufficient experience. It should be noted that a significant portion of respondents (40%-50%) selected the 'neutral' option in responding to the statements relating to previous experience and academic background in accounting and auditing. This might happen because many respondents felt hesitant to comment on the background of AC members who are also executive directors of the board. Regarding the independent AC members, only 1 (3%) company secretary agreed that the majority of AC members are independent directors, and only 19% of the respondents of this group thought that the chairpersons of ACs are independent directors.

In relation to the statements on AC composition, mixed responses were received from the finance heads. It can be observed that 79% of the finance heads agreed that size of the ACs is appropriate in order to carry out its duties, while only 2 (4%) of the respondents in this group agreed that the majority of AC members are independent directors. Furthermore, only 14% of the finance heads felt that the chairperson of the AC is nominated from among the independent directors. This reflects that the ACs in Bangladesh are mostly occupied and chaired by executive directors. A significant portion of respondents (around 50%) selected the 'neutral' option when expressing their opinions about the relevant academic background and experience of the AC members. This might happen because the finance heads are either unsure about the background of the AC members or are unwilling to disclose the fact.

It is further shown in Table 6.6 that only one statement relating to AC composition was agreed by the majority of external auditors. This statement was regarding the appropriateness of AC size and 72% (or 21 out of 29) of the external auditors agreed with this statement. It is worth noting that most of the external auditors either disagreed or remained neutral with the statements regarding the previous experience of the AC members in similar jobs and academic backgrounds in a related area. Regarding the inclusion of independent directors in the ACs, only 7% of external auditors agreed that the majority of AC members are independent directors and only 5 respondents (17%) in this group agreed that the AC chairperson is an independent member. Therefore, responses of the external auditors reflect that the ACs in Bangladesh are clearly lacking in the appointment of independent, experienced, and expert members. One possible reason for this might be that the board is reluctant to appoint many independent directors because if the majority of members (including the chairperson of the committee) are independent directors who are appointed on the basis of their expertise, then the board will lose its control over the committee's affairs.

Overall, the statement regarding the appropriateness of AC size was agreed with by 81% (or 113 out of 140) of the respondents, which was the highest number. This response is consistent with the findings of Pincus et al. (1989); Felo et al. (2003); and Pucheta-

Martinez and Fuentes (2007) who highlighted that the appropriate AC size is a crucial component for AC effectiveness. However, a few studies (such as Kalbers and Fogarty, 1996; Yermack, 1996; Scarbrough et al., 1998; Lin et al., 2008) have documented that a large sized AC may sometimes hinder its effectiveness. Nevertheless, the BRC (1999) and the ICEW (2001) have suggested that there should be a minimum of three members in an AC. In the context of the U.K. and the U.S.A., the ACs generally consist of between three to five members (Carcello and Neal, 2000; Raghunandan et al., 2001; Spira, 2002; Davidson et al., 2004). The combined response of all four sample groups suggests that size of the ACs as practised in Bangladesh is appropriate for them to function effectively. The majority (67%) of respondents also agreed that the AC members are appointed after consulting with the AC chairperson. On the other hand, only 5% (or 7 out of 140) of the respondents agreed that the majority of members of the AC are independent directors, and 18% of the respondents of agreed that the AC chairperson is an independent director. These findings reflect the inadequacy of independent members in the ACs of Bangladesh, while many studies (such as: the Olivencia Report, 1998; and Osma and Noguer, 2007) have argued in favour of a majority of independent members in ACs and noted that the chairperson should also be an independent director. Regarding qualification and experience, a great deal of research (for example, Beasley and Salterio, 2001; DeZoort and Salterio, 2001; McDaniels et al., 2002; Bedard et al., 2004) has argued that experience and expertise in accounting/auditing or related areas of the AC members is a vital factor in its effective functioning. It is important to note that the majority of respondents either disagreed or selected the 'neutral' option in the case of two statements relating to previous academic background and experience in relevant fields. This finding indicates the view that the AC members in Bangladesh are lacking in terms of qualification and experience.

6.3.1.2 Authority and Resources

Regarding the statements on authority of and resources provided to the ACs in Bangladesh, 87% (or 26 out of 30) of the AC chairpersons agreed that the ACs are delegated adequate authority with which to perform their duties, and that the ACs have

ready access to the required information when they need it. More than 75% of the respondents from this group also agreed that the ACs receive prompt responses to their queries from management, and that the ACs are provided with sufficient resources in order to carry out their duties properly. However, only 46% of the AC chairpersons agreed that the independent members are paid sufficient honorariums for their time devoted to the committee's affairs.

Furthermore, around 90% (or 33 out of 37) of the company secretaries agreed with the four statements relating to authority and resources provided to the ACs, namely:

- (i) The ACs are delegated enough authority to perform their duties;
- (ii) The ACs have ready access to the required information;
- (iii) The ACs receive prompt response from management to their queries; and,
- (iv) The ACs are provided sufficient resources to carry out their duties.

On the other hand, only 21 (57%) of the company secretaries agreed that the independent AC members are adequately paid. However, the remuneration paid to the independent members of ACs was viewed as inadequate by the majority (57%) of respondents. Overall, the ACs in Bangladesh, as viewed by the company secretaries, are provided with sufficient authority and resources to carry out their duties.

Table 6.6 also shows that 96% (or 42 out of 44) of the finance heads agreed that the ACs are delegated adequate authority in order to perform their duties properly, while 93% of the respondents in this group agreed that the ACs receive prompt response to their queries from management. The majority (around 60%) of finance heads disagreed or remained neutral to the statements on the sufficiency of payment to the independent members for their time. This indicates that the remuneration paid to the independent members is not enough compared to their time and efforts devoted to the committee's affairs. It is notable that 41% of the finance heads neither agreed nor disagreed (i.e. selected the 'neutral' option) with the statement that the ACs have ready access to relevant information required for their job. In the interview survey (the second phase of the data collection, which is discussed in the next chapter), two finance heads were requested to explain why most of them remained neutral on this issue. They explained

that this was because the independent members rarely have such access, whereas the executive members of the committee have free access to the required information. This reflects the view that the independent members of the ACs in Bangladesh do not receive required information from the management in order to carry out their responsibilities.

The majority of external auditors agreed with the first four statements relating to authority and resources provided to the ACs, while only 35% (10 out of 29) of the respondents in this group agreed with the statement that the independent AC members are paid sufficient remuneration compared to their time given to the committee's affairs. These responses suggest that the ACs in Bangladesh are delegated enough authority, and are also provided with the required resources for the smooth functioning of their tasks.

The aggregated responses of all the 140 respondents in relation to the statements on authority of and resources of the ACs in Bangladesh imply that the ACs are provided with adequate resources and authority in order to carry out their responsibilities. This might happen because most of the AC members, including the chairpersons, are executive directors who are deemed to be powerful in the company. Out of the five statements on authority and resources of the ACs, the first four statements were agreed with by the majority (more than 80%) of respondents, while only 44% (or 62 out of 140) agreed that the independent members are adequately paid when compared to the time and effort they give to the company. Overall, it is a sign of good practice that the ACs in Bangladesh are provided with sufficient authority and resources as suggested by the well-recognised AC guidelines, including the Sarbanes-Oxley Act (2002).

6.3.1.3 Diligence

The majority of AC chairpersons agreed to all five statements on the diligence of ACs in Bangladesh. However, the lowest agreement (only 54% of respondents) was with the statement relating to the annual review of the AC charter, while the statement concerning AC members' understanding on their responsibilities was agreed with by the highest number (84%) of respondents of this sample group.

The majority of company secretaries agreed with the first (64%); third (70%); fourth (70%) and fifth (56%) statements relating to AC diligence. The only exceptional response was in the case of the second statement where only 29% of the company secretaries agreed that the AC charter is reviewed annually. This result indicates that most of the ACs have their charters in black and white, but that they are not regularly updated.

It can also be seen that 50% (or 22 out of 44) of the finance heads agreed that the AC has a charter outlining their responsibilities, and only 29% of the respondents in this group agreed that the charter is reviewed annually. Furthermore, 66% of the finance heads agreed that the AC members have a clear understanding on their role, and 68% of the respondents of this group agreed that the members readily assume their responsibilities. However, only 41% of the finance heads agreed that the AC members devote sufficient time in carrying out their duties, and a significant portion (45%) of the finance heads neither agreed nor disagreed (i.e. selected the 'neutral' option) with this statement. This might happen because the finance heads are not sure about the time devoted by the AC members because in most of the cases the finance head is not a member of the AC and, therefore, he or she does not have frequent interactions with all AC members.

The table also shows that 51% (or 15 out of 29) of the external auditors agreed that the AC has a charter of their duties; while only 17% of the respondents agreed that the charter is reviewed annually. Furthermore, 49% of the external auditors agreed that the AC members have a clear understanding of their role, and 66% of the respondents in this group agreed that the members readily assume their responsibilities. However, only 38% of the respondents in this group agreed that the AC members devote sufficient time to their job. This result implies that, in the view of the external auditors, the amount of time given by the AC members to the committee's affairs is not enough to successfully achieve the objectives of the ACs.

Overall, 71% (or 99 out of 140) of the respondents agreed that the members readily assume the responsibilities of the ACs; 67% of the respondents agreed that the AC members have a clear understanding of their responsibilities in the committees; and, 59% of the respondents agreed that there is charter (terms of reference) for the ACs. However, only 32% of the respondents agreed that the AC charters are reviewed annually, and only 49% of the respondents agreed that the AC members devote enough time to the committees' affairs. Since the majority of respondents felt that the charters are not updated regularly, the researcher feels that the charters of the ACs are there only in spirit and are not being followed properly. The reasons behind the insufficient time given by the AC members may include: firstly, that most of the AC members are executive directors of companies and also busy with their many other businesses; and secondly, the independent members are not adequately valued and paid for their efforts. Therefore, the findings suggest that AC diligence in Bangladesh is not at a satisfactory level as required for the effective functioning of the ACs. This is inconsistent with the results of Kalbers and Fogarty (1993) who noted that AC diligence is one of the key components for its effectiveness.

6.3.1.4 Meeting

All of the AC chairpersons participating in the survey agreed that:

- (i) The AC members can express their views freely;
- (ii) The agenda and related materials are supplied to the AC members in advance;
and
- (iii) The duration of the AC meeting is sufficient for a full discussion of the issues.

Further, the vast majority (more than 80%) of respondents in this sample group also agreed with the other four statements on AC meeting.

Similarly, the majority of company secretaries agreed with all eight statements relating to AC meeting. The highest number of company secretaries (95%) agreed that the agenda and related materials are supplied to the AC members beforehand.

The responses of the third sample group (i.e. the finance heads) were similar to those of the previous two groups. The majority of finance heads agreed with all the statements on the procedure of AC meetings. However, 48% (or 21 out of 44) of the finance heads disagreed or remained neutral with the statement that the AC chairman discusses the meeting agenda with other members before finalising them. As stated earlier, most of the finance heads are not members of the ACs and, perhaps for this reason, they are not quite sure how the agenda are finalised.

Finally, the majority of external auditors agreed with all but one statement in this group. More specifically, only 12 (41%) respondents from this group agreed that the AC chairperson consults other members before finalising the meeting agenda, while the majority of external auditors agreed with the rest seven statements on AC meeting. This implies that the members of ACs in Bangladesh do not have significant role in choosing the agenda for the meetings, instead, the chairperson mainly finalises the agenda.

Overall, it is a good sign that all eight statements on AC meeting were agreed with by the majority of respondents. The highest number (90%) of respondents agreed with the statement that the meeting agenda are supplied to the members beforehand, while 85% of the respondents agreed that the agenda is finalised mainly by the chairperson of the committee. Furthermore, 85% of the respondents agreed that the minutes of AC meetings are circulated to the members of the BoDs, and 75% of the respondents agreed that non-members do attend the meetings if required. On the other hand, only 86 respondents (61%) agreed that non-members attend the AC meetings if required. The frequency of AC meetings has been regarded as an important factor by some researchers (such as Spira, 2002 and Anderson et al., 2004) and a vast majority (81%) of respondents participating in the questionnaire survey agreed that the frequency of AC meetings is adequate in order to carry out its responsibilities. Furthermore, 88% (123 out of 140) of the respondents agreed that the duration of the AC meetings is long enough to discuss and decide on the committees' affairs. Overall, the responses reflect the view that the ACs in Bangladesh generate a congenial environment in which to conduct effective meetings.

6.3.1.5 Role in Financial Reporting

In relation to the statements on AC's role in financial reporting, none of the AC chairpersons disagreed with any of the given statements, although a significant number of the AC chairpersons remained neutral in the expression of their opinion on some of the statements. Out of six statements of this group, the role of ACs in reviewing full disclosure in financial reports was agreed with by the highest number of respondents (97%). The responses reflect the view that the AC chairpersons of Bangladeshi ACs do play a significant role in relation to the financial reporting of the company.

Regarding the responses of company secretaries regarding AC's role in financial reporting, all six statements were agreed with by the majority of respondents. The statement relating to AC's role in reviewing the integrity of company's financial statements was agreed to by the highest number of respondents (83%). It should also be noted that a significant portion (43%) of the company secretaries neither agreed nor disagreed (i.e. they selected the 'neutral' option) with the statement that the ACs play a role in reviewing the compliance of accounting standards in financial reporting. This might be because, 62% of the company secretaries participating in the survey are from non-accounting background (see Table 6.2) and, therefore, they may be reluctant in commenting on such a purely accounting related technical issue.

Similarly, a large portion of finance heads neither agreed nor disagreed (i.e. they remained neutral) with the statements on AC's role in financial reporting. However, 26 (59%) of the finance heads agreed that the ACs review the integrity of financial reporting, and 30 (68%) respondents in this sample group agreed that the ACs review different reports and highlights (for example, auditors' report, chairman's report, financial highlights etc.) presented in the annual report.

We can also see in Table 6.6 that none of the statements, with one exception, was agreed with by the majority of external auditors. The exceptional statement was that the AC reviews different reports and highlights presented in the annual report: 59% (or 17 out of 29) of the external auditors agreed with these statements. Overall, the responses of

the external group demonstrate that there are still plenty of vacuums relating to financial reporting where the ACs can, and should, significantly contribute.

Concerning the statements on AC's role in financial reporting, all six statements were agreed with by the majority of respondents. The highest level of agreement was 75%, (or 105 out of 140 respondents) which was observed in the case of the statement that the ACs review relevant information (e.g. financial highlights and auditors' reports) which are presented in the annual report. On the other hand, only 51% of the respondents agreed that the ACs review the compliance of accounting standards in preparing financial statements. Although all the statements in relation to AC's role in financial reporting have been agreed with by the majority of respondents, it is important to note that a significant portion of respondents (around 30%) selected the 'neutral' option when responding to the questionnaire. This might be because, either the respondents are not sure about AC's role in financial reporting or they are not willing to disclose the committee's lack in this respect. The AC's considerable role in financial reporting is documented by a great deal of research, including: Urbancic (1996); Spira (1999b); Rezaee et al. (2003); Gendron and Bedard (2006); and Turley and Zaman (2007). The responses generally indicate that the ACs in Bangladesh definitely play some role in the financial reporting of the company, but that there are some areas where the ACs can enhance their involvement in order to enhance the integrity in company's financial reporting.

6.3.1.6 Role in External Auditing

Table 6.6 shows that only 37% (or 11 out of 30) of the AC chairpersons agreed that the AC reviews the Engagement Letter (EL) prepared for the external auditors, and only 40% of the respondents in this group agreed with the statements on AC's role in reviewing the expertise and resources of the external auditors. On the other hand, 94% of the AC chairpersons agreed that the ACs review the findings of external auditors, and 77% of the respondents in this group agreed that the ACs monitor management's responsiveness to the findings obtained by the external auditors.

Mixed responses were received from the company secretaries in the case of the statements relating to AC's role in external auditing. Only 27% (or 10 out of 37) of the company secretaries agreed that the ACs review the EL prepared for the external auditors, and only 40% of the respondents from this group agreed with the statements relating to AC's role in reviewing the expertise and resources of the external auditors. On the other hand, 73% of the company secretaries agreed that the ACs review the findings of the external auditors, and 60% of the respondents from this sample group agreed that the ACs monitor management's responsiveness to the findings obtained by the external auditors.

The finance heads participating in the survey also gave mixed opinions on AC's role in external auditing. Only one statement (i.e. that the ACs review the findings of the external auditors) was agreed with by the majority (64%) of respondents. Only 25% (or 11 out of 44) of the respondents agreed that the ACs review and approve the EL prepared for external auditors. A significant portion of finance heads remained neutral in expressing their opinions on the statements relating to AC's role in external auditing. This might happen because, either the finance heads are reluctant to disclose AC's limited role in external auditing or they really are unsure about AC's role in this respect.

The responses of the external auditors in relation to the eight statements on AC's role in external auditing show that only one statement was agreed with by the majority of respondents. The majority (62%) of external auditors participating in the survey agreed that the ACs review the findings of the external auditors. On the other hand, only 21% (or 6 out of 29) of the respondents in this group agreed that the ACs review and approve the EL prepared for external auditors. It can be inferred that in the view of the external auditors, the role of ACs in dealing with them and their activities is unsatisfactory.

It can be seen from the responses of the 140 respondents from the four samples that three out of eight statements were agreed with by the majority of respondents. A vast majority (72%) of the respondents agreed that the AC reviews the findings of the external auditors, while only 27% of the respondents agreed that the AC reviews the EL

of the external auditors. Overall, the responses reflect the fact that the ACs in Bangladesh are still not yet able to perform their role in dealing with external auditing, as suggested by many prior researchers including Wolnizer (1995) and Lambe (2005).

6.3.1.7 Role in Internal Auditing

The majority of AC chairpersons agreed with all of the eight statements on AC's role in internal auditing. 90% (27 out of 30) of the AC chairpersons agreed with three statements which relate to:

- (i) AC's role in reviewing internal auditor's report and findings;
- (ii) AC's role in enhancing the independence of internal auditors; and,
- (iii) AC's role in monitoring the effectiveness of internal auditing.

However, only 63% (or 19 out of 30) of the AC chairpersons agreed that the AC plays a significant role in appointing or removing the head of internal audit division of the company.

Similarly, the majority of company secretaries agreed with all eight statements on AC's role in internal auditing. The statement regarding AC's role in evaluating the effectiveness of internal audit functions has been agreed with by 78% of the company secretaries. Again, 51% (or 19 out of 37) of the company secretaries agreed with three statements which relate to:

- (i) AC's role in the appointment or removal of the head of the internal audit division;
- (ii) AC's role in reviewing the charter of the internal auditor; and,
- (iii) AC's meeting with the internal audit team without presence of the top management.

These findings indicate that AC's role in internal auditing is not as significant as expected. One reason for this might be that the AC members have neither the required expertise nor can they give much time to the committee's affairs.

Table 6.6 also shows that only 41% (or 18 out of 44) of the finance heads agreed that the ACs recommend the appointment and/or removal of the head internal auditors, and

39% of the respondents in this group agreed that the ACs review the charter of internal auditors, although 73% of the finance heads agreed that the ACs monitor the management's responsiveness towards the recommendations of the internal audit team. 68% of the finance heads agreed that the ACs evaluate the effectiveness of the internal audit function, while only 44% of the respondents from this group agreed that the ACs meet with the head internal auditor without the management's presence.

Similarly, only 35% (10 out of 29) of the external auditors agreed that the AC makes recommendations on the appointment and/or removal of the head of the internal audit section, and that the AC reviews the charter of internal auditors. On the other hand, 73% of the external auditors agreed that the AC monitors the responsiveness if management towards the recommendations of the internal audit team. However, only 41% of the respondents in this group agreed that the AC meet with the head of the internal audit section in absence of the management.

The overall response from all four sample groups indicates that the respondents tend to be somewhere between neutrality and agreement on the statements. The majority of respondents agreed with the last six statements, while only 47% (or 66 out of 140) respondents agreed with the first two statements, which are: (i) the AC recommends the appointment or termination of the internal audit head; and, (ii) the AC reviews the charter of the internal auditors. Therefore, the scenario of the Bangladeshi ACs indicates that they still have many areas in which they could play a role in making the internal auditing functions of the company more effective.

6.3.1.8 Overall AC Practice

Two general statements were aimed at investigating the overall independence and effectiveness of ACs in Bangladesh. The statement that the ACs can work independently was agreed with by the majority of respondents of four sample groups (80%; 81%; 89%; and 72% respectively) and the statement that the ACs are effective was agreed with by 74% of the AC chairpersons, 76% of the company secretaries, and 66% of the

finance heads. Whereas only 31% of the external auditors agreed that the ACs are effective. It is important to note that 48% (or 14 out of 29) of the external auditors remained neutral in the case of the last statement. This might be because, the external auditors were unwilling to express concerns about the AC functions of their clients and, therefore, they neither agreed nor disagreed when responding to the overall effectiveness of the ACs. Overall, 82% of the respondents agreed that the ACs can work independently. Regarding the overall effectiveness of the ACs in Bangladesh, 63% (or 88 out of 140) of the respondents felt that the ACs are working effectively. This result indicates that the ACs in Bangladesh are somewhat effective, but that the level of effectiveness is not up to the mark.

6.3.2 Responses towards the Statements on Audit Committee Practices: Mean and Standard Deviation

Table 6.6 presented the percentage of frequencies of disagree (strongly disagree and disagree), neutral, and agree (agree and strongly agree) of the four sample groups. The analysis of the responses might be more facilitated if the mean values with standard deviations of response in relation to the statements are reported. Therefore, the following table (Table 6.7) presents the mean scores and standard deviations of the responses towards the 50 statements.

Table 6.7: Analysis of Mean and Standard Deviation (SD) of Responses towards the Statements on Audit Committee Practices

Statements	AC Chairperson		Company Secretary		Finance Head		External Auditor		All Four Samples	
	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.
A. Composition	3.54	0.91	3.39	0.84	3.32	0.90	2.81	0.95	3.29	0.95
1. The AC members are appointed in consultation with the AC chairperson.	4.23	0.97	3.68	1.03	3.73	0.92	3.14	0.79	3.70	0.99
2. The AC members have sufficient knowledge on the entity's business.	4.03	0.85	4.11	0.74	3.89	0.92	2.90	0.86	3.77	0.95
3. The AC members have sufficient knowledge on Accounting and/or Auditing practices.	3.80	0.81	3.62	0.79	3.55	0.85	2.72	1.00	3.45	0.93
4. The AC members have sufficient experience in Accounting and/or Auditing.	3.93	0.74	3.35	0.86	3.50	0.82	2.69	0.97	3.38	0.94
5. The AC members are capable of mediating problems in performing their duties.	3.90	0.84	3.76	0.68	3.66	0.75	2.93	0.88	3.58	0.85
6. The majority of AC members are independent /non-executive directors.	1.90	0.89	2.11	0.86	2.05	0.88	1.97	.98	2.09	0.91
7. The chairperson of the AC is an independent director.	2.50	0.92	2.27	0.98	2.17	1.02	2.31	1.03	2.29	0.98
8. The size of the AC is appropriate for carrying out its duties properly.	4.00	0.95	4.22	0.71	4.07	0.82	3.79	0.77	4.04	0.82
B. Authority and Resources	4.14	0.88	4.17	0.85	4.18	0.77	3.71	0.96	4.07	0.88
9. The AC has adequate authority in order to carry out its responsibilities.	4.33	0.80	4.30	0.81	4.39	0.65	3.83	0.93	4.24	0.81
10. The AC has ready access to relevant information if required.	4.37	0.81	4.41	0.76	4.45	0.63	3.90	0.94	4.31	0.79
11. The AC receives prompt responses from the management in carrying out its duties.	4.30	0.92	4.38	0.72	4.45	0.63	3.72	1.03	4.25	0.85
12. The AC is provided with sufficient resources including secretarial support to carry out its duties.	4.20	0.85	4.30	0.88	4.23	0.89	3.90	0.94	4.17	0.89

Statements	AC Chairperson		Company Secretary		Finance Head		External Auditor		All Four Samples	
	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.
13. The non-executive AC members are adequately paid for their time and efforts.	3.50	1.01	3.49	1.10	3.36	1.06	3.21	0.94	3.39	1.04
C. Diligence	3.89	0.97	3.68	0.92	3.50	0.91	3.20	0.84	3.57	0.94
14. The AC has a charter which outlines its objectives, duties and responsibilities.	3.87	1.01	3.68	1.08	3.39	1.02	3.34	0.86	3.56	1.01
15. The AC charter is reviewed annually.	3.47	1.04	3.00	0.97	3.07	1.02	2.66	0.86	3.05	1.01
16. The AC members have a clear understanding of their responsibilities.	4.23	0.82	4.00	0.91	3.89	0.81	3.34	0.81	3.88	0.89
17. Members of the AC readily assume their responsibilities.	4.07	1.01	4.05	0.88	3.84	0.91	3.72	0.70	3.92	0.89
18. The AC members devote sufficient time to the committee's affairs.	3.83	0.95	3.68	0.75	3.34	0.81	2.93	0.96	3.45	0.91
D. Meeting	4.41	0.63	4.10	0.82	4.14	0.72	3.66	0.84	4.09	0.80
19. The agendas of the AC meetings are finalized by the chairperson.	4.50	0.90	4.14	0.89	4.30	0.76	3.79	0.86	4.19	0.87
20. The chairperson cooperates with other committee members before finalizing the agenda of the meetings.	4.10	0.71	3.76	0.80	3.55	0.76	3.38	0.68	3.69	0.78
21. The agenda and related materials are provided to members fairly ahead of the meetings.	4.63	0.49	4.51	0.61	4.36	0.61	3.83	0.71	4.35	0.67
22. All members can express their views freely and independently in the meetings.	4.80	0.41	4.41	0.72	4.39	0.69	3.79	0.86	4.36	0.76
23. The frequency of the AC meetings is sufficient to carry out its responsibilities.	4.40	0.62	4.03	0.73	4.07	0.79	3.66	0.94	4.04	0.80
24. The duration of the AC meetings is sufficient for a full discussion of important issues.	4.50	0.51	4.05	0.74	4.18	0.79	3.72	0.92	4.12	0.79
25. Non-members attend the AC meetings if required.	3.83	0.83	3.81	1.10	4.00	0.72	3.52	0.83	3.81	0.89
26. The minutes of the AC meetings are circulated to all members of the Board of Directors (BODs).	4.53	0.57	4.11	0.97	4.30	0.67	3.62	0.90	4.16	0.84

Statements	AC Chairperson		Company Secretary		Finance Head		External Auditor		All Four Samples	
	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.
E. Role in Financial Reporting	4.26	0.69	3.88	0.73	3.61	0.86	3.23	0.75	3.74	0.84
27. The AC reviews the integrity of companies' financial statements.	4.20	0.66	4.00	0.67	3.68	0.77	3.24	0.69	3.79	0.78
28. The AC reviews accounting policies and changes made therein.	4.27	0.64	3.92	0.68	3.50	0.79	3.21	0.73	3.71	0.81
29. The AC reviews accounting estimates and judgments done in preparing financial statements.	4.20	0.85	3.78	0.75	3.45	0.85	3.21	0.77	3.65	0.87
30. The AC reviews the compliance of the Accounting Standards (e.g. IAS, BAS etc.) in preparing financial statements.	4.00	0.79	3.59	0.80	3.43	0.95	3.00	0.85	3.51	0.91
31. The AC reviews the clarity and completeness of disclosures in financial statements.	4.40	0.56	3.84	0.69	3.66	0.91	3.24	0.69	3.78	0.83
32. The AC reviews other information (e.g. the auditors' report, financial highlights etc.) presented in the annual report.	4.47	0.63	4.14	0.79	3.91	0.91	3.48	0.78	4.00	0.86
F. Role in External Auditing	3.82	0.83	3.43	0.90	3.24	0.86	3.14	0.75	3.39	0.88
33. External auditors are appointed and/or removed upon recommendation of the AC.	3.53	0.82	3.35	1.03	3.02	1.09	3.00	0.80	3.21	0.98
34. The AC reviews the expertise of the external auditors.	3.43	0.86	3.24	0.89	3.00	0.94	3.14	0.74	3.19	0.88
35. The AC reviews and approves the terms of the Engagement Letter (EL) prepared for the external auditors.	3.37	0.81	3.03	0.99	2.89	0.92	2.90	0.72	3.03	0.89
36. The AC monitors the external audit firm's compliance with the existing ethical and regulatory requirements in Bangladesh.	3.83	0.83	3.35	0.82	3.27	0.87	3.00	0.80	3.36	0.87
37. The AC reviews the findings of the annual audit obtained by the external auditors.	4.27	0.69	3.81	0.84	3.75	0.72	3.59	0.68	3.84	0.77
38. The AC reviews the management's responsiveness to the external auditors' findings.	4.07	0.83	3.62	0.89	3.52	0.73	3.34	0.72	3.63	0.83
39. The AC meets with the external auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit.	3.87	0.86	3.32	0.88	3.11	0.75	3.00	0.76	3.31	0.86

Statements	AC Chairperson		Company Secretary		Finance Head		External Auditor		All Four Samples	
	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.
40. The AC reviews and monitors the independence and effectiveness of the external auditing process.	4.17	0.95	3.70	0.88	3.34	0.83	3.17	0.80	3.58	0.93
G. Role in Internal Auditing	4.18	0.85	3.70	1.02	3.58	0.90	3.46	0.85	3.72	0.94
41. The AC recommends and approves the appointment or termination of the heads of the internal audit division.	3.73	0.83	3.43	0.96	3.20	1.00	3.10	0.77	3.36	0.93
42. The AC approves and reviews the charter of the internal auditors.	3.83	0.99	3.41	1.04	3.32	0.91	3.14	0.74	3.41	0.95
43. The AC assesses and reviews the annual internal audit work plan.	4.07	0.83	3.57	1.04	3.57	0.93	3.45	0.91	3.65	0.95
44. The AC reviews the internal audit reports, and other findings.	4.27	0.74	3.84	1.04	3.73	0.79	3.62	0.94	3.85	0.91
45. The AC reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.	4.40	0.86	4.00	1.05	3.77	0.89	3.66	0.86	3.94	0.95
46. The AC meets with the head of the internal audit function without the presence of the management.	4.23	0.90	3.49	0.99	3.36	0.92	3.31	0.76	3.57	0.96
47. The AC enhances the independence of the internal auditors of the company.	4.43	0.90	3.78	1.11	3.75	0.78	3.59	0.87	3.87	0.96
48. The AC monitors and evaluates the effectiveness of the internal audit function.	4.47	0.78	4.08	0.92	3.95	0.99	3.79	0.98	4.06	0.95
H. Overall Practice	4.25	0.84	4.18	0.80	3.97	0.63	3.52	0.84	3.99	0.81
49. The AC can work independently.	4.43	0.82	4.27	0.84	4.25	0.65	3.86	0.83	4.21	0.79
50. The AC is effective.	4.07	0.87	4.08	0.76	3.68	0.60	3.17	0.85	3.76	0.83

Table 6.7 shows that the mean scores of the responses to the statements relating to the AC composition are: 3.54 (AC chairpersons); 3.39 (company secretaries); 3.32 (finance heads); and 2.81 (external auditors); and that these result in an aggregated mean score of 3.29 for all 140 respondents. It is notable that the mean score of the responses of the external auditors is lower than that of the other three groups. This might happen because all of the other three groups are either executives or directors of the company (i.e. internals) and they might tend to hide some weaknesses of the ACs. It is important to note that both statements relating to whether the majority of AC members are independent directors, and whether the AC chairperson is an independent director, had significantly low means in the case of all four groups. This reflects the view that the ACs of Bangladesh are mainly led and dominated by the executive directors which is against the spirit of the formation of the ACs as suggested in the most of the guidelines, including: the Cadbury Report (1992); the BRC (1999); and the Sarbanes-Oxley Act (2002). A lower aggregated mean score (which is less than 3.50) in the case of the statements on AC members' literacy and experience in a related area indicates that the AC members are lacking in terms of literacy and experience in related areas. However, the statement relating to the appropriateness of AC size has been agreed with by the highest number of respondents in the cases of each of the four sample groups, and this implies that there is no major problem regarding the size of ACs in Bangladesh.

Regarding the statements on authority and resources provided to the ACs, the mean scores of the responses of the first three sample groups are very similar (4.14, 4.17, and 4.18 respectively) while the mean score of the same three statements obtained from the external auditors' responses is slightly lower (3.71). The second statement of this section that the AC has ready access to the relevant information has received the highest combined mean score (4.31). This result is consistent with Bull and Sharp (1989) and Rittenberg and Nair (1994) who reported on the importance of open lines of communication that must exist between the ACs and those of the company who can provide them with the required information. However, the lowest mean value (3.39) was observed in the case of the statement on the payment of remuneration and benefits to the independent directors compared to their time and effort devoted to the committee's

affairs. This reflects the fact that the independent members of the committee are not paid adequate remuneration for their efforts.

Relating to the statements on diligence of the ACs, the mean values obtained from the responses of the four sample groups are: 3.89 (AC chairpersons); 3.68 (company secretaries); 3.50 (finance heads); and 3.20 (external auditors). Furthermore, the statement that the AC charter is reviewed annually has been assigned the lowest mean value in the case of all the four sample groups. The statement that the AC members readily assume their responsibilities has achieved the highest combined mean value. In relation to the statement on the sufficiency of time devoted by the AC members for the committee's affairs, a lower aggregated mean score of 3.45 demonstrates that the AC members in Bangladesh do not devote enough time to the committee's affairs.

Out of the eight sections of statements included in the questionnaire, the highest overall mean value (4.09) is observed in the case of the statements on AC meetings. Samples group-wise mean scores on this aspect are: 4.41 (AC chairpersons); 4.10 (company secretaries); 4.14 (heads of finance); and 3.66 (external auditors). It is encouraging that the statement stating that all members can express their views and opinions freely in the AC meeting has obtained the highest overall mean value in this section of statements (4.36). However, the lowest mean value (overall 3.69) is seen in the case of the second statement (i.e. the AC chairperson discusses with the other members before finalizing the agenda for the meetings). This result implies that the AC members do not play any significant role in choosing the agenda for the AC meetings.

In relation to the statements on AC's role in financial reporting, the mean score of the responses from the AC chairpersons' group is relatively higher than those of the other three sample groups. The statement on AC's role in reviewing relevant information (auditor's report, financial highlights) presented in the annual report has been assigned the highest overall mean score (i.e. 4.00) which implies AC's significant role in this regard. This view is not surprising because Jenkins and Robinson (1985) stated that the primary function of an AC is to oversee the financial reporting and disclosures prepared

by the management. On the other hand, the statement relating to AC's role in reviewing the compliances of accounting standards in preparing financial statements has obtained the lowest aggregated mean value (3.51), which shows the weakness of the ACs in ensuring the satisfactory compliance of the accounting principles and standards in preparing the financial reports. Although AC's considerable role in financial reporting is documented by a great deal of research (including McMullen, 1996; the SEC, 1999, 2003; Gendron et al., 2004; Gendron and Bedard, 2006; Turley and Zaman, 2007; Cohen et al., 2007a), a lower mean score of the overall responses (i.e. 3.74 on a 5-point scale) indicates that the ACs can play more proactive role in this area.

The significant role of ACs in the case of external auditing has been documented by a large amount of the prior research (such as: Rezaee and Farmer, 1994; Wolnizer, 1995; Beasley et al., 2009). However, the responses indicate that the ACs in Bangladesh cannot yet satisfactorily perform their role in this area (overall mean scores 3.39 out of 5). The mean values of the responses to eight statements on this aspect are: 3.82 (AC chairpersons); 3.43 (company secretaries); 3.24 (finance heads); and 3.14 (external auditors). A relatively lower mean score (3.17) for the responses from external auditors to the statements on AC's role in insuring the independence of the external auditors indicates that the external auditors are not satisfied with the role of ACs in relation to external auditing functions.

In the case of the statements on AC's role relating to internal auditing, the mean score obtained from the responses of the AC chairpersons (4.18) is higher than that of the other three sample groups. The lowest mean value has been assigned in the case of the first statement (i.e. that the ACs recommend and approve the appointment or termination of the heads of internal audit division). This indicates that the ACs play insignificant role in appointing or terminating the head of internal audit functions. On the other hand, the highest mean value (overall 4.06) is observed in the case of the statement that the AC monitors and evaluates the effectiveness of internal audit functions. This result reflects the view that the ACs in Bangladesh do play an important role in ensuring effective internal auditing functions and this result is consistent with

DeZoort (1997) who highlighted the role of ACs in encouraging the internal audit division to work independently and effectively.

Davidson and Ebersole (2002) pointed out that independence from management is widely recognised as an important characteristic of an effective AC. The last two statements that aimed to measure the general scenario of the AC's independence and effectiveness obtained different mean values. The mean score of the statement regarding AC independence is 4.21, while the statement on the overall effectiveness of the ACs obtained a lower mean value of 3.76. The difference in mean scores in case of these two statements can be interpreted by the fact that the respondents have evaluated the ACs as independent, but they still think that the ACs are not yet able to fulfil their duties effectively.

6.3.3 Responses towards the Factors Affecting the Audit Committee Practices: Mean, Standard Deviation (SD) and Ranking

As discussed in *Chapter Five*, the respondents were requested to share their views on the factors that affect the AC practices in Bangladesh. A total of nine factors were listed in the questionnaire. It should be mentioned that the factors were chosen on the basis of the literature as reviewed in *Chapter Four*, and were also the participants' opinions obtained from the pre-testing of the questionnaire. Table 6.8 presents the mean values along with the standard deviations of the responses towards these factors. Furthermore, the factors have also been ranked on the basis of the mean scores as obtained from the responses.

It is seen in Table 6.8 that the AC chairpersons considered the non-appointment of independent directors as the chairperson of the AC as the most affecting factor (mean value of 4.13), followed by the non-inclusion of majority independent directors in the AC (mean value of 4.10). As per the responses received from the AC chairpersons, the third most affecting factor is the lack of AC members' experience and expertise (mean value of 3.83). The lack of AC members' qualification (mean value of 3.70) is perceived

as the fourth most affecting factor. These results are consistent with the earlier findings (as presented in Tables 6.6 and 6.7) where shortfalls in these areas were clearly highlighted by the majority of respondents.

The responses from the company secretaries indicate that lack of AC members' qualification (mean value of 4.11) is the most affecting factor, followed by lack of AC members' experience and expertise (mean value of 4.08). As viewed by this group of respondents, the third most affecting factor is the non-appointment of independent directors as the chairperson of the AC (mean value of 4.03), followed by non-inclusion of majority independent directors in the AC (mean value of 3.81). Inadequate authority has been considered to be the least important of the factors (mean value of 2.70) that affect AC effectiveness.

Furthermore, the inclusion of majority executive directors in the ACs has also been considered by the finance heads as the top most affecting factor (mean value of 4.25), followed by lack of AC members' qualification (mean value of 4.23). Lack of AC members' experience and expertise (mean value of 4.18) has been regarded as the third most affecting factor, while the fourth ranked factor is the non-appointment of independent directors as the chairperson of the AC (mean value of 4.14). Consistent with the responses of the previous two groups of respondents, inadequate authority delegated to the ACs is perceived as the least affecting factor while inadequate resources provided to the ACs was regarded as the second least important factor (among the given nine factors) that affects AC practices in Bangladesh.

The responses of the external auditors are similar to those of the other three samples. For example, the inclusion of majority executive directors in the ACs, and the non-appointment of independent directors as the chairperson of the ACs, have been considered to be the top two most affecting factors of AC practices in Bangladesh. This group of respondents viewed the lack of AC members' qualification as the third most affecting factors (mean value of 3.97), followed by the lack of AC members' experience and expertise (mean value of 3.90). The two least affective factors out of the given nine

factors have been viewed as: the inadequacy of the authority of ACs, and the inadequacy of resources provided to the ACs. This finding is consistent with the responses towards the statements on authority and the resources of the ACs (see Table 6.6) where most of the respondents agreed that the ACs in Bangladesh are provided sufficient authority and resources in order to carry out their responsibilities.

Overall, Table 6.8 highlights the view that the non-appointment of independent directors as the chairperson of ACs is at the top of the given nine factors (mean value of 4.10), followed by the non-inclusion of majority independent directors in the ACs (mean value of 4.07). The respondents' emphasis on the importance of independent directors in the AC are supported by AcMullen and Raghunandan (1996) and Chan and Li (2008). These studies have emphasised the importance of independent members in ACs. DeZoort and Salterio (2001); Farber (2005); Krishan and Lee (2009); Bedard and Gendron (2010) and many other studies have argued that the background of the AC members in a similar area is a vital factor for an effective AC, and this view was reflected in the opinions of the respondents in this survey. For example, as per the combined responses of all participants, the third most affecting factor is the lack of AC members' qualification in relevant fields (mean value of 4.03), while lack of AC members' experience and expertise in the relevant field (mean value of 4.02) is regarded as the fourth most affecting factor. Although some researchers (including Klabers and Fogarty, 1993; and Sharma et al., 2009) noted that diligence of AC members is a vital factor for an effective AC, the respondents participating in this survey placed this as a less important factor in Bangladesh (where it was ranked as the fifth most affecting factor out of nine stated factors). One possible reason for the respondents' less emphasis on this factor might be that the ACs in Bangladesh are lacking heavily in some other areas (e.g. an independent director and experience of the AC members). Lack of support from the management (mean value of 2.98) was found to be the sixth most affecting factor, which implies that in the context of Bangladesh, the ACs are not significantly affected because of the lack of support from management. It can be interpreted that the AC members get quicker responses to their queries from the management because most of the AC members are the executive directors of their respective companies. The three

factors that generated low mean scores are:

- (i) The infrequent meeting of the ACs (mean score of 2.95);
- (ii) A lack of resources provided (mean score of 2.89); and,
- (iii) An insufficient authority delegated (mean score of 2.81).

These results are consistent with the responses of earlier sections of the questionnaire where it was revealed that the majority of respondents feel that the ACs in Bangladesh are provided with sufficient authority and resources, and the frequency of AC meetings is quite satisfactory.

Table 6.8: Analysis of the Responses in Relation to Factors Affecting AC Effectiveness in Bangladesh

Factors	AC Chairperson (N=30)			Company Secretary (N=37)			Finance Head (N=44)			External Auditor (N=29)			All Respondents Combined (N=140)		
	Mean	S.D.	Rank	Mean	S.D.	Rank	Mean	S.D.	Rank	Mean	S.D.	Rank	Mean	S.D.	Rank
1. Lack of AC members' qualification in relevant field.	3.70	1.12	4	4.11	0.77	1	4.23	0.94	2	3.97	1.15	3	4.03	1.00	3
2. Lack of AC members' experience and expertise in the relevant field.	3.83	1.09	3	4.08	0.86	2	4.18	1.06	3	3.90	1.18	4	4.02	1.04	4
3. Non-inclusion of majority independent/non-executive members in the AC.	4.10	0.88	2	3.81	1.02	4	4.25	0.99	1	4.10	1.08	1	4.07	1.00	2
4. Non-appointment of AC chairperson from independent/non-executive members.	4.13	0.82	1	4.03	0.99	3	4.14	1.03	4	4.10	1.11	1	4.10	0.98	1
5. Low frequency of AC meetings.	2.97	1.00	7	2.84	0.76	7	2.95	0.81	7	3.07	0.84	6	2.95	0.84	7
6. Lack of diligence in AC members.	3.20	1.21	5	2.92	0.98	6	3.16	0.94	5	3.10	0.86	5	3.09	1.00	5
7. Inadequate authority delegated to the AC.	2.93	1.31	9	2.70	1.13	9	2.86	1.29	9	2.72	1.22	8	2.81	1.23	9
8. Inadequate resources provided with the AC.	3.20	1.42	5	2.73	1.10	8	2.93	1.28	8	2.72	1.00	8	2.89	1.22	8
9. Lack of supports from top management.	2.97	1.10	7	2.97	0.93	5	3.05	1.06	6	2.90	0.94	7	2.98	1.00	6

Table 6.9: Analysis Showing the Suggestions for Improving AC Effectiveness

Suggestions	AC Chairperson (N=30)			Company Secretary (N=37)			Finance Head (N=44)			External Auditor (N=29)			All Respondents Combined (N=140)		
	Mean	S.D.	Rank	Mean	S.D.	Rank	Mean	S.D.	Rank	Mean	S.D.	Rank	Mean	S.D.	Rank
1. Voluntary and self- regulation by the companies.	3.83	1.02	10	3.50	0.85	10	3.39	1.06	10	3.03	0.98	10	3.44	1.01	10
2. Increased pressure from general investors.	4.07	0.98	8	3.95	1.08	8	4.16	0.68	6	3.90	0.72	6	4.03	0.87	7
3. Increased monitoring of existing rules and guidelines.	4.27	1.05	5	4.19	1.08	4	4.36	0.87	4	4.55	0.69	2	4.34	0.93	3
4. Introducing new rules and guidelines.	4.33	0.76	3	4.22	0.79	3	4.39	0.78	3	4.24	0.69	4	4.30	0.76	4
5. Compulsory inclusion of AC report in the Annual Corporate Report.	4.23	0.77	7	3.97	0.60	7	3.91	0.71	7	3.66	0.72	8	3.94	0.72	8
6. Mandating the appointment of AC chairperson from independent /non-executive directors.	4.67	0.55	1	4.57	0.77	1	4.59	0.66	1	4.62	0.49	1	4.61	0.63	1
7. Mandating inclusion of majority independent/non-executive members in the AC.	4.57	0.68	2	4.32	0.58	2	4.50	0.59	2	4.24	0.74	4	4.41	0.65	2
8. Including AC practices in the listing requirements of stock exchanges.	4.07	0.91	8	3.95	0.78	8	3.80	0.76	9	3.48	0.83	9	3.83	0.83	9
9. Offering some incentives to the firms that comply with AC guidelines of SEC (issued in 2006).	4.30	0.75	4	4.16	0.65	5	3.89	0.81	8	3.90	0.62	6	4.05	0.73	6
10. Compulsory compliance of SEC order of 2006 regarding the guidelines of AC practices.	4.27	1.01	5	4.16	1.07	5	4.34	0.94	5	4.34	0.72	3	4.28	0.95	5

6.3.4 Responses on the Suggestions for Improving Audit Committee Effectiveness: Mean, SD and Ranking

The last section of the questionnaire consisted of ten possible ways of improving AC effectiveness in Bangladesh. Table 6.9 presents the responses towards this section in terms of mean, standard deviation and ranking of the responses.

It is seen in Table 6.9 that the AC chairpersons emphasised some possible improvements for effectiveness of the ACs in Bangladesh. The three most recommended improvements, as viewed by the AC chairpersons are:

- (i) Mandating the appointment of independent directors as the chairperson of the ACs (mean value of 4.67);
- (ii) Mandatory inclusion of majority independent directors in the ACs (mean value of 4.57) and,
- (iii) Introducing new rules and guidelines in this respect (mean value of 4.33).

It is not surprising that voluntary and self-regulations by the companies (mean value of 3.83) have been regarded as the least recommended way of improving the AC effectiveness. It is interesting to see the consistency of responses regarding factors affecting AC practice and suggestions for improving AC effectiveness in Bangladesh. The key recommendations given by the respondents are related to the main factors that affect AC practices in Bangladesh.

The suggestions as viewed by the company secretaries participating in the survey include:

- (i) The mandatory appointment of independent directors as the chairperson of ACs (mean value of 4.57);
- (ii) Mandating the inclusion of majority independent directors in the ACs (mean value of 4.32);
- (iii) Introducing new rules and guidelines in this respect (mean value of 4.22); and,
- (iv) Increasing monitoring of the existing compliance rules (mean value of 4.19).

The voluntary and self-regulations by the companies and the inclusion of AC practice as a compulsory listing requirement have unsurprisingly been regarded as the two least important ways of improving effectiveness of the ACs in Bangladesh.

The responses of the finance heads are very similar to those of the previous two groups (i.e. the AC chairpersons and company secretaries). Table 6.9 shows that the top four and the bottom two suggestions (in terms of the mean scores) are very similar in the case of these three groups of respondents. The appointment of independent directors as the chairperson of the AC is at the top of the ten given possible ways (mean value of 4.59), and mandating the inclusion of majority independent directors in the AC (mean value of 4.50) has been regarded as the second most suggested way to improve the AC effectiveness. As per the responses of this group, the third ranked recommended measure (mean value of 4.39) is to introduce more new rules and guidelines in this respect, while increased monitoring of the existing rules is placed in the fourth position (mean value of 4.36) among the given ten recommendations. Voluntary and self-regulations by the companies and the inclusion of AC practice as a compulsory listing requirement are in the two bottom positions of the list as per the ranking (with mean values of 3.39 and 3.80, respectively).

The external auditors also emphasised on the appointment of independent directors as the chairpersons of the ACs (mean value of 4.62). However, they feel that the second most necessary step is to increase the monitoring of existing rules and guidelines (mean value of 4.55), and the inclusion of majority independent members in the AC has been considered to be the fourth most recommended way of improving the effectiveness of the ACs (mean value of 4.24). The AC guidelines given by a SEC order in 2006 are now optional, which means that the listed companies will either comply or explain for non-compliance. The external auditors generally think that if these guidelines are compulsorily imposed, the effectiveness of ACs will be significantly increased and, in their view, this is the third ranked (mean value of 4.34) recommended way of improving AC effectiveness in Bangladesh. Although the external auditors differ in prioritising the top four recommendations, they agreed with the previous groups regarding the two least

effective ways out of a given ten. The two least suggested ways of improving the AC effectiveness in the views of the external auditors were:

- (i) Voluntary and self-regulations by the companies (3.03); and,
- (ii) The inclusion of AC practice as compulsory listing requirements of stock exchanges (3.48).

The overall responses indicate that the appointment of independent directors as the chairperson of AC is the most recommended way of improving the effectiveness (mean value of 4.61) of the ACs followed by the mandatory inclusion of majority independent directors in the AC (mean value of 4.41). These suggestions are consistent with the guidelines for AC effectiveness as given in: the Olivencia Report (1998); the BRC (1999); the Treadway Commission report (1987) and the Cadbury Report (1992). A great deal of research studies (including Baseley and Salterio, 2001; Klein, 2002b; Bedard et al., 2004; Chan and Li, 2008; Garcia-Meca and Sanchez-Ballesta, 2009) have also highlighted the importance of independence directors in ACs. Other suggestions that are seen to significantly improve the AC effectiveness include increasing monitoring in the case of existing rules and guidelines (mean value 4.34) and introducing new rules and guidelines (mean value 4.30). With rigorous monitoring by the SEC in ensuring the compliance of the guidelines issued, the AC practices can ensure that better AC practices in the corporations and, therefore, the scenario of AC practices is likely to improve significantly. New rules might include the minimum qualification and experience of AC members. Sensibly, the voluntary and self-regulations by the companies and the inclusion of AC practice as a compulsory listing requirement are in the two lowest positions (with the mean values of 3.44 and 3.83, respectively).

Therefore, there appears to be consensus among the four groups of respondents in relation to the possible measures to improve AC effectiveness in Bangladesh. Although the mean values differ in groups, the degree of importance (ranking) given to the suggestions is very similar. All the four sample groups unanimously agreed that it is very essential to appoint an AC chairperson from independent directors. Similarly, all

the four sample groups unanimously agreed that voluntary and self-regulation by the company itself is the least suggested measure out of the ten given ways of improving AC effectiveness. This is insistent with Bradbury's (1990) analysis of the extent of voluntary AC formation which indicated that, in a purely voluntary environment, very few firms form ACs. Furthermore, increased pressure from general investors has been considered to be of the least important measures (an aggregated mean value of 4.03) for improving the AC effectiveness, while mandating the AC chairperson from an independent director, the increased monitoring of existing rules, and introducing new rules have been assigned top priority in the list of recommendations. These findings are not surprising because the majority of general investors in Bangladesh are not aware of the significance of having ACs in practice. Therefore, it is very unlikely that there will be severe pressure from general investors to enhance the AC effectiveness. Again, it should be admitted that the CG scenario in Bangladesh has not yet developed to an acceptable level where the companies themselves can voluntarily exercise the best guidelines on AC practices.

This section has discussed descriptive statistics in order to describe the nature of the data collected from the field survey. These descriptive results need confirmation by some inferential statistics. Therefore, some non-parametric statistics (namely, the Wilcoxon Signed Rank Test, the Kruskal Wallis Test and the Mann Whitney U Test) have been run, and the results obtained in these tests are discussed in following section.

6.4 Statistical Testing and Discussion

The previous section focused on the descriptive characteristics of the questionnaire survey responses. This section continues with the analysis of the responses and a discussion of the test results of the hypotheses as proposed in *Chapter Five*. Firstly, the significance of the responses has been examined by the Wilcoxon Signed Rank Test; and secondly, the hypotheses (as stated in *Chapter Five*) have been tested using the Kruskal Wallis Test and the Mann Whitney U Test as applicable.

6.4.1 Testing the Significance of Responses towards the Statements

Table 6.7 reports the mean values and SDs of responses to the 50 statements on AC practices in Bangladesh. It is observed that some mean values are above 4.00, some are between 3.00 and 4.00, and a few values are below 3.00. The researcher feels that it is worth comparing the mean responses with 3 (the mid score of a 5 point scale) to examine the significance of agreement/disagreement using the Wilcoxon Signed Rank Test. This test is used as non-parametric statistics, as opposed to one sample 't' test in parametric statistics (as explained in *Chapter Five*). Table 6.10 presents the mean scores of the responses to the statements as compared with '3' (the midpoint of a 5 point scale) to examine whether the agreement or disagreement of the responses to the statements is statistically significant or not.

Table 6.10: Analysis Showing the Significance of Responses towards the Statements on Audit Committee Practices

Statements	AC Chairperson			Company Secretary			Finance Head			External Auditor		
	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value
A. Composition												
1. The AC members are appointed in consultation with the AC chairperson.	4.23	4.05	0.00*	3.68	3.33	0.00*	3.73	4.05	0.00*	3.14	0.94	0.35
2. The AC members have sufficient knowledge on the entity's business.	4.03	4.11	0.00*	4.11	4.92	0.00*	3.89	4.53	0.00*	2.90	0.65	0.51
3. The AC members have sufficient knowledge on Accounting and/or Auditing practices.	3.80	3.81	0.00*	3.62	3.67	0.00*	3.55	3.58	0.00*	2.72	1.41	0.16
4. The AC members have sufficient experience in Accounting and/or Auditing.	3.93	4.24	0.00*	3.35	2.29	0.02**	3.50	3.45	0.00*	2.69	1.66	0.10***
5. The AC members are capable of mediating problems in performing their duties.	3.90	3.98	0.00*	3.76	4.50	0.00*	3.66	4.34	0.00*	2.93	0.43	0.67
6. The majority of AC members are independent/non-executive directors.	1.90	3.19	0.00*	2.11	4.50	0.00*	2.05	4.59	0.00*	1.97	3.92	0.00*
7. The Chairperson of the AC is an independent/non-executive director.	2.50	1.98	0.05**	2.27	2.94	0.00*	2.17	3.70	0.00*	2.31	2.59	0.01*
8. The size of the AC is appropriate for carrying out its duties properly.	4.00	3.83	0.00*	4.22	5.08	0.00*	4.07	5.12	0.00*	3.79	3.85	0.00*
B. Authority and Resources												
9. The AC has adequate authority in order to carry out its responsibilities.	4.33	4.52	0.00*	4.30	5.00	0.00*	4.39	5.74	0.00*	3.83	3.55	0.00*
10. The AC has ready access to relevant information.	4.37	4.55	0.00*	4.41	5.13	0.00*	4.45	5.76	0.00*	3.90	3.70	0.00*
11. The AC receives prompt responses from the management in carrying out its duties.	4.30	4.37	0.00*	4.38	5.17	0.00*	4.45	5.76	0.00*	3.72	3.15	0.00*

Statements	AC Chairperson			Company Secretary			Finance Head			External Auditor		
	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value
12. The AC is provided with sufficient resources including secretarial support to carry out its duties.	4.20	4.33	0.00*	4.30	4.93	0.00*	4.23	5.25	0.00*	3.90	3.68	0.00*
13. The non-executive AC members are adequately paid for their time and efforts.	3.50	2.52	0.01*	3.49	2.43	0.02**	3.36	2.25	0.02**	3.21	1.22	0.22
C. Diligence												
14. The AC has a charter which outlines its objectives, duties and responsibilities.	3.87	3.48	0.00*	3.68	3.30	0.00*	3.39	2.43	0.02**	3.34	2.04	0.04**
15. The AC charter is reviewed annually.	3.47	2.15	0.03**	3.00	0.00	1.00	3.07	0.55	0.58	2.66	2.05	0.04**
16. The AC members have a clear understanding of their responsibilities.	4.23	4.41	0.00*	4.00	4.39	0.00*	3.89	4.75	0.00*	3.34	2.13	0.03**
17. Members of the AC readily assume their responsibilities.	4.07	3.97	0.00*	4.05	4.51	0.00*	3.84	4.45	0.00*	3.72	3.87	0.00*
18. The AC members devote sufficient time to the committee's affairs.	3.83	3.62	0.00*	3.68	4.04	0.00*	3.34	2.61	0.01*	2.93	0.37	0.71
D. Meeting												
19. The agendas of the AC meetings are finalized by the chairperson.	4.50	4.69	0.00*	4.14	4.59	0.00*	4.30	5.52	0.00*	3.79	3.65	0.00*
20. The chairperson cooperates with other committee members before finalizing the agenda of meetings.	4.10	4.44	0.00*	3.76	4.14	0.00*	3.55	3.87	0.00*	3.38	2.67	0.01*
21. The agenda and related materials are provided to members fairly ahead of the meetings.	4.63	4.96	0.00*	4.51	5.34	0.00*	4.36	5.76	0.00*	3.83	4.07	0.00*
22. All members can express their views freely and independently in the meetings.	4.80	5.11	0.00*	4.41	5.12	0.00*	4.39	5.68	0.00*	3.79	3.63	0.00*
23. The frequency of the AC meetings is sufficient to carry out its responsibilities.	4.40	4.77	0.00*	4.03	4.86	0.00*	4.07	5.20	0.00*	3.66	3.12	0.00*

Statements	AC Chairperson			Company Secretary			Finance Head			External Auditor		
	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value
24. The duration of the AC meetings is sufficient for a full discussion of important issues.	4.50	4.93	0.00*	4.05	4.89	0.00*	4.18	5.31	0.00*	3.72	3.35	0.00*
25. Non-members attend the AC meetings if required.	3.83	3.84	0.00*	3.81	3.42	0.00*	4.00	5.32	0.00*	3.52	2.88	0.00*
26. The minutes of the AC meetings are circulated to all members of the Board of Directors (BODs).	4.53	4.86	0.00*	4.11	4.42	0.00*	4.30	5.68	0.00*	3.62	3.08	0.00*
E. AC Role in Financial Reporting												
27. The AC reviews the integrity of companies' financial statements.	4.20	4.62	0.00*	4.00	4.99	0.00*	3.68	4.36	0.00*	3.24	1.81	0.07***
28. The AC reviews accounting policies and any changes made therein.	4.27	4.70	0.00*	3.92	4.83	0.00*	3.50	3.54	0.00*	3.21	1.50	0.13
29. The AC reviews accounting estimates and judgments done in preparing financial statements.	4.20	4.33	0.00*	3.78	4.34	0.00*	3.45	3.16	0.00*	3.21	1.41	0.16
30. The AC reviews the compliance of the Accounting Standards (e.g. IAS, BAS etc.) in preparing financial statements.	4.00	4.21	0.00*	3.59	3.62	0.00*	3.43	2.80	0.01*	3.00	0.00	1.00
31. The AC reviews the clarity and completeness of disclosures in financial statements.	4.40	4.85	0.00*	3.84	4.67	0.00*	3.66	3.89	0.00*	3.24	1.81	0.07***
32. The AC reviews other information (e.g. the auditors' report, financial highlights etc.) presented in the annual report.	4.47	4.77	0.00*	4.14	4.83	0.00*	3.91	4.61	0.00*	3.48	2.86	0.00*
F. Role in External Auditing												
33. External auditors are appointed and/or removed upon the recommendation of the AC.	3.53	3.01	0.00*	3.35	1.92	0.05**	3.02	0.04	0.97	3.00	0.00	1.00
34. The AC assesses and reviews the expertise and resources of the external auditors.	3.43	2.50	0.01*	3.24	1.60	0.11	3.00	0.10	0.92	3.14	1.00	0.32

Statements	AC Chairperson			Company Secretary			Finance Head			External Auditor		
	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value
35. The AC reviews and approves the terms of the Engagement Letter (EL) prepared for the external auditors.	3.37	2.30	0.02**	3.03	0.20	0.84	2.89	0.84	0.40	2.90	0.77	0.44
36. The AC monitors the external audit firm's compliance with the existing ethical and regulatory requirements in Bangladesh.	3.83	3.84	0.00*	3.35	2.38	0.02**	3.27	1.99	0.05**	3.00	0.00	1.00
37. The AC reviews the findings of the annual audit obtained by the external auditors.	4.27	4.66	0.00*	3.81	4.12	0.00*	3.75	4.74	0.00*	3.59	3.54	0.00*
38. The AC reviews the management's responsiveness to the external auditors' findings.	4.07	4.21	0.00*	3.62	3.42	0.00*	3.52	3.82	0.00*	3.34	2.36	0.02**
39. The AC meets with the external auditors without the presence of management to discuss any issues, problems or reservations arising from the audit.	3.87	3.85	0.00*	3.32	2.10	0.04**	3.11	1.01	0.31	3.00	0.00	1.00
40. The AC reviews and monitors the independence and effectiveness of the external auditing process.	4.17	4.18	0.00*	3.70	3.74	0.00*	3.34	2.51	0.01*	3.17	1.15	0.25
G. Role in Internal Auditing												
41. The AC recommends and approves the appointment or termination of the heads of the internal audit division.	3.73	3.62	0.00*	3.43	2.50	0.01*	3.20	1.26	0.21	3.10	0.73	0.47
42. The AC approves and reviews the charter of the internal auditors.	3.83	3.41	0.00*	3.41	2.23	0.03**	3.32	2.11	0.03**	3.14	1.00	0.32
43. The AC assesses and reviews the annual internal audit work plan.	4.07	4.21	0.00*	3.57	2.92	0.00*	3.57	3.37	0.00*	3.45	2.38	0.02**
44. The AC reviews the annual internal audit reports, budget and other findings.	4.27	4.57	0.00*	3.84	3.73	0.00*	3.73	4.43	0.00*	3.62	2.92	0.00*

Statements	AC Chairperson			Company Secretary			Finance Head			External Auditor		
	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value	Mean	z value	P value
45. The AC reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.	4.40	4.54	0.00*	4.00	4.06	0.00*	3.77	4.29	0.00*	3.66	3.27	0.00*
46. The AC meets with the head of the internal audit function without the presence of the management.	4.23	4.29	0.00*	3.49	2.58	0.01*	3.36	2.37	0.02**	3.31	2.06	0.04**
47. The AC enhances the independence of the internal auditors of the company.	4.43	4.37	0.00*	3.78	3.50	0.00*	3.75	4.55	0.00*	3.59	3.04	0.00*
48. The AC monitors and evaluates the effectiveness of the internal audit function.	4.47	4.67	0.00*	4.08	4.55	0.00*	3.95	4.58	0.00*	3.79	3.41	0.00*
H. Overall Practice												
49. The AC can work independently.	4.43	4.56	0.00*	4.27	4.88	0.00*	4.25	5.63	0.00*	3.86	3.84	0.00*
50. The AC is effective.	4.07	4.12	0.00*	4.08	4.77	0.00*	3.68	4.99	0.00*	3.17	1.11	0.27

* Significant at 1% level

**Significant at 5% level

***Significant at 10% level

It can be seen in Table 6.10 that out of the eight statements on AC composition, six statements have been significantly agreed by the first three groups of respondents. On the other hand, the external auditors agreed (as it was found statistically significant) with only one statement (i.e. that the AC size is appropriate). It is notable that the size of ACs in Bangladesh has been regarded as appropriate for them to carry out their responsibilities. This result is consistent with the studies of Pincus et al. (1989) and Pucheta-Martinez and Fuentes (2007) who emphasised on the importance of appropriate AC size. Unlike other three sample groups, the external auditors neither significantly disagreed nor significantly agreed at the 5% level of significance regarding the first five statements on AC composition. However, all four sample groups significantly disagreed with two particular statements, which are: firstly, that the majority of members of the ACs are independent directors; and secondly, that the chairperson of AC is appointed from independent directors. This finding is inconsistent with Davidson and Ebersole (2000) who noted that there is strong relationship between AC independence and AC effectiveness. Verschoor (1993) also pointed out that AC independent is widely recognised as an important characteristic of an effective AC.

Regarding the statements on authority and resources provided to the ACs, the first four statements were agreed at a 1% level of significance by all four sample groups. This result is consistent with the recommendation of Bull and Sharp (1989) and Rittenberg and Nair (1994) who recommended the importance of management's support and open lines of communication with the AC members. However, in relation to the last statement of this group (i.e. whether the independent members receive enough remuneration or benefits for their time) the external auditors' agreement was insignificant, while the agreement with the statement by other three sample groups was found statistically significant at a 5% level of significance.

Regarding the statements on diligence of the ACs, the first statement (i.e. that the AC has a charter for its duties) was significantly agreed with by the AC chairpersons and company secretaries at a 1% level of significance, and by the finance heads and external auditors at a 5% level. Extremely mixed responses were observed in the case of the

second statement in this group (i.e. that the AC charter is reviewed annually). While the AC chairpersons significantly agreed with this statement, the company secretaries and the finance heads neither agreed nor disagreed significantly at a 5% level of significance. On the other hand, the external auditors significantly disagreed with this statement. With the exception of the statement regarding the annual review of the AC charter, all of the other statements relating to AC diligence were agreed with by the three groups of respondents (namely, AC chairpersons, company secretaries and finance heads). The significance was high at a level of 0.01 in the case of the external auditors' responses in relation to the statement that the AC members readily assume their responsibilities, whereas agreement to the statements on availability of AC charters and AC members' understanding of their responsibilities was found to be significant at a 5% level. The external auditors disagreed that the AC members devote sufficient time to the committee's affairs, but their disagreements were found to be statistically insignificant at a 5% level of significance.

As discussed earlier (see Tables 6.6 and 6.7), a better picture of AC practices was observed in the case of the statements relating to AC meeting. All of the statements on AC meeting were significantly agreed with at a 1% level, and this finding is consistent with the recommendations and results of Raghunandan et al. (1998); the BRC (1999); Gendron and Bedard (2006); Beasley et al. (2009) who emphasised the importance of various issues of effective AC meetings. Therefore, the responses reflect that there is no major lack of the ACs in Bangladesh of relation to AC meeting.

In relation to the statements on AC's role in financial reporting, three groups of respondents (i.e. AC chairpersons, company secretaries and finance heads) significantly agreed with all six statements. This is reflected in the view of these three sample groups, that the ACs in Bangladesh are performing satisfactory role in relation to the company's financial reporting. Different views are observed in the case of the external auditors. The external auditors significantly agreed with only the last statement of this group (i.e. that the ACs review information included in the annual report) while their agreements with the other five statements were statistically insignificant at a 5% level. Therefore, it

is clear that the external auditors differ from the other three groups of respondents in relation to most of the statements on AC's role in financial reporting.

There were eight statements related to AC's role in external auditing and the significance test produced mixed results. The AC chairpersons significantly agreed with all eight statements while the external auditors significantly agreed with only two of these statements, namely: that the ACs review the findings of the external auditors, and that the ACs review the management responsiveness to the external auditors' findings. The test reveals the agreement/disagreement of the external auditors in relation to the other six statements to be statistically insignificant (at a 5% significance level). The role of the ACs in reviewing the expertise of the external auditors and reviewing the terms of EL prepared for the external auditors, was neither significantly agreed to nor significantly disagreed with by the three groups of respondents (i.e. company secretaries, finance heads and external auditors). Furthermore, the agreement of the AC chairpersons and the company secretaries with the first statement (i.e. that the external auditors are appointed and/or removed upon the recommendation of the ACs) and the seventh statement (i.e. that the ACs meet with the external auditors without the presence of management) was found to be statistically significant. However, the agreement with these two statements by the other two groups of respondents (i.e. the finance heads and the external auditors) was found to be statistically insignificant. In relation to the statement that the AC reviews and approves the EL prepared for the external auditors, the AC chairpersons significantly agreed but the agreement/disagreement of the other three sample groups was found to be statistically insignificant. Therefore, the results indicate that there are some differences in opinion within the four respondent groups, and in attempting to examine whether these differences are statistically significant, some other statistical techniques (e.g. Kruskal Wallis Test and Mann Whitney U Test) have been applied (as will be detailed in the next section).

Concerning the statements relating to AC's involvement in internal auditing, agreement with all the eight statements by both the AC chairpersons and the company secretaries was found to be statistically significant at a 5% level of significance. Again, the finance

heads agreed with all of the statements (the mean scores are more than 3 in all cases) but agreement with the first statement (i.e. that the ACs recommend and approve the appointment or termination of the head of the internal audit division) was found to be statistically insignificant. Similarly, the external auditors neither significantly agreed nor significantly disagreed with the first statement (i.e. that the ACs recommend and approve the appointment or termination of the head of the internal audit division) and the second statements (i.e. that the ACs approve and review the charter of internal auditors). The rest of the statements were significantly agreed (at a 5% level) by all four groups of respondents. The overall results of the significance test reflect the view that the ACs in Bangladesh do play an important role in internal auditing, which is consistent with the AC duties that were suggested by Wolnizer (1995), Woodlock and Claypool (2001), and Porter and Gendral (1998).

In relation to the last two statements concerning the overall AC practices in Bangladesh, all four sample groups significantly agreed that the ACs can work independently. This result is consistent with the studies of McHugh and Raghunandan (1994), Yeo (2001); Scarborough et al. (1998) and Christopher et al., (2009) who noted the importance of AC independence for its effectiveness. A great deal of studies (for example, Campbell, 1990; Vicknair et al., 1993; Chen and Zhou, 2007; Chan and Li, 2008) noted the importance of an effective AC for sound governance of the company. Hence, the last statement was about the overall effectiveness of the ACs in Bangladesh, and the agreement with this statement was found statistically to be significant in the case of three of the samples (namely, the AC chairpersons, company secretaries and finance heads) although the external auditors' agreement on this statement was statistically insignificant at a 5% level of significance.

Table 6.10 indicates that most of the statements were agreed with by the four sample groups, which were also found statistically significant using the Wilcoxon Signed Rank Test. However, it is clear that the significance of agreement in the case of the external auditor groups is much lower than that of the rest three groups. This implies that there are some differences in the responses of the four sample groups. In attempting to

examine whether there is any significant difference in terms of the mean scores of the responses in the four sample groups regarding the different aspects of the ACs, the next section presents and discusses the Kruskal Wallis Test results.

6.4.2 Analysis of Hypothesis Testing Results

It was highlighted in *Chapter Five* that the main objective of hypothesis testing in this study is to examine whether there is significant difference in responses of sample groups. It also discussed that the first eight (hypotheses 1 to 8) hypotheses were developed on eight broad aspects of ACs with a view to compare the mean scores of responses obtained from the four sample groups. Furthermore, three more hypotheses were developed to compare the mean scores of response obtained from two respondent groups divided according to:

- (i) The academic discipline;
- (ii) The professional qualification; and,
- (iii) The length of work experience.

The test results will also assist in concluding whether different groups of respondents and the samples have been chosen from the same or identical population. The test results of these hypotheses have been presented in Tables 6.11; 6.12; 6.13 and 6.14.

Table 6.11: Analysis Showing the Test Results of Hypotheses 1 to 8

Hypothesis	AC Aspect	1. AC Chairperson		2. Company Secretary		3. Finance Head		4. External Auditor		Kruskal Wallis (H)Test		Kruskal Wallis Pair-Wise Comparison		
		Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.	Value	Sig	Group	Value	Sig.
Hypothesis 1	Composition	3.543	0.914	3.393	0.837	3.319	0.904	2.814	0.950	5.205	0.157	-	-	-
Hypothesis 2	Authority and Resources	4.140	0.876	4.173	0.854	4.177	0.771	3.710	0.956	5.458	0.141	-	-	-
Hypothesis 3	Diligence	3.893	0.966	3.681	0.919	3.504	0.914	3.200	0.838	7.011	0.072***	-	-	-
Hypothesis 4	Meeting	4.412	0.631	4.101	0.819	4.142	0.723	3.664	0.837	17.669	0.001*	1 & 2	3.579	.059***
												1 & 3	5.465	.065***
												1 & 4	17.663	.001*
												2 & 3	0.177	.674
												2 & 4	10.990	.004*
												3 & 4	7.478	.006*
Hypothesis 5	Role in Financial Reporting	4.256	0.688	3.878	0.729	3.606	0.864	3.230	0.751	19.686	0.000*	1 & 2	7.030	.008*
												1 & 3	12.678	.002*
												1 & 4	19.686	.000*
												2 & 3	4.333	.037**
												2 & 4	12.458	.002*
												3 & 4	6.610	.010*
Hypothesis 6	Role in External Auditing	3.817	0.831	3.429	0.904	3.239	0.857	3.142	0.754	15.461	0.001*	1 & 2	5.843	.016*
												1 & 3	10.660	.005*
												1 & 4	15.461	.001*
												2 & 3	2.165	.141
												2 & 4	5.336	.069***
												3 & 4	0.339	.561

Hypothesis	AC Aspect	1. AC Chairperson		2. Company Secretary		3. Finance Head		4. External Auditor		Kruskal Wallis (H)Test		Kruskal Wallis Pair-Wise Comparison		
		Mean	S.D.	Mean	S.D.	Mean	S.D.	Mean	S.D.	Value	Sig	Group	Value	Sig.
Hypothesis 7	Role in Internal Auditing	4.179	0.851	3.699	1.020	3.582	0.899	3.457	0.854	14.972	0.002*	1 & 2	6.353	.012*
												1 & 3	10.860	.004*
												1 & 4	14.972	.002*
												2 & 3	1.103	.294
												2 & 4	2.535	.282
												3 & 4	.893	.345
Hypothesis 8	Overall Independence and Effectiveness	4.250	0.843	4.176	0.799	3.966	0.626	3.517	0.841	3.667	0.300	-	-	-

*Significant at 1% level.

**Significant at 5% level.

*** Significant at 10% level.

Hypothesis 1[Ho (1)]: Differences observed in the mean scales of the four sample groups (AC Chairperson, Company Secretary, Finance Head and External Auditor) with respect to composition of the ACs are statistically insignificant.

Table 6.11 indicates that, at a 5% significance level, no significant difference was found in the opinions of the four sample groups on AC composition in Bangladesh ($p > .05$). The associated p-value of the Kruskal Wallis Test (i.e. 0.157) shows that it is very likely to find such a value if a null hypothesis is true and, hence, the null hypothesis is accepted at a 5% significance level. Therefore, the test results suggest that no significant difference exists in the responses of the four different groups of respondents and, therefore, it can be inferred that the samples for the study have been taken from an identical population. This also reflects the fact that similar views on AC composition have been obtained from all samples which is an indication of robustness of the findings.

Hypothesis 2[Ho (2)]: Differences observed in the mean scales of responses within four sample groups with respect to authority and resources provided to the ACs are statistically insignificant.

It can be seen that, at a 5% level, there is no significant difference in the views of the four responding groups in respect of authority and resources provided with the ACs in Bangladesh ($p > .05$). The associated p-value of the Kruskal Wallis Test (i.e. 0.141) indicates that the null hypothesis is likely to be true and it is accepted at a 5% significance level. Therefore, it can be inferred from the test results that the differences observed in the response of the four responding groups are not statistically significant.

Hypothesis 3[Ho (3)]: Differences observed in the mean scales of responses within the four sample groups with respect to diligence of the ACs are statistically insignificant.

Table 6.11 shows that at a 5% level, there is no significant difference in the responses of the four sample groups in relation to diligence of ACs in Bangladesh ($p > .05$). The

associated p-value of the Kruskal Wallis Test (i.e. 0.072) suggests the null hypothesis to be accepted at a 5% significance level, which means there is no significant difference in the response of the four responding groups.

Hypothesis 4[Ho (4)]: Differences observed in the mean scales of responses within the four sample groups with respect to the effectiveness of AC meetings are statistically insignificant.

It is interesting to note that, at a 5% level there is a significant difference in the opinions of the four sample groups regarding AC meeting in Bangladesh ($p < .05$), although all the statements in this group were significantly agreed with by all four sample groups (see Table 6.10). The associated p-value of the Kruskal Wallis Test (i.e. 0.001) signals that it is very unlikely to find such a value if the null hypothesis is true. Therefore, the null hypothesis is rejected at a 5% significance level. The reason that the Kruskal Wallis Test found a significant difference might be because the level of agreement measured by the mean score differs significantly between the groups. In order to identify exactly which sample group(s) differ(s) with which, further investigation has been undertaken using the Kruskal Wallis pair-wise comparison. The results show that the external auditor group differs with the other three sample groups ($p = .001$, $p = .004$ and $p = .006$ respectively) regarding the statements on AC meeting. The test results indicate that there is no significant difference in the opinions of the other three sample groups ($p > .05$).

Hypothesis 5[Ho (5)]: Differences observed in the mean scales of responses within the four sample groups with respect to role of the ACs in financial reporting are statistically insignificant.

Table 6.11 also presents that, at a 5% level, there is significant difference in the responses of the four sample groups on AC's role in financial reporting ($p < .05$). The associated p-value of the Kruskal Wallis Test ($p = .000$) indicates that it is almost unlikely to find such a value if null hypothesis is true and, therefore, the null hypothesis is

rejected at a 5% significance level. A further investigation reveals that all four groups significantly differ with each other regarding their opinions on AC's role in financial reporting ($p=.008$; $p=.002$; $p=.000$; $p=.037$; $p=.002$ and $p=.010$ respectively). These results indicate that all four groups expressed different opinions in respect of AC's role in financial reporting. This might happen because some of the statements dealt with technical issues (such as: accounting estimates, accounting policies, accounting standards, disclosure etc.) and different sample groups (who also differed in terms of background) viewed differently on the statements.

Hypothesis 6[Ho (6)]: Differences observed in the mean scales of responses within the four sample groups in respect of AC's role with respect to internal auditing are statistically insignificant.

Table 6.11 indicates that, at a 5% level, there is significant difference in the responses of the four sample groups in relation to AC's role in external auditing ($p<.05$). The associated p-value of the Kruskal Wallis Test (i.e. 0.001) shows that it is very unlikely to find such a value if null hypothesis is true and, therefore, the null hypothesis is rejected. Further investigation using the pair-wise comparison reveals that AC chairpersons significantly differ with other three samples ($p= .016$; $p=.005$ and $.001$ respectively). However, the results suggest that there is no significant difference in opinion of the rest three groups ($p> .05$). Therefore, the pair-wise comparison results suggest that these three groups (with the exception AC chairpersons) belong to the same population.

Hypothesis 7[Ho (7)]: Differences observed in the mean scales of responses within the four sample groups in respect of AC's role with respect to external auditing are statistically insignificant.

Table 6.11 also suggests that, at a 5% level, there is significant difference in the opinions of the four respondent groups on AC's role in external auditing ($p<.05$). The associated p-value of the Kruskal Wallis Test (i.e. 0.002) indicates that it is very unlikely to find such a value if null hypothesis is true and, therefore, the null hypothesis

is rejected at a 5% significance level. A further investigation using Kruskal Wallis pairwise comparison reveals that the AC chairperson group differs with other three respondent groups ($p = .012$, $p = .004$ and $p = .002$ respectively) in relation to AC' role in internal auditing. The test results suggest that there is no significant difference in opinions of these three groups ($p > .05$).

Hypothesis 8 [Ho (8)]: Differences observed in the mean scales of responses within the four sample groups with respect to overall perception on independence and effectiveness of the ACs are statistically insignificant.

Table 6.11 further indicates that, at a 5% level, there is no significant difference in the responses of the four sample groups on the overall independence and effectiveness of ACs in Bangladesh ($p > .05$). The associated p-value of Kruskal Wallis Test (i.e. 0.030) indicates that the null hypothesis seems to be true and, therefore, the null hypothesis is accepted at a 5% significance level; which implies that no significant difference has been found in the responses of the four sample groups.

Hypothesis 9 [Ho (9)]: Difference observed in the mean scales of responses between the respondents having accounting subject and respondents having other subjects in last education is statistically insignificant.

Table 6.12 indicates that, at a 5% significance level, there is a significant difference in the opinions of two responding groups ($p < .05$). The associated p-value of the Kruskal Wallis Test (i.e. 0.002) shows that it is very unlikely to find such a value if the null hypothesis is true and, therefore, the null hypothesis is rejected at a 5% significance level. It can be inferred that the views of respondents having accounting background in education are significantly different from the views of respondents not having accounting background. This might happen because the respondents having accounting background are more familiar with the issues covered in the questionnaire and, therefore, their responses were different from the respondents without any accounting background.

Table 6.12: Analysis Showing the Test Results of Hypothesis 9

Description	Respondents Having Accounting Background			Respondents Having Non-Accounting Background			Mann Whitney U Test	
	Frequency	Mean	S.D.	Frequency	Mean	S.D.	Value	Sig
AC Practices in Bangladesh (Responses on the 50 Statements)	66	3.56	0.56	74	3.83	0.50	-3.087	0.002*

*Significant at 1% level.

Table 6.13: Analysis Showing the Test Results of Hypothesis 10

Description	Respondents Having Professional Qualification			Respondents Not Having Any Professional Qualification			Mann Whitney U Test	
	Frequency	Mean	S.D.	Frequency	Mean	S.D.	Value	Sig
AC Practices in Bangladesh (Responses on the 50 Statements)	89	3.59	0.52	51	3.90	0.53	-3.413	0.001*

*Significant at 1% level.

Table 6.14: Analysis Showing the Test Results of Hypothesis 11

Description	Respondents Having Experience of 10 or more Years in Relevant Area			Respondents Having Experience of less than 10 Years in Relevant Area			Mann Whitney U Test	
	Frequency	Mean	S.D.	Frequency	Mean	S.D.	Value	Sig
AC Practices in Bangladesh (Responses on the 50 Statements)	73	3.76	0.53	67	3.64	0.56	-1.068	0.286

Hypothesis 10[Ho (10)]: Difference observed in the mean scales of responses between the respondents having professional qualification and respondents without professional qualification is statistically insignificant.

Table 6.13 indicates that, at a 5% significance level, there is a significant difference in the responses of two sample groups on the AC practices in Bangladesh ($p < .05$). The associated p-value of the Kruskal Wallis Test (i.e. 0.001) indicates that it is very unlikely to find such a value if null hypothesis is true and, therefore, the null hypothesis is rejected at 5% significance level. The test results suggest that there is significant difference between the responses of the participants having professional qualification(s) and not having any qualification. The difference may occur because the respondents with related professional qualification are more knowledgeable on the issues and, therefore, they expressed views which were significantly different from the views of the respondents without any such qualification.

Hypothesis 11[Ho 11)]: Difference observed in the mean scales of responses between the respondents having 10 and more years experience and respondents having below 10 years experience in related field is statistically insignificant.

Table 6.14 shows that, at a 5% level of significance, there is no significant difference in the response of two sample groups in relation to the AC practices in Bangladesh ($p > .05$). The associated p-value of the Kruskal Wallis Test (i.e. 0.286) shows that it is very unlikely to find such a value if null hypothesis is false and, therefore, the null hypothesis is accepted at a 5% significance level. Therefore, no statistical significant difference was found in responses of more experienced (10 years and more) and less experienced (below 10 years) respondents. This implies that length of experience does not cause the respondents to respond differently to the issues on AC practices in Bangladesh.

6.4.3 Analysis of Regression Statistics

The following subsections present two multiple regression models for investigating AC effectiveness in Bangladesh using the questionnaire survey data.

6.4.3.1 Regression Model for AC Role

Table 6.15 shows that the constant (intercept) and the slope of AC composition (X1) are 2.325 (on a 5-point scale) and 0.550 respectively and these are statistically significant ($p < .05$). Therefore, the regression model is:

$$Y = 2.325 + 0.550X_1 \text{ (where, } Y = \text{AC Role, } X_1 = \text{AC Composition).}$$

Table 6.15: Summary of Regression Model for AC Role

Model Summary	Constant	Slope- X1	R	R Square
	2.325	.550	.911	.784
ANOVA Summary	F-Ratio	df1	df2	Significance
	205.479	4	15	.000*
Coefficient Summary	Variable	B	t-value	Significance
	Constant	2.325	5.101	.000*
	X1	.550	5.214	.000*
	X2	-.227	-1.231	.210
	X3	.246	1.187	.254
	X4	.128	.512	.616

*Significance at 5% level.

The model explains that the composition of the AC has a significant positive impact on performing the AC role successfully and 55% of the score in AC composition is added with the constant in evaluating the role of an AC. This finding is consistent with the studies undertaken by Scarborough et al. (1998) and Raghunandan et al. (2001) who highlighted the significance of AC composition. The other variables (namely, authority and resources (X2), diligence (X3) and meeting (X4)) do not have a significant impact on the performance of AC role ($p > .05$), although two of these have strong positive correlations with AC role (see Table 6.16). This happens because a regression model explains the combined effect of the independent variables whereas a correlation explains the association of only two variables. It is important to note that R (.911) in

Table 6.15 is much higher than any bi-variant correlation with AC role as presented in Table 6.16. This reflects that the regression model is a significant improvement over the correlation results in explaining the impact of AC input variables on performing its role properly. It is interesting to note that authority and resource (X2) has a negative impact (although statistically insignificant i.e. $p > .5$) on performing AC role successfully. This is not consistent with previous AC literature and guidelines as discussed in *Chapter Four* (for example, the Treadway Report, 1987; Arthur Anderson, 1994; Sarbanes-Oxley Act, 2002; Combined Code, 2003; and PricewaterhouseCoopers, 2005). This might perhaps be happening because in Bangladesh, the ACs are composed of mainly executive directors who are very powerful in the company. Therefore, they do not suffer from a lack of authority or resources. The negative correlation between AC composition, and authority and resources (see Table 6.16) also supports this argument.

Table 6.16: Analysis of the Correlations between AC Characteristics and AC Role

Description	Composition	Authority and Resources	Diligence	Meeting	Role
Composition	-	r= -.150	r= .557*	r= .571*	r= .661*
Authorities & Resources	r= -.150	-	r= .309	r= .347	r= -.148
Diligence	r= .557*	r= .309	-	r= .898*	r= .542*
Meeting	r= .571*	r= .347	r= .898*	-	r= .580*
Roles	r= .661*	r= -.148	r= .542*	r= .580*	-

*Significance at 5% level.

6.4.3.2 Regression Model for AC Effectiveness

Table 6.17 indicates that the constant (intercept) and the slope of AC role in financial reporting (X1) are 2.153 (on a 5-point scale) and 0.491 respectively, and these are statistically significant ($p < .05$). Therefore, the regression model is:

$$Y = 2.153 + 0.491X_1 \text{ (where, } Y = \text{AC Effectiveness, } X_1 = \text{AC Role in Financial Reporting).}$$

Table 6.17: Summary of the Regression Model for AC Effectiveness

Model Summary	Constant	Slope- X1	R	R Square
	2.153	.491	.879	.773
ANOVA Summary	F-Ratio	df1	Df2	Significance
	7.538	3	4	.049*
Coefficient Summary	Variable	B	t-value	Significance
	Constant	2.153	2.784	.0048*
	X1	.491	2.856	.046*
	X2	.284	1.381	.232
	X3	.221	1.205	.247

*Significance at 5% level.

The model describes that the AC role in financial reporting has a significant positive impact on AC effectiveness and this is consistent with the remarks of many researchers (for example, Turley and Zaman, 2007; Cohen et al, 2007a; Laux and Laux, 2009; Bedard and Gendron, 2010) who have noted the importance of AC role in financial reporting. As in the previous model, two independent variables (namely, AC role in external auditing (X2) and AC role in internal auditing (X3)) have an insignificant impact on AC effectiveness ($p > .05$); although they are strongly correlated (see Table 6.18). It is important to note that R (.879) is much higher than any bi-variant correlation with AC effectiveness, as presented in Table 6.18. This reflects that the model is a significant improvement in explaining the impact of various AC roles on AC effectiveness.

Table 6.18: Analysis of the Correlations between AC Roles and AC Effectiveness

Description	Role in Financial Reporting	Role in External Auditing	Role in Internal Auditing	Effectiveness
Role in Financial Reporting	-	$r = .684^*$	$r = .601^*$	$r = .771^*$
Role in External Auditing	$r = .684^*$	-	$r = .769^*$	$r = .520$
Role in Internal Auditing	$r = .601^*$	$r = .769^*$	-	$r = .552$
Effectiveness	$r = .771^*$	$r = .520$	$r = .552$	-

*Significance at 5% level.

6.4.3.3 Investigating Multicollinearity in Regression Models

Since most of the independent variables of both regression models are strongly

correlated (see Table 6.16 and Table 6.18), the Variance Inflation Factors (VIFs) statistics (as explained in *Chapter Five*) have been used in order to investigate the multicollinearity problem of the regression models. The results (VIFs<8) indicate that the models are reasonably free from any extreme multicollinearity problem.

6.5 Conclusion

Several observations can be made from the results presented in this chapter. Firstly, it reflects the fact that the AC chairpersons in Bangladesh are appointed from executive directors of the company and the majority members of the AC are also executive directors of the company. These two factors relating to independent directors in the AC were also viewed as the two key factors that affect AC effectiveness in Bangladesh. Secondly, it appears that the AC members in Bangladesh do not have sufficient qualification and experience. Thirdly, the agreement level (mean score) towards the statements in the questionnaire viewed by the AC chairpersons is higher in comparison with that of the other three samples, whereas the lowest level of agreement is observed in the case of the responses obtained from the external auditors.

The results of hypothesis testing suggest that there is no significant difference in opinions of the four groups in relation to four aspects of AC practices (such as: composition, authority and resources, diligence, and overall independence and effectiveness). The opinions of the company secretaries and finance heads are very similar. However, the external auditors differ with the other three sample groups on one aspect i.e. AC meeting and the AC chairpersons differ with the other three sample groups on two AC aspects i.e. AC's roles in internal auditing and external auditing. The responses received from the respondents with an accounting background have been found to be significantly different from the responses obtained from those with a non-accountancy background. Similarly, the respondents who have professional qualification(s) differ in views with the respondents who do not have any professional qualification. However, no such significant difference is observed in the opinions of the two groups of respondents divided by years of experience. Furthermore, the regression

analysis results indicate that successful performance of an AC largely depends on its composition and that AC effectiveness is highly dependent on its role in financial reporting.

This chapter has discussed the results obtained from the questionnaire survey of the study. The next chapter discusses the findings of interview survey.

CHAPTER SEVEN: ANALYSIS AND DISCUSSION OF THE INTERVIEW SURVEY FINDINGS

7.1 Introduction

The aim of this chapter is to analyse and discuss the findings of interview survey which was undertaken during the second phase of the data collection for the current study. As discussed in *Chapter Six*, the responses of questionnaire survey describe various aspects of the Audit Committee (AC) practices prevailing in Bangladesh. In fact, the outline of the interview checklist (appendix 5) broadly covers the same issues as are covered in the survey questionnaire (appendix 3). Therefore, the structure of this chapter is similar to that of the previous chapter. Section 7.2 discusses the interview results in relation to a number of different aspects of the ACs in Bangladesh, namely: the attributes of the ACs; the different roles being played by the ACs; the scenario of the overall effectiveness of the ACs in Bangladesh; the factors that affect the AC effectiveness; and finally, some suggestions on how AC effectiveness can be improved are discussed. A summary of the interview findings are presented at the end of this section. Finally, Section 7.3 concludes the chapter.

7.2 Interview Findings

At the outset of the interview, the interviewees were asked to express their views on the importance of establishing an AC as a Corporate Governance (CG) mechanism in the company. As outlined in the interview checklist, the interviewees were gradually asked to talk on different aspects of ACs, namely:

- (i) The various attributes of the ACs, including composition, size, authorities, diligence, and meetings;
- (ii) The role and function of the ACs;
- (iii) The overall effectiveness of the ACs in Bangladesh;
- (iv) The major factors that have an impact on AC practices; and,
- (v) Some possible ways of improving the effectiveness of ACs.

The findings obtained from the interview responses are discussed in the following sub-sections.

7.2.1 Importance of Audit Committees

A great deal of the literature discussing the significance of ACs was discussed in *Chapter Four* of this thesis. It was highlighted that the role played by independent directors on the board continues to be a prominent feature of CG. In recent years, increasing attention has been paid to ACs, both by regulatory authorities and by academics. Given that the financial reporting oversight role is often delegated to ACs, Beasley (1996) noted that: “*the audit committee is associated with a reduced likelihood of financial statement fraud*”. An AC is commonly believed to be an effective mechanism to ensure transparency and accountability in corporate affairs, where the owners appoint professional management to undertake some responsibilities of the business in the best interests of all stakeholders. The AC plays an important role in bridging the gap between the owners and management (commonly known as the ‘agency gap’). In other words, an effective AC minimizes the agency problem by reducing information asymmetry between the owners and management, and also acts as a safeguard for the stakeholders’ interests. All of the interview respondents agreed that the AC is a very important and effective CG mechanism for any company.

The interviewees noted that the importance of ACs is vital in: monitoring the integrity of financial statements, preventing fraudulent activities, ensuring adequate disclosures, strengthening the internal audit, and appointing external auditors. These findings are consistent with those of Lambe (2005) who highlighted the role of ACs in all of these areas. However, a vast majority (90%) of respondents suggested that the role of an AC is more visible and important in financial reporting, particularly in reducing the likelihood of overstating the earnings and ensuring adequate disclosure. Respondents further highlighted the fact that a positive relationship exists between the establishment of an AC and the quality of financial reporting, as well as the quality of earnings as shown in the annual or interim reports. These findings are supported by the results of

prior research studies. For example, Defend and Jiambalvo (1991) found that companies overstating their earnings were less likely to have ACs in practice; McMullen (1996) found a positive association between the existence of ACs and the quality of financial reporting and full disclosure; and, Wild (1996) found a positive association between AC formation and the quality of the accounting earnings.

Highlighting the importance of ACs in Bangladesh, the company secretary of a large private bank noted:

The audit committee is an important operating organ of the board of directors of publicly-traded companies. It bridges the gap between the management and the owners by undertaking some oversight responsibilities on the stakeholders' behalf. Audit committees have certainly enlightened our board of directors, mainly on financial and accounting matters.

This implies that the ultimate beneficiaries of ACs are the stakeholders of the companies, and the most visible role of an AC is seen to be that of financial reporting. Illustrating this further, the AC chairperson of a medium sized textile company remarked that:

Our audit committee ensures that the management and the board of directors behave better and make the external auditors more serious when they audit companies. I believe that if an audit committee is effectively functioning, internal problems can be identified early before the publishing of financial reports. The existence of the audit committee is also important for enhancing the independence of external and internal auditors, and improving the performance of the board of directors.

Furthermore, the company secretary of a large real estate company remarked that:

Establishing an audit committee makes the process of nominating the external auditors fair. Also, the comments of external auditors are carefully reviewed by the audit committee. The capability of management has increased since they are now accountable. Finally, the audit committee gives confidence to the stakeholders on the governance of the company as a whole.

It can be noted from the views above that the ACs do play a multiple role for the companies and that the necessity of the ACs in enhancing the quality of financial reporting, external auditing, internal auditing and the overall governance of the company has been widely acknowledged by the respondents.

Furthermore, the AC chairperson of a small sized cement company reported that:

An effective audit committee can improve the quality of financial reporting by reviewing the financial statements on behalf of the board which subsequently increases public confidence in the credibility and objectivity of the financial statements.

This remark is consistent with the results of Osman and Noguier (2007); Sori et al., (2007); FRC (2008); Chen et al. (2008); and Sarens et al. (2009) who observed that ACs have a significant role in financial reporting. A similar opinion was given by the company secretary of a medium sized pharmaceutical company:

An audit committee is an effective control mechanism and plays a very vital role in improving the governance system in the company by bringing out better internal control systems, better monitoring and oversight, and better disclosures and quality of internal and external reporting.

This indicates that the establishment of AC enhances the stakeholders' confidence in the company's governance mechanism through its rigorous oversight role in internal control and financial reporting. This view is consistent with the studies of DeZoort et al. (2002); Hemraj (2003); Abbott et al. (2004); and Pergola (2005) who highlighted the necessity of the AC in carrying out different oversight responsibilities for the company. Similarly, an external auditor (partner of a Non-Big 4 audit firm) highlighting the benefits of ACs remarked:

The extent to which the quality of financial reporting can be directly attributable to the audit committee is debatable. However, it can undoubtedly be said that if there is an effective audit committee, financial reporting irregularities are at least disclosed within the financial statements and, stakeholders are informed of these irregularities.

This remark indicates the significance of ACs in detecting and preventing irregularities in financial reporting, which ultimately leads to enhancing the quality of the financial reports of the company. Although most of the interviewees viewed the necessity of ACs as an effective mechanism in protecting stakeholders' interests, the finance head of a state-owned company remarked that:

The audit committee sometimes unnecessarily interferes in management activities. In particular, external members come only to attend meetings and they criticise management decisions without properly understanding the whole thing. This causes misunderstanding between the management and the board.

This view is consistent with the studies of Pomeranz (1997); Barker (2002); and Rainsbury et al. (2008) who criticised the non-performing AC for their wastage of time and resources without making any significant contributions. Furthermore, one external auditor remarked that:

The audit committees have not done anything visible except nominating external auditors. The audit committees play advisory role only, their reports include some recommendations. The final decision is taken by the board of directors.

Another external auditor (who was from a Big 4 audit firm) mentioned that the members of the ACs view themselves as investigators who control management, and this leads to growing gaps between them. He explained:

There are some conflicts between the audit committee and management which lead to misunderstanding and non-interaction between them. The management feels that the committee are controlling them and, therefore, they may restrict some of the activities of the audit committees. Sometimes, the management recommends to the board of directors that the audit committee should be restricted and the board agrees with this recommendation. However, I strongly believe that the audit committee is much needed in the company. At the same time, it should be truly effective.

This reflects the fact that an inactive AC sometimes becomes a burden for the company instead of improving the company's governance.

Therefore, it can be inferred from the above discussion that the practice of ACs is very important to ensure good governance within the corporations. However, the state of the current practices of ACs in Bangladesh is not ideal and companies do not fully benefit from them at the moment. The ACs in Bangladesh need to be strengthened in terms of their composition and independence in order to function effectively. Otherwise, their contribution will always remain an illusion. Mendez and Garcia (2007) also highlighted that only the presence of an AC does not guarantee stronger financial reporting systems; the AC should perform more effectively in order for this to take place.

7.2.2 Composition of the Audit Committees

The prior literature (for example, Scarborough et al., 1998; Raghunandan et al., 2001) has documented that appropriate composition is one of the pre-requisites for AC effectiveness. Bedard and Gendron (2010) noted that most previous studies had found a positive association between members' independence and competence, and AC effectiveness. They also highlighted the fact that contemporary best practices and regulations recommend that the AC members should possess certain personal characteristics in terms of qualification and competencies. Interestingly, the majority (75%) of interviewees in this study reported that the AC members do not have sufficient qualification and experience. This might be because the AC members are appointed on the basis of their personal relationship instead of qualification. However, the respondents regarded that the size of ACs in Bangladesh is appropriate in order to carry out their responsibilities and this response confirms the findings acquired through the earlier questionnaire survey (as reported in *Chapter Six*).

Generally, the ACs in Bangladesh differ from organisation to organisation in relation to the terms of reference and organisational structure. However, there are certain common elements that should be present in order for the ACs to be considered effective. For instance, an AC must be perceived to be independent before it can be considered to be objective, credible, and useful. Although the Olivencia Report (1998) stated that ACs should be composed of a majority of independent members, all of interview respondents

of this study believe that this recommendation is not followed in Bangladesh. The finance head of a large commercial bank mentioned:

Since the audit committees in Bangladesh are known as board sub-committees, the audit committee members are also members of the board of directors of the company. Therefore, most of the audit committee members are executive directors. Even though there are some audit committees that do not have any independent members, let alone the appointment of a chairperson from independent members. However, in the financial institution sector, most audit committees include at least one independent director and in some cases the audit committee chairpersons are appointed from independent directors.

These remarks are consistent with the results obtained from the questionnaire survey which showed that the majority of AC members are executive directors. Another finance head's comment was that:

Because the majority of the audit committee members are appointed from the internal management team, it is obvious that the committee cannot achieve its objective independently. Because the audit committees are dominated by an executive director, most of the independent directors' opinions are not properly valued in the audit committee meetings and, as a result, they lose interest in playing an active role in the committee. As a result, they come only to attend the meetings, do not participate actively and go back with the remuneration in an envelope.

This remark is consistent with the results of Gendron et al. (2004) and McMullen and Raghunandan (1996), who noted that a probing attitude in AC members is seen if the majority of the committee are independent members. Most guidelines for AC best practices (for example, the Treadway Commission, 1987; the Cadbury Report, 1992; the American Law Institute, 1994; and the BRC, 1999) also recommend that independent directors should sit on the AC in order for it to function effectively.

It was previously discussed in *Chapter Four* that researchers (such as: Beasley and Salterio, 2001; DeZoort and Salterio, 2001; McDaniels et al., 2002; Bedard et al., 2004) documented that knowledge, expertise, and experience of the AC members are directly associated with the effective functioning of the ACs. In consistent with the responses in the questionnaire survey (see Table 6.6 in *Chapter Six*) which indicated that more than

50% of respondents did not agree that the AC members in Bangladesh have sufficient knowledge and experience in similar jobs, mixed opinions were observed in the interview survey on this issue. The AC chairperson of a medium sized company noted that:

When appointing an external/independent member to the committee, his/her background in terms of education and experience is duly considered. Hence, the independent members of the committee do possess more or less relevant literacy and/or experience in an accounting and auditing field.

These responses tend to indicate that the independent members of the ACs are appointed on the basis of their expertise in a related area. Different views were also observed in the responses of some interviewees. For example, an external auditor from a Big 4 audit firm noted:

Most members of the board of directors have neither proper knowledge, nor do they have any previous experience in the field of accounting and/or auditing, but the majority of audit committee members are appointed from board of directors. So, how can you expect them to do the committees' jobs? Moreover, the independent members are appointed on the basis of their personal relationships with the chairperson or chief executive officer/managing director instead of on their expertise. You will be surprised to learn that I know of one audit committee chairperson who is an independent director of the company and more importantly, he is an engineer with no previous experience in auditing or in accounting related jobs.

The quality of the non-executive directors was emphasised by an AC chairperson (who is an external director of the board):

The background of some members is poor and they are chosen on the basis of patronage. I mean 'patronage' as the relationship with the chairperson/managing director of the company or with other influential board members. Ideally the non-executive members should be selected mainly based on two criteria: the extent to which the audit committee members are financially literate; and the extent to which the audit committee is considered experienced and competent.

Therefore, the procedure of appointing non-executive members to ACs has been questioned by some of the respondents. Evidence exists to suggest that the Chief Executive Officer (CEO) may influence the composition of the board (Mace, 1971; Vancil, 1989; Hermalin and Weisbach, 1988). Given that the AC members are chosen from the board, the preferences of the CEO may affect its composition. This may result in an AC which is composed of non-executive directors who are preferred by the CEO on the basis of their personal relationships, as opposed to those members who possess the appropriate skills and experience. Therefore, the system of nominating the members is identified as one of the main problems. There seems to be a preference for the nomination of members who would not upset the status quo. The regulations as they currently exist in Bangladesh are insufficient to overcome this problem. Emphasising this point further, the finance head of a bank remarked:

I think the major problem lies with the members' expertise, because most of them are not practitioners and may not have the qualification or background on how they should undertake their duties and responsibilities.

An external auditor added:

Importantly, the audit committees are not really composed of qualified members because the audit committee members and the chairman of the committee are usually drawn and selected from among the members of the company's board of directors.

These responses show that the AC members do not have sufficient experience and qualification in order to carry out their responsibilities properly. This view is consistent with the findings obtained in the questionnaire survey, where the majority of respondents opined that most of the ACs in Bangladesh fall behind in relation to the AC members' sufficient qualification and experience. The company secretary of a medium sized company however, gave a mixed view and remarked:

I cannot evaluate all of the audit committees. There are many members who are brilliant, enthusiastic and highly qualified. However, in some companies, the opposite is the case, as a result of unqualified members and a lack of knowledge

of accounting that might threaten the activities of the organisation.

In response to the question regarding the size of ACs in Bangladesh, an external auditor (who is also an independent member of an AC) remarked:

Too many members in the audit committee sometimes create unnecessary conflicts within the committee instead of working more effectively. I think the committee should consist of three to five members, and most of the audit committees in Bangladesh are suitable in terms of their size.

This opinion confirms the findings obtained through the questionnaire survey (presented in *Chapter Six*, see Table 6.7) that only 5% of the respondents disagreed with the statement on the ‘appropriateness’ of the AC size in Bangladesh. The opinion, on the number of members an AC should have, is also consistent with recommendations of the best practice suggested by the Cadbury Committee (1992); the Combined Code (1999); the Hampel Report (1998); KPMG (1999); and the BRC (1999) that the AC should include at least three members to provide the necessary expertise for the oversight function. Many studies, including Kalbers and Fogarty, (1996); Yermack (1996); Scarbrough et al. (1998) and Lin et al. (2008), have argued that a large AC may not necessarily result in more effective functioning as more members in an AC may lead to unnecessary debates and delay the decisions although Pucheta-Martinez and Fuentes (2007) and Felo et al. (2003) found a positive relationship between the size of AC and the quality of financial reporting.

7.2.3 Authority and Resources of the Audit Committees

Because of the wide scope of responsibilities, an AC requires adequate resources to perform effectively (PricewaterhouseCoopers, 2005). Most AC guidelines, including the Treadway Report (1987); the Cadbury Committee (1992); the Hampel Report (1998); the BRC (1999) and the Sarbanes-Oxley Act (2002), recommend that an AC should be provided with sufficient authority and resources for its effective functioning.

In the context of the ACs in Bangladesh, the majority (60%) of interviewee respondents

perceived that the ACs are delegated adequate authority. They explained that the main reason was due to the fact that all AC members are also executive board members and, hence, they are highly influential in the company. The majority (70%) of respondents agreed that the ACs receive prompt responses from management to their queries. However, interview responses highlighted the fact that the independent directors of ACs in Bangladesh are not compensated enough for the amount of their time and efforts which are devoted to the committee's affairs and this might be one of the reasons for their nominal involvement. These responses are consistent with the questionnaire survey findings as presented in the previous chapter (see Table 6.6 in *Chapter Six*). Higg's (2003) comment is notable in this relation that the remuneration of a non-executive director should be sufficient to attract and fairly compensate high quality individuals.

With regards to the authority and resources provided to the ACs, the finance head of a small sized company noted that:

The audit committee is typically provided with sufficient resources to perform their responsibilities. The secretary of the company ensures that all secretarial supports needed by the audit committee are provided and that top management provides access to information as and when the committee needs it.

In a probing question he explained:

In fact, most audit committee members are influential in the company because they are executive directors and, therefore, they always receive all the required support and prompt responses from all levels of the company.

A similar view was echoed by the company secretary of a large bank:

I think authority is not at all a problem for the audit committee, and the same for resources. Rather, management wants to keep them happy providing everything they need because they are in the board of directors that decides the fate of top management to some extent. But, the question is- Do the members use the resources for the committee's affairs efficiently? Perhaps not, instead they just enjoy the oversight authorities without making a significant contribution to the company. Independent members merely come to the meeting on the day and endorse most of the decisions taken by executive members; they could contribute more if they were given more scope to work.

Therefore, it is observed that because all of AC members are also members of the board of directors (BODs), authority and resources are not a problem for the smooth functioning of the committee. Different views, however, were also obtained; for example, one external auditor remarked:

The audit committees do not have any real executive authority. What's more, the non-executive members lose interest in being involved in audit committee affairs because they have neither substantive authority nor physical support to work, nor are they compensated by a reasonable amount of remuneration.

This opinion is consistent with the responses in the questionnaire survey in which the majority of respondents (56%) did not agree that independent members are provided with adequate remuneration for the amount of time devoted to the committee's affairs. Smith (2003) made some recommendations, which seem to be useful in the Bangladeshi environment:

Each company should consider the further remuneration that should be paid to members of the audit committee to decompensate them for the additional responsibilities of membership. Consideration should be given to the time that the members are required to give, the skills they bring to bear and the onerous duties they take on and the value of their work to the company.

7.2.4 Diligence of the Audit Committees

The interviewees unanimously agreed that the diligence of the AC members is a vital factor for the effective functioning of the committee's affairs, which is consistent with the findings of Kalbers and Fogarty (1993) and Sharma et al. (2009) in this regard. The members' understanding of the responsibilities and willingness to undertake these responsibilities are important indicators of AC diligence. A well-designed AC charter is essential for defining the responsibilities of AC members. The charter should be used to guide the functioning of the ACs so that the key roles delegated by the BoDs on behalf of the shareholders are properly performed. The charter should clearly define the role, responsibilities, and the authority of the committee. The interview responses also reveal that although the ACs do have their charters in black and white, these are not updated

regularly. The majority of interview participants noted that most of the AC members do not have a clear idea of their roles, and this finding differs from the questionnaire survey findings. This difference might be because in the interviews the respondents could talk at length and more freely on the issue. However, the interview responses confirm that the AC members do not devote enough time to the committee's affairs, although they readily assume their responsibilities.

It should be noted that the absence of an updated charter has been viewed by the majority (80%) of interviewees as a common phenomenon in Bangladeshi ACs, and this may cause the AC members to not be properly aware of their responsibilities. Knapp (1991) claimed that the lack of clearly defined responsibilities and insufficient authority for the ACs has severely hampered their effectiveness. In relation to the AC charter, the finance head of a medium sized textile company noted:

There was no plan or charter for members, which made the duties of the audit committees disorganised. Therefore, the implementation of audit committees is jumbled.

The reverse response was obtained from an AC chairperson who is also a member of another AC. He said:

I am a member of two audit committees including this one, and in both companies there is a very clear charter and all responsibilities are explained. Most of the companies in Bangladesh do have a charter for their audit committees but few of them are reviewed from time to time. Again, most audit committee members are full time businessmen and members of the board of directors of different companies. Therefore, they cannot manage to devote sufficient time to the committee's affairs, although they are willing to assume their responsibilities as audit committee members.

These remarks confirm the findings obtained from the questionnaire survey that the majority of respondents disagreed or remained neutral regarding the annual review of the AC charter, and that sufficient time is given by members to deal with AC affairs. Again, one company secretary remarked that:

The independent/external member of the audit committee is very experienced in this area and he is fully aware of his role and responsibilities. He always tries to contribute his best efforts to the committee's affairs. But, the problem is that the other three members who are the executive directors of the company, do not have know enough about the nature of their role within the committee, let alone their abilities to contribute to the committee's affairs. They rather enjoy the prestige of being members of such committees and try to have control over the committee's affairs, despite having no knowledge or expertise.

The respondent highlighted the fact that some executive members of the AC behave as if the company belongs to only them. This might be happening because the executive directors are very powerful in the company and when they are in the AC, they also exercise their undue influence in the AC and tend to try to dictate most of the committee's affairs.

7.2.5 Meetings of the Audit Committees

The success of an AC largely depends on its effective meetings, as indicated in the literature; for example, Spira, (2002) and Anderson et al. (2004). As discussed in *Chapter Four*, Abbott et al. (2007) noted that an effective AC should meet at least four times annually. Further, Sharma et al. (2009) noted that the ACs in New Zealand formally meets on an average of 3.75 times in a year while R and R (2007) reported that the ACs of the U.S. S&P SmallCap 600 companies meet around seven times in a year. Interestingly, a negative association between AC independence and meeting frequency was found by Sharma et al. (2009), which might be because independent ACs can perform freely as part of their plan and they do not have to meet for frequent discussions. Bedard and Gendron (2010), however, noted that the number of meetings is not frequently associated with AC effectiveness, instead that the AC should meet as often as its role and responsibilities require. The interview survey reveals that most ACs hold formal meetings two to four times a year, and that each meeting lasts for an average of two hours. Most of the interviewees of this study agreed with the questionnaire survey finding that the frequency and duration of AC meetings are sufficient in order to carry out the responsibilities. The interviews also revealed that the AC members have a nominal role in fixing the agenda of meetings. In most cases, the

AC chairperson finalises the agenda of meetings, and to do this they are guided by the CEO and/or CFO. This response is somewhat inconsistent with the questionnaire survey findings (see Table 6.6, *Chapter Six*) that the majority (61%) of respondents agreed that the AC chairperson finalises the meeting agenda after discussion with other members.

According to Sabia and Goodfellow (2005), asking questions during AC meetings and being demanding in the quality of the answers provided are, perhaps, the most important traits that AC members should have. This requires an independent and congenial AC environment where members can discuss all the important issues freely and elaborately. While some respondents noted that AC members sometimes cannot freely express their views because of some unseen reasons; the majority (60%) of interviewees agreed with the questionnaire survey findings that the members can talk freely in the AC meetings. The interview survey reveals that sometimes non-members are also invited to attend AC meeting, most frequently, finance heads and internal audit division heads are invited to attend most of the AC meetings. One external auditor noted:

The head of the internal audit division is also a member of the audit committee and the finance head regularly attends the audit committee meetings as an invitee.

The AC chairperson of a large company mentioned:

Members in the committee can speak freely because most of them are executive directors. Also, the independent directors can express their views without any interference; their opinions are given more importance in the committee. Last year we had four formal meetings, each of which lasted for around 2 to 3 hours. Apart from these, I discuss with other members on a regular basis on a number of important issues. Therefore, most of the decisions are taken unanimously in the committee, and it is functioning quite effectively.

These remarks indicate that a congenial environment for effective AC meetings exists in Bangladeshi corporations, and this finding is consistent with Gendron et al. (2004) and Gendron and Bedard (2006) who highlighted the positive impact of effective AC meetings on the overall governance a company.

Most of the AC members in Bangladesh are full-time businessmen, and/or are holding directorship positions in more than one company. Therefore, they can usually not devote enough time to the committee's affairs. It is understandable that as the number of additional directorships held by AC members rises, the ability to fulfil their monitoring responsibility decreases. Because they are too busy, the AC members sometimes cannot manage to attend the AC meetings. Given the infrequency of meetings and the limited time available, it is important that a detailed agenda is prepared for each meeting. This agenda is necessary to focus the attention of members on the objectives of the meeting and, over the course of the year, should address all the duties and responsibilities outlined in the audit charter. The agenda should be circulated along with any relevant submissions to clarify the subject to the AC members in advance of the meeting. One AC chairperson noted that the notice along with the agenda of the meeting is served to the members at least one week before the meeting date so that they know the issues to be discussed beforehand, and have sufficient time to prepare for the meeting. Sabia and Goodfellow (2005) noted that current best practices and regulations recognise that the agenda is an important tool for the AC meetings to be effective. The company secretary of an insurance company noted:

Choosing the agenda for the audit committee meeting is a collaborative effort between the board, senior management, legal counsel, both the internal and external auditors, and the audit committee itself; however, the chairpersons do not always discuss this issue with other members.

Another company secretary stated:

The agenda of meeting is mainly chosen by the chairperson after discussion with the finance head or the internal audit head of the company, and it is circulated to the audit committee members at least one week before the meeting.

The effectiveness of the AC meeting, however, was questioned by one finance head:

How can committees perform their tasks if we know that many audit committees meet once or twice a year and their reports are prepared in advance? I think it has just become a ritual. The committee meet occasionally and members are

paid their remuneration for it. In reality, most of the decisions are imposed by the board and the audit committee members just endorse them.

Therefore it is indicated that the decision is taken in advance by the chairperson in discussion with the management, and the AC members simply endorse their decisions in the meeting. One external auditor (who is a partner of a Big 4 audit firm) noted:

Four meetings in a year, two hours each is not sufficient to take decisions on so many things that the audit committee has to undertake for the companies. Also, the independent members do not feel motivated to give enough time to the committee when they see that most of their recommendations are not implemented and also their remuneration compared to their time given for the companies is not adequate. Thus, in many cases the audit committee meeting becomes just another ritual that ends with a heavy lunch in a five star hotel.

Some respondents highlighted the need for ACs to meet more frequently, and for a longer duration. This might facilitate in better decision making after detailed discussion of the issues. The dominance of the executive members in the AC meetings is also another problem for Bangladeshi ACs. However, in general it can be inferred that the process of holding AC meetings in Bangladesh is satisfactory for their effective functioning.

7.2.6 Roles of the Audit Committees

The main reason for the development of ACs, regardless of country, remains the same, which is to improve the credibility of financial reporting. An AC can also play an important role in some other areas of the company. VENABLES and IMPEY (1991) noted that ACs are developed in order to increase confidence in the credibility of the financial statements; and strengthen the independence of the external auditors. This indicates the point that an AC has to undertake multiple roles for the company, which are related to different functional areas. WOLNIZER (1995) summarised the AC recommendations of the CG commissions and committees in the U.S.A., the U.K., Canada, and Australia. The author demonstrated that ACs are expected to perform almost exclusively in the technical areas of financial reporting, auditing, and internal control. SHARMA et al. (2009)

noted that ACs play an important role in overseeing and monitoring financial reporting, external auditing, and internal auditing. Apart from these three key areas, the interviewees of this survey also mentioned some other areas of the company where ACs are expected to undertake some important oversight responsibilities. The following subsections discuss the interview responses in relation to how the ACs in Bangladesh do contribute to these three key areas and also to some other miscellaneous issues.

7.2.6.1 Role in Financial Reporting

Information about the company's operations is made publicly available through different statements, namely, the board of director's report, the auditor's report, the balance sheet, the income statement, the statement of retained earnings, cash flow statements and the notes to the financial statements included in the annual corporate report (Al-Razeen and Karbhari, 2004). However, the annual corporate report is considered to be the key source of public information regarding the company and its performance for the general stakeholders. In general, the interview respondents agreed that the ACs in Bangladesh play a role in the financial reporting of the company; for example, the ACs review financial highlights presented in the annual corporate reports, and they also review the adequacy of financial disclosures. However, the majority of interview participants felt that most ACs rarely review the accounting policies, compliance of accounting standards, and account estimates done by accountants. Some interviewees (40%) also questioned the ability of AC members to review the integrity of company's annual report.

It is considered that certain financial reporting problems which primarily arise due to inadequate disclosures within the financial statements may be attributable to an ineffective AC. One finance head noted:

The audit committee is mainly charged with the oversight responsibilities of financial reporting and disclosure. The committee mainly oversees the integrity of the financial statements and other statements (e.g. auditor's report) before these are included in the annual corporate report.

This response is consistent with the remarks of Rezaee and Farmer (1994), and Laux and Laux (2009) who highlighted AC's role in financial reporting. One external auditor mentioned:

The audit committee typically reviews financial reports quarterly, half yearly and annually in publicly-traded companies. In addition, the committee often reviews complex accounting estimates and judgements made by management, and the implementation of new accounting principles or regulations.

The respondent further added:

Sometimes the committee reviews the accounting disclosures, but it hardly ever reviews the compliance of accounting standards. The committee relies heavily on the external auditors for this.

This might happen because most of the AC members feel that the external auditors are more expert and qualified in this field and that they can judge it more accurately.

Another external auditor reported:

A very insignificant involvement of the audit committee is seen in reviewing the overall quality for financial reporting. Sometimes, it reviews some accounting disclosures, estimates and judgements done by accountants. But in general, they do not play the sufficient roles which are expected. The reason for this minimum involvement is mainly the fact that they are incapable of doing such a job, and in some cases they lack the scope to do what they should.

The review of interim financial statements is also a part of the financial oversight role of the ACs. Interim reports have become increasingly important to investors and security analysts. The share price of a company may change dramatically in response to interim reports if the reported earnings are significantly different from those that the investors expected or anticipated. The Treadway Commission Report (1987) recommends that ACs should oversee the interim reporting process. This recommendation has been adopted in the U.S.A., where the SEC rules suggest that the ACs are expected to review the interim reports. In Bangladesh, the listed companies are required to publish interim financial reports (i.e. quarterly and half yearly financial statements) and submit them to

the SEC. The ACs have a significant role in the reviewing of these financial statements and considering whether they are complete and consistent. On this subject, the finance head of a bank said:

The interim reports are reviewed by the audit committee before making them publicly available. But, it is not possible to review these reports in a two-hour meeting while there is only one accounting expert on the committee. So, the committee mostly relies on the external auditors review, and they just endorse the prepared report. However, it is a good sign that these reports have to go through the audit committee.

It is important to re-state the fact that the AC reviews the going concern status of a company on behalf of the board. Kida (1980) was one of the pioneers to suggest a separate section in the auditor's report regarding the going concern status of the company. Kida's results indicated that the auditor may be influenced by the perceived consequences of issuing or of not issuing a qualified audit report. An AC is generally responsible for reviewing the compliance of international accounting standards, principles, and conventions. However, the majority (75%) of interview participants noted that the ACs in Bangladesh rarely review these standards (including the going concern assumption of the company) and principles. For example, the company secretary of a leasing company said that:

The audit committee does not properly review whether the going concern assumption has been properly reflected in the financial statements. Instead, they simply rely on the external auditor's opinion on the going concern status of the company.

This might happen because most AC members in Bangladesh are not competent enough to review such technical matters and to disagree with the external auditors' opinion.

7.2.6.2 Role in External Auditing

One of the main responsibilities of ACs is to oversee the external audit functions; including the selection, compensation, work, and independence of the external auditor (Bedard and Gendron, 2010). Their study further noted that ACs are directly responsible

for the appointment and oversight of their work, including the regulation of the disagreement and the auditor. The ultimate focus of the audit process is to arrive at an opinion on the truth and fairness of the financial statements and, thus, to convey an independent opinion to the users of the financial statements as to whether these statements as a whole, represent a true and fair view of the company's profits or losses, and its state of affairs at balance sheet date. To achieve these objectives, the external auditors should be assured that they can work independently. In general, an AC is expected to protect and enhance the independence of external auditors.

The majority (85%) of interview respondents noted that the ACs in Bangladesh play a significant role in appointing external auditors or approving the Engagement Letter (EL) prepared for the external auditors. Their responses suggest that the ACs typically approve the selection of the external auditors and fix their fees. It was also agreed by most of the interviewees (75%) that the ACs review the findings of the external auditors and monitor management responsiveness to these findings. The external auditors traditionally review the entity's financial statements quarterly and issue an opinion on the accuracy of company's annual financial statements. The ACs also review the key findings obtained by the external auditors and monitor management responsiveness to these findings.

Significant involvement of the ACs in appointing external auditors is observed in Bangladesh. The response of an external auditor on this issue was:

The audit committees' roles are to appoint the external auditor, negotiate audit fees, and sometimes to invite one representative from an external audit team to attend the audit committee meetings.

This implies that the ACs play a key role in appointing or dismissing the external auditors, and that they also negotiate and fix the audit fees to be paid to the auditors.

Another external auditor, however, mentioned that:

Many audit committees do not comprehend much of what they should do. The main objective of the committee, in actual practice is to find the cheapest price

for the external auditors whereas the external auditors should be selected according to their quality and experience.

The respondent further added:

There is no obvious contribution of the audit committee to the effectiveness of the external auditing since they hardly saw any of audit committee members during the last year.

This indicates that role of most ACs in Bangladesh in relation to external auditing is limited to making recommendation to the board on the appointment or removal of external auditors.

Furthermore, an AC does have a defined role in ensuring the external auditors' independence and mitigating the conflict of interests that might interfere with the auditors' ability to express their opinions on the financial statements. The committee should, therefore, ensure that no such factor exists that might impair the independence of the external auditors. The response of an AC chairperson (who is an independent director of the company) was:

While the committee is supposed to oversee and ensure the independence of the external auditor; its role seems quite inadequate and almost absent regarding this issue

This reflects the view that the AC does not play any significant role in protecting and enhancing the independence of the external auditors. Another AC chairperson's comment was:

The audit committees draw management's attention to the weaknesses that are discovered in the company. The committee reduces the level of interaction between the companies and the external auditors since they work as a liaison between the management and external auditors. Additionally, external auditors are able to talk to audit committees about any problem that arise.

One company secretary appreciated the role of the AC in external auditing, saying:

External auditors benefited from audit committees through increased responsibilities since the external auditors are also required to meet with the audit committee in addition to their meetings with the management.

Therefore, the ACs in Bangladesh maintain a close relationship with external auditors on behalf of the management and the BODs so that the auditors can perform their tasks more independently and objectively. An external auditor from a Big 4 audit firm highlighted the fact that an AC report should be included in the annual corporate report and that this report should state:

- (i) Whether the AC has reviewed and discussed certain matters with the independent auditors;
- (ii) Whether the AC has reviewed and discussed the audited financial statements with the management; and,
- (iii) Whether the AC has followed up the management responsiveness to the auditors' findings.

7.2.6.3 Role in Internal Auditing

Scarborough et al (1998) and Raghunandan et al (2001) suggested that the existence and composition of an AC greatly improves the effectiveness of an internal audit division. Laux and Laux (2009) also argued that one of the key responsibilities of the AC is to oversee the internal auditing function. Sarens et al. (2009) had also noted that the internal auditing function serves as a comfort provider for the AC. A key feature of an effective internal audit department is its independence. Independence is crucial to the nature of internal auditing because it allows the auditor to render impartial and unbiased judgement. In relation to AC's role in internal auditing, an external auditor noted:

The internal auditor cannot work independently. Sometimes, they are dictated to by the board of directors through the CEO. The audit committee can play a role in enhancing the independence of internal auditors.

The AC can also protect the independence of internal audit department by ensuring that the chief internal auditor is not dismissed as a result of reports which reflect unfavourably on the management. Furthermore, the chief internal auditor should have

direct communication with the AC. The finance head of a small pharmaceutical company viewed:

The audit committees in Bangladesh do not have frequent communication with internal auditors; they sometimes invite the head of the internal audit division to attend the audit committee meetings.

The majority of interviewees argued that the internal audit functions were strengthened after the ACs had been established. For example, the AC chairperson of a medium sized company noted:

The audit committees added something new to internal auditing, which is the interaction with the board of directors. In the past, they only interacted with the management. Also, the role of the internal auditors has increased dramatically. However, the concern about independence matters is on-going since the internal auditors are mostly dictated by their dependence on the chief officer/managing director in all affairs.

The finance head of a small company (who is also in charge of the internal audit division) noted the role of internal audit division in making the AC functional, and remarked:

There are many differences between companies in actual practice. Generally, the audit committees have frequent interaction with internal auditors. The role of internal auditing in achieving the objectives of the audit committees is important since they can help the audit committees discharge their duties. In addition, its success depends on the skills and abilities of the team of internal auditors because an effective internal control division can significantly contribute to making the audit committee more effective.

The Treadway Commission (1987) stressed this fact and recommended that the committee should review the appointment and dismissal of the chief internal auditor. Further, the company secretary of a large sized company remarked:

The establishment of the audit committee in 2006 has advanced the role of internal auditors by informing them on how to realise the risks inside companies and how to detect them. Similarly, the role of the internal auditors has changed

from reviewing invoices to participating in putting strategies and plans of companies together. In brief, there has been a big change in the manner of thinking about the role of the internal audit and audit committees within companies' management.

One AC chairperson noted that the AC interacts regularly with the senior financial management, including the finance head or internal control head, to review their activities and decisions on some vital issues.

Some interviewees (30%), however, expressed their concerns on the extent of the role played by the ACs in relation to internal auditing. For example, the finance head of a large bank felt that:

Theoretically, the audit committees should help the internal auditors in two main areas: firstly, to enhance their independence; and secondly, to develop their positions by making sure that the management looks into the points of weakness that internal auditors discover. However, practically speaking, these two benefits are not derived so far since the audit committees are not qualified enough to be helpful to internal auditors.

An external auditor (who is a partner of a Big 4 auditing firm) also claimed:

The internal auditors have not yet benefited much from the establishment of the audit committee. The internal auditors are actually influenced and pressured by management. The management seems to restrain the internal auditors from raising any issue related to management activities.

This reflects the insufficient role of the ACs in ensuring the independence of the internal auditors. The responses suggest that although the ACs in Bangladesh play some roles in the internal auditing of the company, these seem to be generally insufficient.

7.2.6.4 Other (Miscellaneous) Roles

Apart from the three broad roles discussed above, the interviewees noted a few other roles (including the oversight of regulatory compliance and risk management strategies of the company) of the ACs in Bangladesh. Many interviewees (9 out of 20) noted that

the ACs in Bangladesh do play some role in minimising the risk of the company by reviewing company's strategies. For example, a finance head noted:

The audit committees discuss the status of litigation or regulatory compliance with the management, generally via briefings or reports from the top lawyer in the entity.

The majority (65%) of interviewees also mentioned the role of an AC in advising the company on ethical issues. These responses are consistent with the recommendations of the AICPA (2004) that highlighted the role of an AC in risk management and compliances issues of the company. The AC chairperson of a commercial bank, who is a university professor and also an independent board member of the bank, elaborated the necessity of an AC as:

Among many responsibilities, the boards can entrust the audit committee with ethics and compliance systems, review of the risk management strategies etc. But frankly speaking, in reality we [i.e. the committee] have a very limited contribution to risk management for the company. However, we monitor whether the company lacks compliance with existing laws and rules.

Furthermore, another AC chairperson remarked:

Many organisations are developing their practices towards a goal of a risk-based management approach called enterprise risk management. The audit committee's involvement in non-financial risk topics varies significantly from company to company.

The interaction between the AC and the management was highlighted by the company secretary of a medium sized bank. He noted that many audit committee chairpersons conduct interim calls with key members of the management between quarterly meetings. Key contacts might include the CEO/MD, CFO/FD, chief internal auditor, and external audit partner. One AC chairperson stated:

These are formally scheduled, private meetings between the AC and key members of the management or the external auditor. These meetings are typically unstructured and provide the opportunity for the committee to get feedback on the company's affairs from the managers in private.

The responses, therefore, reflect the view that the ACs play an interactive role in the company by liaising with different parties in the company (including the external auditors, internal auditors, finance head, BoDs etc).

7.2.7 Overall Effectiveness of the Audit Committees

An effective AC is needed to boost up investors' confidence on the governance of a company, to improve trust in the financial reporting process, and to lend more credibility to the audited financial statements (McMullen, 1996; Urbancic, 1996; Spira, 1999b; Rezaee et al., 2003). Although effectiveness is an elusive concept that can be approached through several models, none of which is appropriate in all circumstances (Cameron, 1981), it is commonly believed that an effective AC enhances the protection of the interests of stakeholders. Mixed views are observed in the interview responses on the overall effectiveness of ACs in Bangladesh. Some interviewees (30%) perceived that AC effectiveness is reasonably satisfactory, while other respondents (40%) stated that the ACs seem to be unsuccessful. There are some respondents who believed that the ACs had not been as successful as expected. With respect to the overall effectiveness of the ACs in Bangladesh, one external auditor (who is a partner of a Big 4 audit firm) highlighted:

The audit committee practice in Bangladesh is still in its early stages, and more time is needed to evaluate its success. However, the audit committees in Bangladesh have moderately achieved their objectives since they carry out an important role in protecting shareholders' interests overall. Actual practice could be divided into two main categories: banks and other corporations. I think the audit committees in the banks are much better than other corporations. The reason that the audit committees in banks are better than others is because in banks there are double controlling parties namely, the SEC and the central bank.

These remarks are in conformity with the findings of Bhuiyan and Biswas (2007), who noted that in Bangladesh, the financial sector is subject to close monitoring and supervision by the Bangladesh Bank (the central bank) and the SEC and, therefore, more restrictions are imposed on this sector while the non-financial sector is more relaxed. It is worth mentioning that all banks in Bangladesh must have an AC, as

provided by the Bangladesh Bank's Circular No: 12, 23 December 2002²⁵.

Regarding the achievement of ACs, another external auditor stated that:

The audit committee has been established with the aim of enhancing confidence in the integrity of an organisation's processes and procedures relating to internal control and corporate reporting including financial reporting. However, to be very honest, I think the audit committees in most firms in Bangladesh can hardly achieve their objective properly.

One finance head, who is also an AC member of another company said:

Although the audit committee has become one of the main pillars of the corporate governance system in most of the developed economies, in Bangladesh it is still a new issue and general investors are not properly aware of its role until now. However, it is good that in steering companies through today's complex business environment, many boards have started emphasising greater and stronger leadership from their audit committees.

These responses indicate that the overall AC effectiveness is not currently at a satisfactory level. However, the scenario is gradually improving. Furthermore, one AC chairperson noted that the issue of AC in Bangladesh is still in its early stage. It should be re-stated that the first formal guidelines on AC practices in Bangladesh was issued by the SEC in February 2006.

The comments of a finance head of a large sized commercial bank are important to note here because he covered some key aspects of AC effectiveness and stated that:

The background of the AC members is not in the field of accounting or finance. Also, their meetings seem to be insufficient and there is no follow up from the members for their reports. I would say that the systems for internal auditing in companies are very weak and the members of audit committees are not full-timers as far as the company is concerned; so it is difficult to properly deliver what is expected from them. However, there are many members who have the desire to work hard but they encounter many difficulties in discharging their

²⁵ The Bangladesh Bank Circular has covered different issues such as the overall purpose/objectives, roles and responsibilities of the audit committee, the structure and composition of the audit committee, the qualifications of the member; and the meetings.

responsibilities. Much of the advice of independent directors is not implemented at all. Also, the remuneration paid to the members is insufficient.

This indicates that the members of the ACs are not properly utilised for the effective functioning of the committee, and they do not have the scope to contribute to the committee's affairs. This might be happening because the majority of AC members are executive directors who are often dictated to by the BODs and/or CEO. One external auditor remarked:

The decisions of the audit committees are not influential; they do not have sufficient executive authority. Instead of detecting regularities and violations, many audit committee members flatter the board. Even the non-executives cannot ignore the policies of the executives.

The company secretary of one large sized organization reported that:

The goals of audit committees have not been achieved yet, but the scenario is improving year by year. For the first two years, the audit committee was just a committee without any significant role, but in the last three years the committee is coming into the limelight through some of its contributions in some areas including financial reporting and internal control.

Therefore, it can be inferred that the significance of the ACs in Bangladesh is gradually being acknowledged, and their effectiveness has recently shown signs of improvement.

7.2.8 Factors Affecting the Audit Committee Effectiveness

The majority of interview respondents emphasised two broad issues: composition and diligence. This finding is consistent with the earlier findings of the questionnaire survey. More specifically, the interviewees highlighted the fact that the lack of requirements for qualification and experience is one of the main causes that affects the performance of ACs in Bangladesh. Consequently, the AC members cannot perform their duties properly. In general, the interviewees also highlighted the fact that the majority members (including the chairperson) of most ACs in Bangladesh are executive (i.e. shareholding) directors of the company. It is understandable that these executive

directors often tend to take decisions favouring their vested interest, and this hampers the AC effectiveness. The majority (70%) of respondents also pointed out that the AC members do not devote sufficient time to the committee's affairs, which hampers the effectiveness of ACs in Bangladesh.

The selection process of AC members has been viewed as a major cause of existing weaknesses of the ACs in Bangladesh. For example, the company secretary of a small leasing firm remarked:

The idea of audit committees is excellent, but the current practice is not as expected because these duties have been entrusted to unqualified members. They have been nominated according to personal relationships and favouritism.

The level of financial/accounting knowledge and skill of the AC members has obvious consequences in dealing with different financial issues. One external auditor said:

Many members of the audit committees, who are also members of the board of directors, have no knowledge or qualification in business. They are in the committee not because of their competence but because they are rich or wealthy. The task of the external auditor is specialised but only members of audit committees have enough ability to follow them.

These remarks are consistent with most of the previous studies that found positive association between members' independence and competence, and AC effectiveness (Bedard and Gendron, 2010). The interviewee further noted that:

One of the members is a specialist in one of the pure sciences, so you can imagine which criteria they are looking for when they nominate an external auditor. Low fees are the most important criteria for audit committee members when they nominate an audit firm.

The finance head of one large company focused on a few factors:

Inadequate numbers of qualified members, lack of awareness of the purposes of audit committees, a lack of members' independence. Also, little knowledge about an entity's business (firm-specific knowledge) is one of the problems.

Similarly, one company secretary noted that:

The audit committees need to strive harder to reach the required level of competence. The audit committee members who have financial expertise are capable of providing professional evaluation on financial estimates, and the appropriateness of accounting principles and disclosure practices of the firm. A firm can enhance transparency in financial reporting and can gain a positive impression in the market by appointing reputed financial experts to the audit committee.

Another finance head added:

The members are not qualified and, with a few exceptions, they have no accounting or financial knowledge. There is hardly any interaction between the shareholders and the audit committee.

Therefore, the respondents highlighted two main factors that impair the effectiveness of ACs in Bangladesh: firstly, the AC members are not truly independent, they merely serve the wills of management; and secondly, the AC members are not properly qualified and experienced in related areas. The finance head of a state owned company remarked:

At present the independence of the audit committees is relative because they are nominated by the board, mostly because of their personal relationships. There is not enough concern from the board of directors in nominating specialists to the audit committee. In many cases, there are no specialists in accounting who have been appointed as members and this is one of the major reasons for the ineffectiveness of audit committees.

Similarly, an external auditor disclosed that:

The appointment of the audit committee is made by the board of directors on the basis of personal relationships. How can the audit committee control the management? The major difficulty is that the committee members are not qualified enough to monitor and oversee the activities of the internal auditors.

The responses indicate that most members of the ACs are nominated from the BoDs of the same company. It was also noted that there are some bureaucratic procedures to be

followed when the members of ACs are drawn from the BoDs. One AC chairperson suggested including an AC report in the annual corporate report so that the general shareholders can be made aware of the AC and its activities.

The physical distance of the AC members and the company's head office has been noted as another factor that affects the functioning of the ACs in some cases. One external auditor pointed out this issue:

The distance between the companies and the members of the audit committees is another big problem. I live here [in Dhaka] and am a member of an audit committee in Chittagong, which is more than 200 km away. Therefore; I cannot contribute to the committee as much as I am supposed to.

It might be worth mentioning here that the remote distance of AC members from a company's head office was one of the criticisms of the AC of Enron before it failed (Tonge et al, 2003).

7.2.9 Measures for Improving Audit Committee Effectiveness

The majority (85%) of interview respondents highlighted that the AC should include more independent directors who are qualified and experienced in carrying out similar tasks. Many interviewees (70%) also emphasised that the chairperson of the committee should be an independent director. They felt that these measures will enhance independence of the ACs, which will ultimately lead to the improved effectiveness of the ACs. It can also be inferred from the interview responses that the existing rules (including the SEC Order of 2006) regarding AC practices should be imposed on a compulsory compliance basis instead of on a 'comply or explain' basis. Rigorous monitoring of the compliance with existing rules should be done by regulatory bodies, including the SEC. The interviewees also highlighted that some new rules (such as: AC members' minimum qualification in terms of education and experience) should be introduced for the proper functioning of the ACs. These suggestions from the interviewees are almost identical and consistent with the findings obtained from the questionnaire survey responses.

The interview respondents re-emphasised the necessity of AC member's knowledge and experience in the field of accounting and/or auditing. One finance head suggested:

The members should have sufficient accounting knowledge and experience but some members have qualification in political science or geography. Therefore, everything is controlled by a board of directors. If the executive directors were in the position for the long term, they might consolidate their positions and even carry out their responsibilities as if the company belonged to them.

One AC chairperson suggested that all members of the AC should be qualified in accounting or finance. He also recommended holding regular meetings between the AC members and the BoDs to carry out their responsibilities. Again, one company secretary focused on the role of BoDs when they nominate members of the AC. He added:

If the board of directors is interested in having good governance in the company, they should nominate qualified members and give them sufficient authority.

In relation to composition, another AC chairperson thought that the AC should be comprised of a wide variety of members (such as shareholders, auditors, academics, and businessmen). The members of the BODs ought to be outside the AC. One finance head noted:

I highly recommend that an expert in accounting and auditing who is financially literate should be one of the members of the audit committee.

This response indicates that there should be a minimum level of qualification and experience for AC members. The opinion of an AC chairperson of a bank was that:

Since the primary task of an audit committee is to oversee corporate financial reporting and the auditing processes, I think all of its members should have sufficient knowledge and exposure in this area.

A similar opinion was given by the company secretary of a large company:

I think the members' knowledge and experience in the field of accounting and

auditing experience is essential for enabling an audit committee to be effective. If the audit committee comprises knowledgeable and experienced members, it will undoubtedly play a leading role in the committee by providing valuable views and comments, which will increase the committee's productivity.

These views are consistent with the findings of Lin et al. (2008), who highlighted the significance of AC members' expertise in a related area. Some respondents argued that the AC effectiveness may be enhanced if the external auditor is co-opted in the AC. Another company secretary added:

Since most of the current members do not have accounting or financial competence, I think it would be better if one of the external auditors is included/co-opted in the audit committee.

Most of the interviewees (95%) emphasised on the importance of AC composition for its effectiveness, and they felt that the AC should be composed in a way that it can work independently and confidently. The respondents emphasised on the need for the inclusion of more independent members in the AC for it to be effective, which confirms the questionnaire survey results (see Table 6.10, in *Chapter Six*) where the inclusion of a majority of independent members has been regarded as one of the top ranked suggestions for improving the effectiveness of ACs in Bangladesh. This is also consistent with the results of Chan and Li (2008) who focused on the importance of including independent directors in ACs. Furthermore, Pucheta-Martinez and Fuentes (2007) revealed that the inclusion of independent members in the AC has a positive impact on improving the reporting quality (both externally and internally). The establishment of an AC aims to delegate the responsibilities to hire external auditors and to facilitate and supervise their work and, therefore, the AC should be composed of a majority of independent members (Osma and Noguer, 2007). An external auditor of a Big4 audit firm suggested that:

The audit committee should consist of independent directors for its independence and effective functioning. Even if all members are not independent directors in the committee, the chairman should be elected from amongst independent directors.

The company secretary of a leasing firm noted:

The audit committees should be composed of independent directors nominated from outside, with at least one qualifying as a financial expert.

It is, therefore, reasonable to consider that for effective functioning, the ACs should be comprised of a majority of non-executive directors, who, as a whole, possess sufficient background experience.

The existence of an updated AC charter, or terms of reference, is very important for understanding and successfully carrying out members' responsibilities. One AC chairperson noted that:

A well-designed charter detailing the terms of reference is essential as this charter should be used to guide the audit committee in their performance, in order for them to adequately fulfil the roles required of them by the main board of directors, shareholders and other third parties.

One external auditor mentioned that a work plan (i.e. charter) for the AC should be established for a whole year since the members spend very little time with the company and they do not know much about what is happening in the company. Another external auditor, however, suggested that the existing responsibilities of the AC should be made known to the public so that they will be informed about what the AC is doing on their behalf. He also suggested that the AC should submit, annually, a report to the AGM about its activities during the year. The respondent emphasised the fact that the shareholders should be informed about the activities of the AC. One external auditor recommended amending some provisions of exiting guidelines as:

The SEC guidelines given in 2006 regarding the audit committees have covered most of the key issues, but we need to make many changes (such as the charter, required qualification, and expertise in accounting) to move from an excellent idea to best practices. Most importantly, the existing guidelines should be mandatory for all companies, instead of leaving them as an option for explanation in case of non-compliance.

One finance head noted an interesting suggestion: that any company applying for a loan to any bank should submit a compliance report obtained from the SEC in relation to AC practices in the company. He added:

Loans should not be approved unless this party issues a positive report about the audit committee practices in these companies.

Further, the finance head of a bank noted:

An effective internal audit department is a valuable resource to an audit committee. The scope of internal auditing should encompass the evaluation of the organisations system of internal audit and the quality of the performance in carrying out the assigned responsibilities. The internal audit department is in a key position to review the adequacy of internal controls. Furthermore, it may ideally provide the audit committee with the support for the public statements required by the directors on internal control.

This implies that an effective internal auditing system can ensure sound internal control within the company and, thus, can significantly contribute to achieving the objectives of the AC. This view is consistent with the remarks of Sarens et al. (2009) who highlighted the role of the internal audit function in AC effectiveness.

The company secretary of a large sized firm suggested that a closer relationship between the AC and internal auditors could allow them to share their views on important matters in the companies. It could, he felt, also help them to discuss the problems that the internal auditor might identify. He noted:

The role of internal auditing in achieving the objectives of the audit committees is crucial. Therefore, there should be frequent interactions between the committee and internal auditors.

A different suggestion was given by an external auditor (who is a partner of one Big 4 firm):

A supervisory panel should exist to ensure the full independence of audit

committees, and to ensure that the committee is free from any influence from the board of directors or the management.

An AC chairperson's recommendation was:

Internal auditors should be independent and they should be fully associated with the audit committees. Also, the members of the committee should give more time and effort in order to attend more meetings and spend more time in the companies. The remuneration that is paid to external members should be increased so as to give them more incentive to increase their efforts.

The views of this respondent indicate that the internal audit division should be strengthened, and that this can significantly contribute to the effectiveness of ACs. He also suggested motivating the independent members with more benefits so that they devote sufficient time to the committee's affairs. Another interesting recommendation was given by a company secretary:

While appointing independent/external directors, apart from their qualification and experience, I think age should also be considered. Usually people who have served for long period in a similar area have already become bored and lost their enthusiasm. Instead, from my experience, I suggest appointing younger, more qualified people who perform their job more sincerely, with interest and, more importantly, they are aware of new technologies, sales wares, and changes. Please do not get me wrong, I am not opposing the necessity of experience any way, experienced people must be on the audit committee but it doesn't mean it should be someone who has retired or who is going to retire soon.

Similarly, another external auditor suggested:

Members should be carefully selected from specialists in accounting and auditing. Also, greater authority should be given to the audit committees, and management should be prevented from putting obstacles in their way . The committees should, as well, undertake the responsibility of choosing and changing the head of internal auditing to ensure his independence.

One finance head noted:

Suppose the audit committee is composed of a majority of non-executive directors and the financial reporting oversight role is usually delegated to the audit committee. Also assuming the audit committee members possess the necessary background and skills to undertake this role; there is no doubt that the committee will achieve most of their objectives for which these are established.

The response of the company secretary of a medium sized firm seems worth citing regarding this issue:

The three main factors that are needed in order to improve the effectiveness of the audit committee regarding the membership of the audit committee are: (i) a minimum of three directors is considered necessary for the audit committee to be effective; (ii) all members of the audit committee are to be independent for the audit committee to be considered independent and effective; and, (iii) the independent members with qualification and experience in accounting/finance /auditing or similar jobs are considered necessary for the effectiveness of the committee.

It is, therefore, considered that an AC composed of non-executive directors, who, as a whole, possess sufficient expertise, tend to be effective. It is interesting to observe that various suggestions have been given by the respondents and that most of these suggestions confirm the results of the questionnaire survey and are also supported by the best AC guidelines and recommendations such as: the Treadway Commission (1987); the Cadbury Report (1992); the BRC (1999). Further, the SEC and stock exchanges should encourage all the companies to include a statement of CG, including AC practices, in their annual reports.

7.2.10 Synopsis of the Interview Findings

The above discussion indicates that most of the earlier findings of the questionnaire survey have been confirmed by the interview survey responses. However, there are a few areas which reveal an inconsistency in the findings obtained from these two methods of data collection. As stated earlier, the objective of adopting an interview survey for this study was to acquire a greater and more detailed picture of the AC practices in Bangladesh. More insight in addition to the questionnaire survey findings have been obtained from the interviews. Table 7.1 presents a summary of the key

findings, with a comparison made to the questionnaire survey findings. Although most of the interview findings are consistent with the questionnaire survey results, a few of them were not in conformity with the interview survey findings. It should be noted that in addition to the questionnaire survey findings, a greater insight of the AC practices was obtained from the interview survey. These additional findings, and the questionnaire survey findings that were not agreed with by the interviewees, have been presented in the same column of the table but to differentiate them from each other the latter has been presented in *italic* text.

Table 7.1: Summary of the Interview Survey Findings

Broad Aspect	Key Findings : Consistent with Questionnaire Survey	Additional Findings/ <i>Key Findings Inconsistent with</i> Questionnaire Survey
Composition	<ul style="list-style-type: none"> • The chairperson plays an influential role in appointing other members of the AC. • The majority of AC members are executive directors of the same company and most of the AC chairpersons are executive directors in the board of the company. • The AC members do not have sufficient qualification and experience in accounting/auditing. • The size of the AC is appropriate. 	No major difference observed.
Authority and Resource	<ul style="list-style-type: none"> • The AC is provided with sufficient authority and resources. • The committee gets ready access to information and quick responses from management level as and when needed. • The non-executive members are not remunerated enough for their time spent for the committee's affairs. 	No major difference observed.
Diligence	<ul style="list-style-type: none"> • The AC charter is not reviewed periodically. • The AC members readily assume their responsibilities. • The members do not devote enough time to the committee' affairs. 	No major difference observed.

Broad Aspect	Key Findings : Consistent with Questionnaire Survey	Additional Findings/ <i>Key Findings Inconsistent with Questionnaire Survey</i>
Meeting	<ul style="list-style-type: none"> • The agenda of AC meetings, which is finalised mainly by the chairperson, are distributed to the other members beforehand. • The members can discuss issues in the meeting freely. • The frequency and duration of the meeting is sufficient for the effective functioning of the committee’s affairs. • Non-members are also invited to attend the AC meetings. 	<ul style="list-style-type: none"> • Non-members who occasionally attend AC meetings include the finance head and/or the internal audit division head • <i>The chairperson rarely discusses the contents with other members before finalising the meeting agenda.</i>
Role in Financial Reporting	<ul style="list-style-type: none"> • Reviews the integrity of financial reporting. • Reviews the completeness of accounting disclosures in financial statements included in the annual corporate reports. 	<ul style="list-style-type: none"> • Does not properly review compliances of going concern status of the company and its financial statements.
Role in External Auditing	<ul style="list-style-type: none"> • Reviews the findings and comments of external auditors. • Monitors management’s responsiveness to external auditors’ queries and findings. • Monitors the independence of external auditors. 	<ul style="list-style-type: none"> • <i>Plays vital role in appointing and/or removing external auditor and preparing EL for them.</i>
Role in Internal Auditing	<ul style="list-style-type: none"> • Plays insignificant role in recommending the appointment/removal of the head of internal audit division. • Meet with the internal auditors in absence of the top management. • Evaluates the effectiveness of internal audit division. 	<ul style="list-style-type: none"> • Monitors the compliance of existing rules and regulations • Monitors compliance of ethical issues. • Review the risk management strategies.

Broad Aspect	Key Findings : Consistent with Questionnaire Survey	Additional Findings/ <i>Key Findings Inconsistent with</i> Questionnaire Survey
Factors Affecting the Effectiveness of the ACs	<ul style="list-style-type: none"> • The majority of executive directors in the AC. • Lack of members' knowledge/qualification. • Lack of members' experience. • Lack of appointing non-executive members as the chairperson. • Lack of members' diligence. 	<ul style="list-style-type: none"> • Remote distance between company's office and AC members.
Possible Measures to Enhance the Effectiveness	<ul style="list-style-type: none"> • Inclusion of a majority of members of the committee from non-executive/independent directors. • Appointing the chairperson from non-executive directors. • Imposing new rules and guidelines in relation to the minimum qualification and/or experience of the AC members. • Increase monitoring of the compliance of the existing rules and guidelines relating to CG and AC practices. • Mandating compliance of the SEC order relating to CG practices issued in 2006. 	<ul style="list-style-type: none"> • The new rules and guidelines should include minimum qualification and/or experience for AC members in accounting/auditing field. • The internal auditing function should be strengthened. • Relatively young qualified external members who have reasonable work experience with more enthusiasm that leads to becoming more functional. • External auditor should be included in the AC.

Table 7.1 shows that the interview responses are consistent with the questionnaire survey responses in most cases, including:

- (i) The majority members of the AC, including the chairperson, are nominated from executive directors of the board;
- (ii) The AC members do not possess sufficient qualification and expertise;
- (iii) The AC is provided with sufficient authority and resources to undertake their responsibilities;
- (iv) The independent members are not paid sufficient remuneration for their time devoted to the committee's affairs;
- (v) The AC charter is not reviewed periodically;
- (vi) The AC members do not devote sufficient time to the committee's affairs, although they readily undertake the responsibilities;
- (vii) The agenda of AC meetings is finalised mainly by the chairperson;
- (viii) The AC reviews the integrity and disclosures of financial reporting;
- (ix) The AC reviews the findings of the external auditors, and also monitors management's responsiveness to those findings; and,
- (x) The AC evaluates the effectiveness of the internal audit function of the company.

The factors that mostly affect the AC practices in Bangladesh as reported by the interview respondents include:

- (i) Lack of qualification and experience of the AC members;
- (ii) Non-appointment of AC chairpersons from independent/non-executive directors;
- (iii) Appointment of AC members from the executive directors of the board; and,
- (iv) To some extent, lack of diligence of the AC members.

The interviewees largely agreed upon the recommendations obtained in the questionnaire survey to overcome the above problems including:

- (i) Appointing a chairperson from external/independent directors;
- (ii) Introducing new rules and guidelines regarding the AC practices;

- (iii) Rigorously monitoring the compliance of the existing rules and guidelines;
- and,
- (iv) Appointing the majority of AC members from the independent/non-executive directors.

The interview responses, however, identified several aspects which are inconsistent with the questionnaire survey results, namely:

- (i) That the chairperson does not usually discuss content with other members of the committee before finalising the meeting agenda; and,
- (ii) That the AC does play a vital role in appointing external auditors and preparing EL for them.

As expected from the interviews, the responses also revealed some additional insight that were not covered in the close-ended questions of the questionnaire survey, they include:

- (i) The new rules and guidelines (as recommended in both questionnaire and interview surveys) should include the minimum qualification and/or experience of AC members in an accounting or auditing field;
- (ii) The finance head and/or the internal audit division head occasionally attend the AC meetings as an invitee(s);
- (iii) A remote distance between the company's office and the AC members sometimes does have adverse impact on its effectiveness;
- (iv) An external auditor should be co-opted in the AC for its better functioning;
- and,
- (v) Initiative should be taken to strengthen the internal audit division.
- (vi) In general, ACs in Financial Institution sector are more effective than other sectors.

7.3 Conclusion

The aim of the interview survey was to complement the questionnaire survey findings through gaining a greater insight of the AC practices in Bangladesh. Several

observations on the current scenario of AC practices in Bangladesh as obtained from the interview responses have been discussed in this chapter. There is a consensus between the respondents that the ACs have had limited success in achieving their objectives. The survey also noted some key factors that influence the ability of the ACs to be effective. Furthermore, the respondents also gave some suggestions on how AC effectiveness can be enhanced in Bangladesh.

This chapter has briefly discussed the findings obtained from the interview responses. The next chapter concludes the thesis by presenting a chapter by chapter overview of the thesis, some policy implications of the research, the major limitations of the study, and the potential scope for future researchers.

CHAPTER EIGHT: CONCLUSION

8.1 Introduction

As set out in *Chapter One* that the main objective of this study is to investigate the current state of Audit Committee (AC) practices in Bangladesh. This thesis is motivated primarily by the fact that to the best of researcher's knowledge there has been no prior academic study in the area of the practices of ACs in Bangladesh. Therefore, the study has comprehensively covered a wide range of issues relating to the AC practices in Bangladesh. The main aim of this chapter is to conclude the thesis with a chapter by chapter overview. It also highlights some policy implications of the study; acknowledges some limitations; and makes several recommendations for further study. Therefore, the structure of this final chapter is: Section 8.2 provides a summary of each chapter of this thesis; Section 8.3 states some policy implications of this research on the capital market development in Bangladesh; Section 8.4 points out some limitations of the research; Section 8.5 indicates some potential areas for future researchers; and, finally, Section 8.6 ends the thesis with some concluding notes.

8.2 Summary and Overview

This thesis has elaborately presented the whole journey of the study including: the background of the study, an environment analysis, the literature review, methodological issues, the findings and finally the implications of the study. *Chapter One* pointed out the need for the study, and also highlighted the prospective contributions of the study. The chapter also discussed the justification of the study, its contribution to accounting knowledge and existing literature, and its potential benefits to Bangladesh. Furthermore, the chapter briefly stated the research methodology, and an outline of the structure of the thesis.

Chapter Two outlined the current environment in Bangladesh in which the ACs operate. This chapter discussed the economic environment, capital market, and the institutional

and legal framework relating to the Corporate Governance (CG) as well as AC practices in Bangladesh. The chapter also gave a brief account of the prevailing guidelines on CG related issues in Bangladesh. It is seen that Bangladesh is improving gradually in terms of most economic indicators. Although there is no mandatory CG law (Act) in Bangladesh, the Company Act, 1994 has included some clauses regarding the governance of companies and has given investors some protection. The Securities and Exchange Commission (SEC) plays a leading role among the monitoring bodies in Bangladesh and in 2006 it issued an order of CG guidelines for the listed companies (which is to be followed on a 'comply or explain' basis). In addition, the Bangladesh Enterprise Institute (BEI) and the Institute of Chartered Accountants of Bangladesh (ICAB) have developed separate codes of CG for Bangladesh on the basis of the CG codes of developed economies including the U.K. and the U.S.A.

Chapter Three reviewed the literature on CG in general. It commenced with the background to the concept of CG which is about ensuring that the business is run properly. This chapter discussed some theories that have underpinned the development of CG. The agency problem, which was brought about by the separation of ownership (principals) and control (agent) is examined in detail. It has also been argued that the focus of CG is to ensure the protection of interests, as well as the welfare, of all stakeholders, instead of considering the shareholders alone. Furthermore, the chapter discussed the guidelines and models of CG as practised across the world. In the case of CG practices, the developing countries follow the models and guidelines instituted in the developed countries. The role of ACs as an effective mechanism of CG has been discussed in this chapter. The chapter underpinned the fact that if CG mechanisms are substitutable, then strong alternative CG mechanisms should mitigate the need for a firm to have an effective AC.

Chapter Four focused on the review of literature relating to the various facets of an AC. Commencing with a definition of an AC, the chapter highlighted that corporate ACs have developed and evolved as a result of dissatisfaction with the methods of CG in avoiding corporate scandals. It is interesting to note that in all of the countries where

they have become established, the ACs have been stimulated by unexpected company failures and/or corporate malpractices. The chapter discussed the advantages and disadvantages of having the AC in practice. The advantages and disadvantages that have been highlighted in this chapter support the proposition that establishing an AC is one thing, but establishing an effective AC is another. This chapter further examined the role and function of an effective AC. The chapter also presented a review of the effectiveness of ACs. Effectiveness is an elusive concept that can be approached through several models, none of which is appropriate in all circumstances. Furthermore, the chapter outlined the determinants of AC effectiveness. These main attributes are abridged as:

(A) Input Attributes:

- (i) Composition;
- (ii) Authority and Resources;
- (iii) Diligence;
- (iv) Meeting.

(B) Output Attributes:

- (i) Role in Financial Reporting;
- (ii) Role in Internal Control and Auditing; and,
- (iii) Role in External Auditing.

Furthermore, this chapter presented a model for AC effectiveness developed by the researcher. A brief background to the development of ACs in the U.K. and several other countries (including the U.S.A. and Bangladesh) was presented in this chapter. This chapter has been very useful in constructing the instruments of this study (i.e., the questionnaire and interview checklist) since it presented the best practices of the AC which has been used to compare with the actual AC practices in Bangladeshi corporations.

Chapter Five focused on the adoption of the research approach. There are two main types of empirical research in Social Science, namely: the quantitative approach and the qualitative approach. Many researchers have pointed out that quantitative research, while being very useful, is greatly improved when used in conjunction with other qualitative research method(s) (such as: case studies, interviews and observation). Triangulation exists when qualitative and quantitative research approaches are combined. The current study has adopted a mixed method of research, comprising a questionnaire survey and an interview survey. This chapter elaborated how the pilot study was carried out to develop the questionnaire, how it was conducted, and the benefits that were gained from respondents to the pilot study. The respondents contributing to the pilot research stage included: academics with an interest in accounting/auditing; AC chairpersons; company secretaries; finance heads; external auditors; and PhD students. The final version of the questionnaire consisted of fifty statements divided into eight broad aspects of an AC. The questionnaire also included nine factors that generally affect AC effectiveness, and also ten suggestions for improving AC effectiveness in Bangladesh. The chapter also gave details of the questionnaire administration procedures.

Chapter Five further discussed the second phase of data collection i.e. semi-structured interviews. The interview participants included five representatives from each of the four sample groups, namely: AC chairpersons, company secretaries, finance heads and external auditors. It had already been decided that the second method for collecting data in this research would be an examination through interviews to explore in more detail the effectiveness of the ACs in Bangladeshi. This chapter introduced eleven research hypotheses, and also explained the statistical tools used for analysing the data and testing the hypothesis. Both descriptive and inferential statistics were used in this study to analyse the data. The descriptive findings have been presented using frequencies, percentage, rank, mean, median and standard deviations. The significance of responses was examined using the Wilcoxon Signed Rank Test. The main objective of the hypothesis testing was to investigate whether there are any significant differences in the different responding groups. In order to test these hypotheses, two non-parametric tests

(namely, the Kruskal Wallis Test and the Mann Whitney U Test) were used. Furthermore, multiple regression models have been used to investigate the AC effectiveness. The interview responses of the study have been analysed using the 'Grounded Theory' which was also discussed in this chapter.

Chapter Six discussed the findings obtained from the questionnaire survey. The widely regarded statistical software 'Statistical Package for Social Science (SPSS)' was used to present the responses with descriptive statistics in the form of frequency, mean, standard deviation, and ranking. Several observations can be made from the results presented in this chapter. Firstly, the ACs are mostly dominated by executive directors, which raises a big question mark about the independence of the committees. Secondly, the expertise (i.e. qualification and experience) of the AC members is not at a satisfactory level. Thirdly, although the ACs play important role in some areas (including financial reporting, external auditing and internal auditing), there are still plenty of vacuums in these areas in which the ACs can play more proactive role. Finally, the regulatory bodies (including the SEC) and the stock exchanges should impose some new rules regarding the above issues, and they should also rigorously monitor the compliance of existing rules instead of leaving them on a 'comply or explain' basis.

Chapter Six also focused on the inferential data analysis. For example, the Wilcoxon Signed Rank Test was employed to examine the significance of agreement/disagreement to the fifty statements included in the questionnaire. The test results show that most of the statements were significantly agreed with by the three sample groups, namely: the AC chairpersons, company secretaries and finance heads. However, the external auditors significantly agreed with only 27 (out of 50) statements. It is noticeable that all four sample groups commonly disagreed with two statements, both of which relate to AC composition. This reflects the view that there are some major issues and absences in the composition of Bangladeshi ACs. The test results also indicate that there may have been some differences in responses within the sample groups.

Furthermore, the Kruskal Wallis Test was used to investigate whether there are differences in responses between the four samples. It has the distinct advantage of being applicable when more than two means are being compared. Another advantage of using this test is that it does not require normality in the distribution of the data set. The test results suggest that there is no significant difference in the responses of the different sample groups regarding four aspects of ACs in Bangladesh which are: (i) composition; (ii) authority and resources; (iii) diligence; and (v) overall independence and effectiveness. However, the null hypotheses in relation to the other four aspects [namely, (i) meeting; (ii) role in financial reporting; (iii) role in external auditing; and (iv) role in internal auditing] have been rejected by the test results at a 5% level of significance. This implies that there is a significance difference in the mean scores of responses obtained from the sample groups in relation to these four aspects. The Kruskal Wallis pair-wise comparison was used to address exactly which group differ with whom. The results suggest that, regarding one aspect (i.e. meeting) of AC, the responses of the external auditors differ to the responses provided by the other three sample groups. Meanwhile, the AC chairpersons differ with the other three groups relating to AC's role in internal auditing and external auditing. However, the company secretaries and the finance heads provided almost similar responses. Further, the Mann Whitney U Test has revealed that there is significant difference in responses between the two groups of respondents divided on the basis of their last education disciplines (i.e. accounting versus others), and professional qualification (i.e. having professional qualification versus not having any professional qualification); however, no significant difference was found between the two groups of responses divided on years of experience. Finally, the multiple regression models indicate that successful performance of an AC's role is significantly dependent on its composition; and the effectiveness an AC is highly dependent on AC's role in financial reporting.

Chapter Seven reported the results of the interview survey that was conducted with twenty participants consisting of five AC chairpersons, five company secretaries, five finance heads and five external auditors. The primary aim of these interviews was to complement the findings of the close-ended questionnaire survey and, therefore, this

approach was adopted to gain more insight into the research issue (i.e. the scenario of AC practices and the problems faced in carrying out AC responsibilities). Most of the interview survey findings were found to be consistent with that of the questionnaire survey findings. However, the interviewees disagreed with a few of the questionnaire survey findings and, importantly, they added more insight of the AC practices in Bangladesh. Several observations can be made from the interview results presented in this chapter. For example, there was a consensus between respondents that the ACs provide limited benefits compared to what they are expected to do. However, some of them claimed that the ACs enhance the independence of internal and external auditors, give confidence to the shareholders, enlighten the board of directors (BoDs), reduce personal relationship and favouritism, make the internal and external auditors more conscientious, detect problems early, and create a useful dialogue between the AC and the external auditors. One of the interviewees mentioned that we should not be pessimistic since the ACs in Bangladesh are at an ‘infant’ stage of evolution, and are still ‘finding their feet’, in terms of developing their role within companies. Furthermore, the affecting factors identified by the interviewees were:

- (i) In general, the AC members do not have sufficient expertise (qualification and experience);
- (ii) The ACs usually include the executive directors from the board;
- (iii) Independent AC members are chosen mainly on personal relationship;
- (iv) There is an absence of an updated charter or agenda;
- (v) Proper functioning of the ACs is sometimes hampered by the physical separation of the AC members from the head office of the company;
- (vi) The AC members do not devote much time to the committee’s affairs; and,
- (vii) The remuneration of the independent members is insufficient.

The interview respondents distinguished between the ACs in financial institutions and in other companies, which are obviously different as a result of the effective control of financial institutions by the central bank (Bangladesh Bank). The scenario of AC practices was better reported in the case of financial institutions when compared to companies of other sectors. The interviewees explained that this difference exists

because financial institutions are closely monitored and regulated by the Bangladesh Bank on the top of the SEC. The interviewees highlighted that the SEC should introduce new guidelines in relation to AC practices. Other suggestions given by the interviewees include:

- (i) The SEC and other regulatory bodies including the stock exchanges should increase their vigilance in monitoring the existing rules in relation to CG practices
- (ii) The majority of AC members (including the chairperson) should be appointed from independent/non-executive directors;
- (iii) The AC should include more expert (knowledgeable and experienced) members; and,
- (iv) An AC report should be included in the annual report of the company.

8.3 Policy Implications

In this thesis some general recommendations have been made, which may serve to advance the work of the ACs in Bangladesh and enhance their role to achieve the requisite effectiveness of these committees. The study shows that the ACs in Bangladesh have a number of weaknesses resulting in many ACs being seen as 'rubber stamps'. Some key attributes (for example, composition, independence from management, diligence) discussed in this research should be addressed for the better functioning of the ACs. There is an obvious need for the specification of the background and experience required for the members of the ACs, to ensure that they are not affected by company management. Furthermore, the duties of the AC, its authorities, literacy, and diligence should be clearly defined. This could be achieved by establishing a feasible mechanism to prepare the members of the ACs and specify their remunerations to enable them to work without any restriction from management.

Therefore, in addition to the contribution to the existing literature, the findings seem to have important policy implications from the perspective of the significance of CG in the development of the capital market in Bangladesh. The study also supports the policy

agenda of the multilateral organisations such as the World Bank (WB), the International Monetary Fund (IMF), and the Asian Development Bank (ADB), which have encouraged the government to improve overall CG standards as a necessary precondition of broad-based corporate sector reform. The development partners emphasise the need to change the corporate laws and develop the capacity building of the regulatory agencies to improve firm-level CG, which in turn helps to avoid potential vulnerability in the financial system, and in enhancing the capital market and corporate sector development.

Whilst the government and regulatory institutions seem to encourage people to invest in the capital market, there have not been any noticeable measures to improve the governance role of the capital market. The issues of transparency and accountability at both firm-level and operational level of the capital market seem to be very important in attracting foreign investors and in restoring the local investors' confidence that has been damaged because of the recent crash in the DSE. The government has taken some initiatives to bring back confidence in investors such as restructuring the SEC. The newly appointed members and chairman of the SEC are committed to reforming the capital market regulations. Since the current study investigated the AC scenario of recent times, it is believed to have made a significant contribution in the development of new capital market regulations as intended by the SEC.

Finally, it is important to mention that the poor state of AC as well as CG practices in a developing country like Bangladesh tends to be derived from the lack of an ethical business philosophy, combined with cronyism amongst the businessmen, the politicians and a group of managers and civil servants, who are trying to maximise their economic benefits. Without breaking this pattern of relationship and instilling ethical values amongst the powerful stakeholders concerned, any type of reform initiative to restructure the CG framework is less likely to be successful. In this line, the researcher feels that the government should take an initiative to establish a National Corporate Governance Institute (similar institutes already exist in some neighbouring countries including India and Pakistan) with the goal of promoting a framework of best CG

practices, structure, processes and ethics in Bangladesh. This study hopefully significantly contributes by recommending establishing such an institution or centre in Bangladesh.

8.4 Limitations

It is important for both the researcher and the users of the research to be aware of the relevant limitations as they seek to develop and interpret the results of the study or to clarify their meaning (Anderson and Poole, 2001). It should be acknowledged that the questionnaire survey method is not free from some of its inherent limitations. Matthews (2002) noted that all surveys have some inherent weaknesses. For instance, the respondents might give answers which they think are expected of them, or which show themselves and their firm in the best light. This concern might be directed to some responses of the internals (AC chairpersons, company secretaries and finance heads) who may have exaggerated their evaluation of the AC practices as this was found to be significantly more than the other sample group (i.e. external auditors). Furthermore, it is possible that the questionnaire may have lacked in clarity, which might have caused the respondents to interpret some questions differently; even though the questionnaire underwent a rigorous pilot survey. Another limitation of the research stems from the small sample size of the interview survey. It may be argued that conducting more interviews could have obtained deeper insight into the issue. However, as discussed in *Chapter Five*, the interview survey was only one of the two data collection methods adopted in the study and the main objective of the interview survey was to complement the questionnaire survey methods by acquiring more insight so that the findings obtained from the questionnaire survey could be more reliable.

8.5 The Potential for Future Research

This has been one of the first academic studies on the AC practices in Bangladesh. Arguably, many of the areas covered in this study warrant more specific and in-depth investigation. Further research could investigate the effectiveness of ACs including

some control variables of the companies (for example, size, industry, age etc) in regression model. Again, it would be interesting to see if there is any relationship between the setting up of ACs in Bangladesh and any increase in earnings and profits within these corporations. Further research could also focus on the second part of AC effectiveness model (i.e. the consequences of AC effectiveness) presented in *Chapter Four* of the thesis. The study can also be extended in some other South Asian countries (such as: India, Pakistan and Sri Lanka) to ascertain and compare the effectiveness of their ACs and so present a larger and more substantial analysis of economies from developing countries. The future research could also solicit opinions of some other stakeholder groups including members of executive management (e.g. CEO); members of BODs; members of regulatory bodies including the SEC and the DSE; internal auditors; independent AC members; institutional investors; academicians, politicians; and ordinary shareholders.

8.6 Conclusion

This study has been able to achieve its main objective. It has also been able to answer all of the research questions posed. More specifically, the study has comprehensively investigated the AC practices in Bangladesh. It has also identified the crucial factors that affect the AC effectiveness. Essentially, this study has taken a holistic view to describe the scenario of AC practices in Bangladesh in light of the AC effectiveness model as depicted in *Chapter Four*. The model has been thoroughly used in both data collection and data analysis of this study. The results of regression analysis also indicate the soundness of the AC effectiveness model. Overall, the model has been very useful in achieving the objective of this study. This study will hopefully add to the literature on AC practices from the perspective of an emerging economy and also will contribute to the development of Bangladeshi capital market. It is hoped that future researchers will be able to carry through the issues highlighted by this study, modify the model of AC effectiveness and also extend the avenues that the study has opened up.

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Appendix 1: Cover Letter from the Researcher for Questionnaire Survey

May 02, 2010

Dear Sir/Madam:

Re: PhD Research on Audit Committee Practices in Bangladesh

I am an assistant professor of the Institute of Business Administration (IBA), Dhaka University. Currently, I am pursuing my PhD at Cardiff Business School, Cardiff University, UK as a Commonwealth Scholar under the supervision of Dr. Yusuf Karbhari.

I am particularly interested in investigating into the audit committee practices of firms listed on the Dhaka Stock Exchange. The study findings are expected to be useful in strengthening corporate governance practices particularly audit committee practices in Bangladeshi firms. This survey is an important part of the research and your valuable cooperation and participation in answering the questionnaire will be greatly appreciated.

I would therefore, be most grateful if you could spare some of your valuable time to complete the enclosed questionnaire and return it in the enclosed envelope. I can assure you that all responses will be used for research purpose only and will be treated with the strictest confidence and anonymity. Results relating to individual organizations will not be tabulated in the research report. Please note that a summary of the research findings will be despatched to all the participants in the study who wish to receive it. If you have any query, please do not hesitate to contact me at: voice: (+88) 01552441240, fax: (+8802) 8621411 and e-mail: mm@iba-du.edu or MohiuddinM@cardiff.ac.uk.

Thank you for your kind cooperation.

Yours sincerely,

(Md. Mohiuddin)

Appendix 2: Cover Letter from the Supervisor for Questionnaire Survey

March 30, 2010

To Whom It May Concern

Dear Sir/Madam:

Re: PhD Research on Audit Committee Practices in Bangladesh

This is to confirm that Md. Mohiuddin is enrolled as a PhD student at Cardiff Business School, Cardiff University, U.K. under my supervision. The research he is undertaking for his PhD studies involves an empirical investigation of the audit committee practices within firms listed on the Dhaka Stock Exchange. The research he is undertaking is both highly relevant and topical and his findings will hopefully contribute to some major policy implications for the advancement of corporate governance in Bangladesh. I would therefore be extremely grateful if you could assist in this very important study by sparing a few moments of your valuable time in completing the attached questionnaire. I am very much hopeful that Md. Mohiuddin can count on your cooperation in this respect.

Yours sincerely,

(Dr. Yusuf Karbhari)

Appendix 3: Survey Questionnaire



**AN EMPIRICAL INVESTIGATION INTO THE
AUDIT COMMITTEE PRACTICES IN
BANGLADESH: THE CASE OF COMPANIES
LISTED ON THE DHAKA STOCK EXCHANGE**

CARDIFF BUSINESS SCHOOL

MAY 2010

Md. Mohiuddin
Assistant Professor (on leave)
Institute of Business Administration (IBA)
University of Dhaka, Bangladesh

Under the supervision of:
Dr. Yusuf Karbhari
Reader in Accounting
Cardiff University, UK

Dear Respondent:

Although you are an extremely busy person, please note that this questionnaire has been designed specifically so that it can be completed with minimum time and effort.

May I also take this opportunity of thanking you in advance for your contribution and cooperation by devoting a few moments of your time in this interesting and topical piece of research on ‘Audit Committee Practices of the Companies Listed on the Dhaka Stock Exchange’. I hereby reassure that the details provided in the completed questionnaire will be treated with utmost confidence. It should also be noted that findings of the study will be presented in an aggregate form and individual company will not be identified.

Kind regards.

Yours sincerely,

Md. Mohiuddin

Part I: Respondent's Information (please circle the appropriate option)

1.1 Your last educational degree:

Bachelors Degree	Masters Degree	Ph. D Degree	Other (please specify)
1	2	3	4_____

1.2 Major of your last educational degree:

Accounting	Finance	Marketing	Management	Economics	Other (please specify)
1	2	3	4	5	6_____

1.3 Do you have any professional qualification (e.g. CA/ACCA/CMA/CFA/CS etc.) in Accounting/Auditing/Finance or related area? 1. Yes 2. No

If yes, please specify the qualification: _____

1.4 Please specify for how long (in years) you are holding the current position in this company. _____

1.5 Do you have any previous work experience in Accounting/Auditing/Finance or related area? 1. Yes 2. No

If yes, please specify total number of years of such experiences: _____

Part II: Responses about Prevailing Audit Committee Practices in the Company

Instructions: The following set of statements deal with your perception towards some issues that relate to the **Existing Practice (NOT the Ideal Practice)** of audit committees (ACs) in your company. Please indicate the extent to which you agree or disagree with each of the following statements by circling only one number, where; 1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, and 5= Strongly Agree. For example, if you strongly agree with any particular statement, please put a circle around 5.

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
A. Composition					
1. The AC members are appointed in consultation with the AC chairperson.	1	2	3	4	5
2. The AC members have sufficient knowledge on the entity's business.	1	2	3	4	5
3. The AC members have sufficient knowledge on Accounting and/or Auditing practices.	1	2	3	4	5
4. The AC members have sufficient experience in Accounting and/or Auditing.	1	2	3	4	5
5. The AC members are capable of mediating problems in performing their duties.	1	2	3	4	5
6. The majority of AC members are independent /non-executive directors.	1	2	3	4	5
7. The chairperson of the AC is an independent/non-executive director*.	1	2	3	4	5
8. The size of the AC is appropriate for carrying out its duties properly.	1	2	3	4	5

*An **external/independent** member of the AC is he/she who is not a member of the Board of Directors and/or Management/Executive Committee and/or any other employee of the company.

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
B. Authority and Resources					
9. The AC has adequate authority in order to carry out its responsibilities.	1	2	3	4	5
10. The AC has ready access to relevant information if required.	1	2	3	4	5
11. The AC receives prompt responses from the management in carrying out its duties.	1	2	3	4	5
12. The AC is provided with sufficient resources including secretarial support to carry out its duties.	1	2	3	4	5
13. The non-executive AC members are adequately paid for their time and efforts.	1	2	3	4	5
C. Diligence					
14. The AC has a charter which outlines its objectives, duties and responsibilities.	1	2	3	4	5
15. The AC charter is reviewed annually.	1	2	3	4	5
16. The AC members have a clear understanding of their responsibilities.	1	2	3	4	5
17. Members of the AC readily assume their responsibilities.	1	2	3	4	5
18. The AC members devote sufficient time to the committee's affairs.	1	2	3	4	5
D. Meeting					
19. The agendas of the AC meetings are finalized by the chairperson.	1	2	3	4	5
20. The chairperson cooperates with other committee members before finalizing the agenda of the meetings.	1	2	3	4	5
21. The agenda and related materials are provided to members fairly ahead of the meetings.	1	2	3	4	5
22. All members can express their views freely and independently in the meetings.	1	2	3	4	5
23. The frequency of the AC meetings is sufficient to carry out its responsibilities.	1	2	3	4	5
24. The duration of the AC meetings is sufficient for a full discussion of important issues.	1	2	3	4	5
25. Non-members attend the AC meetings if required.	1	2	3	4	5
26. The minutes of the AC meetings are circulated to all members of the Board of Directors (BODs).	1	2	3	4	5
E. Role in Financial Reporting					
27. The AC reviews the integrity of companies' financial statements.	1	2	3	4	5
28. The AC reviews accounting policies and any changes made therein.	1	2	3	4	5
29. The AC reviews accounting estimates and judgments done in preparing financial statements.	1	2	3	4	5
30. The AC reviews the compliance of the Accounting Standards (e.g. IAS, BAS etc.) in preparing financial statements.	1	2	3	4	5
31. The AC reviews the clarity and completeness of disclosures in financial statements.	1	2	3	4	5

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
32. The AC reviews other information (e.g. the auditors' report, financial highlights etc.) presented in the annual report.	1	2	3	4	5
F. Role in External Auditing					
33. External auditors are appointed and/or removed upon the recommendation of the AC.	1	2	3	4	5
34. The AC assesses and reviews the expertise and resources of the external auditors.	1	2	3	4	5
35. The AC reviews and approves the terms of the Engagement Letter (EL) prepared for the external auditors.	1	2	3	4	5
36. The AC monitors the external audit firm's compliance with the existing ethical and regulatory requirements in Bangladesh.	1	2	3	4	5
37. The AC reviews the findings of the annual audit obtained by the external auditors.	1	2	3	4	5
38. The AC reviews the management's responsiveness to the external auditors' findings.	1	2	3	4	5
39. The AC meets with the external auditors without the presence of the management to discuss any issues, problems or reservations arising from the audit.	1	2	3	4	5
40. The AC reviews and monitors the independence and effectiveness of the external auditing process.	1	2	3	4	5
G. Role in Internal Auditing					
41. The AC recommends and approves the appointment or termination of the heads of the internal audit division.	1	2	3	4	5
42. The AC approves and reviews the charter of the internal auditors.	1	2	3	4	5
43. The AC assesses and reviews the annual internal audit work plan.	1	2	3	4	5
44. The AC reviews the annual internal audit reports, budget and other findings.	1	2	3	4	5
45. The AC reviews and monitors the management's responsiveness to the internal auditor's findings and recommendations.	1	2	3	4	5
46. The AC meets with the head of the internal audit function without the presence of the management.	1	2	3	4	5
47. The AC enhances the independence of the internal auditors of the company.	1	2	3	4	5
48. The AC monitors and evaluates the effectiveness of the internal audit function.	1	2	3	4	5
H. Overall Practice					
49. The AC can work independently.	1	2	3	4	5
50. The AC is effective.	1	2	3	4	5

Part III: Factors affecting Audit Committee Practices in Bangladesh

Instructions: The following statements deal with your perception towards some factors that affect the existing practice of audit committees (ACs) in the Bangladesh.

Factors	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1. Lack of AC members' qualification in relevant field.	1	2	3	4	5
2. Lack of AC members' experience and expertise in the relevant field.	1	2	3	4	5
3. Non-inclusion of majority independent/external members in the ACs.	1	2	3	4	5
4. Non-appointment of AC chairperson from external/independent members.	1	2	3	4	5
5. Low frequency of AC meetings.	1	2	3	4	5
6. Lack of diligence in AC members.	1	2	3	4	5
7. Inadequate authority delegated to the ACs.	1	2	3	4	5
8. Inadequate resources provided to the AC.	1	2	3	4	5
9. Lack of supports from top management.	1	2	3	4	5

Part IV: Suggestions

Instructions: The following issues deal with your perception about how AC effectiveness can be enhanced in Bangladesh.

Possible Measures	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
1. Voluntary and self regulation by the companies.	1	2	3	4	5
2. Increased pressure from general investors.	1	2	3	4	5
3. Increased monitoring of existing rules and guidelines.	1	2	3	4	5
4. Introducing some new rules and guidelines.	1	2	3	4	5
5. Compulsory inclusion of AC report in the Annual Corporate Report.	1	2	3	4	5
6. Mandating the appointment of AC chairperson from independent/external directors.	1	2	3	4	5
7. Mandating inclusion of majority independent /external members in the ACs.	1	2	3	4	5
8. Including AC practices in the listing requirements of stock exchanges.	1	2	3	4	5
9. Offering some incentives to the firms that comply with AC guidelines of SEC (issued in 2006).	1	2	3	4	5
10. Compulsory compliance of SEC order of 2006 regarding the guidelines of AC practices.	1	2	3	4	5

Follow Up

Would you be willing to be contacted for any further participation (e.g. interview) in this research?

(A) Yes

(B) No

If yes, please state your contact number(s): _____

Study Feedback

Would you like to receive a copy of the summary findings of this research?

(A) Yes

(B) No

If yes, please provide your contact address below:

Name	
Mailing Address	
Phone Number(s)	
E-mail Address(s)	

Researcher's Contacts:

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THANK YOU ONCE AGAIN FOR YOUR GENEROUS COOPERATION.

Appendix 4: Interview Consent Form

Interview Consent Form

This consent form outlines my rights as a participant in the study of “An Empirical Investigation into the Audit Committee Practices in Bangladesh: The Case of Companies Listed on the Dhaka Stock Exchange” being conducted by Md. Mohiuddin, Cardiff Business School, Cardiff University, UK. The interview is intended to explore my opinions about existing Audit committee practices in Bangladesh.

I understand that:

Taking part in this study is entirely voluntary;
The purpose and nature of the interview has been clearly explained to me;
It is my right to decline to answer any question that I am asked;
I am free to end the interview at any time;
I may request that the interview not be taped; and
My name will not appear on any tapes or transcripts resulting from the interview.

I HAVE READ THIS CONSENT FORM. I HAVE HAD A CHANCE TO ASK QUESTIONS CONCERNING ANY AREAS THAT I DID NOT UNDERSTAND.

(Signature of Interviewee and Date)

(Printed Name of Interviewee)

You may decline to participate in this study. You may end your participation in this study at any time. Maintaining your anonymity is a priority and every practical precaution will be taken to disguise your identity. There will not be any identifying information on audiotapes or transcripts of this interview. I will not allow anyone other than the research advisor to hear any audiotape of your voice or review a transcript of this interview. All materials generated from your interview will remain in my direct physical possession and will be dealt with full confidentiality.

I have explained the project and the implications of being interviewed to the interviewee and I believe that the consent is informed and that he/she understands the implications of participation.

(Md. Mohiuddin)

Appendix 5: Interview Checklist



AN EMPIRICAL INVESTIGATION INTO THE AUDIT COMMITTEE PRACTICES IN BANGLADESH: THE CASE OF COMPANIES LISTED ON THE DHAKA STOCK EXCHANGE

CARDIFF BUSINESS SCHOOL

JUNE 2010

Md. Mohiuddin
Assistant Professor (on leave)
Institute of Business Administration
(IBA)
University of Dhaka, Bangladesh

Under the supervision of:
Dr. Yusuf Karbhari
Reader in Accounting
Cardiff University, UK

INTERVIEW GUIDE: AN EMPIRICAL INVESTIGATION INTO THE AUDIT COMMITTEE PRACTICES IN BANGLADESH: CASE OF COMPANIES LISTED ON THE DHAKA STOCK EXCHANGE

Interview Schedule:

Date: _____

Time: _____

Place: _____

Introduction:

Thanks for the consent and appointment.

Introduce yourself (exchange of visiting cards)

Mention nature, relevance and importance of the survey.

Assure anonymity and strictest confidentiality.

Section I: Background Information

- Organization (Name, Sector and Paid up Capital (BDT): _____

- Name of the Participant: _____
- Current Position: _____
- Experience: (i) Current position: _____ years. (ii) Relevant Area: _____ years
- Educational Qualification: (i) Last Degree: _____ (ii) Subject: _____
- Professional Qualification (if any): _____

Section II: Starting Question

- Would you please share your opinions about the importance of an Audit Committee (AC) in improving the overall governance quality of the company and protecting stakeholders' interest?
- Do you think all stakeholders in Bangladesh are properly aware of AC importance?

Section III: Composition of the AC

- Would you please tell us something about the AC in your company in terms of its size, composition etc.?
- Please tell me about the procedure how AC members/chairman are appointed in Bangladesh.
- How do you evaluate the necessity of the following characteristics of AC members for its effective functioning?
 - Relevant qualification:
 - Relevant experience:
 - Independence:
 - Size:

Section IV: Authority and Resources of the AC

- Do you think the ACs in Bangladesh are delegated adequate authority required to perform its duties properly?
- Can the ACs perform their duties independently? Please explain.
- Do the committees get ready access to the information required for performing their job?
- Do the ACs get adequate secretarial supports for carrying out their duties?
- Are the external independent members of the AC paid enough remuneration and benefits for their time and efforts deployed for the company?

Section V: Diligence and Meeting of the AC

- Are the AC members properly aware of their role and responsibilities?
- Do the members of ACs wilfully assume their responsibilities?
- Do the AC members devote adequate time and effort for performing their duties?
- Does the AC meet regularly? How often?
- Please tell me how the agenda of AC meeting is decided.
- Can all members talk freely in the AC meetings?
- Does anybody else (other than AC members) attend the AC meetings regularly?

Section VI: Role of the AC

- What are main areas where the ACs in Bangladesh play role?
- What role does the AC undertake for the company in the following areas?
 - Financial Reporting
 - Internal Control and Auditing
 - External Auditing
- In what other areas (if any) does the AC play role for the company?
- Does the AC have regular contacts with both external auditors and internal auditors?
- Does the AC sit with the head of internal audit section to discuss about their role in absence of management?
- Does the AC have any role in appointing external auditor for the company?
Please explain.

Section VII: Overall Scenario and Recommendations

- What do you think about independence of ACs in Bangladesh?
- Do you think that ACs in Bangladesh can achieve their objectives? Explain.
- Please comment on the overall effectiveness of AC in Bangladesh.

Section VIII: Factors Affecting the AC Effectiveness

- What factors mainly affect the AC practices in Bangladesh and how?
- What are the main barriers of effective AC practices in Bangladesh?

Section IX: Suggested Measures

- Do you think that the existing regulations are adequate for ensuring sound AC practice in Bangladesh?
- Would you please recommend on the following issues that you believe can enhance the AC effectiveness in Bangladesh?
 - Size of AC and members' category
 - Chairmanship of AC

- Qualification/Education of AC members*
- Experience of AC members*
- Authorities of the ACs*
- Resources of the ACs*
- No of meetings in a year, choosing the agendas for meetings etc.*
- Reporting and Communication of the ACs:*

Section X: Ending Question

Are there any issues relating to AC practice in Bangladesh that have not been covered in this interview and which you feel important? Please feel free to share as elaborate as you like.

THANK YOU ONCE AGAIN FOR YOUR GENEROUS COOPERATION.