Audit committee effectiveness: perspectives from South African audit committee members of JSE-listed companies

A research report submitted by

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List of defined terms

Term/Abbreviation	Definition/Full term
AC	Audit committee
ACE	Audit committee effectiveness
CA	Chartered Accountant
CA(SA)	Chartered Accountant (South Africa)
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CV	Curriculum Vitae
ESG	Environmental, Social and Governance
FD	Financial Director
FM	Financial Manager
IASB	International Accounting Standards Board
IIRC	International Integrated Reporting Council
IoDSA	Institute of Directors in South Africa
IRBA	Independent Regulatory Board for Auditors
JSE	Johannesburg Stock Exchange
King IV	King IV Code of Corporate Governance
NYSE	New York Stock Exchange
SA	South Africa
SAICA	South African Institute of Chartered Accountants
SOE	State Owned Enterprise
UK	United Kingdom

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Abstract

This study investigates audit committee effectiveness from the perspective of South African audit committee members. Data were collected from 10 semi-structured open-ended interviews. The observations of 6 current audit committee members of companies listed on the Johannesburg Stock Exchange (JSE) were analysed and corroborated by the opinions of 2 external audit partners, an internal auditor and a regulator of accounting and governance.

This research found that the levels of audit committee effectiveness of JSE-listed companies are poor. Nevertheless, respondents were of the opinion that there seems to have been a marked improvement from 10 or 15 years ago. Poor audit committee effectiveness has been attributed to overreliance on management for information and the lack of diligence to perform independent in-depth enquiry.

Key words:

Accountability, audit committees, audit committee effectiveness, corporate governance, financial reporting, South Africa

Chapter 1: Introduction

1.1 Context of the study

Audit committees (ACs) are regarded as a critical element of ethical and effective corporate governance (Institute of Directors in South Africa (IoDSA), 2016). First established during the 1800's in the United Kingdom (UK), ACs are now an institutional requirement for listed companies in most countries (DeZoort, F. T., Hermanson, D. R., Archambeault, D. S., & Reed, S. A., 2002a).

South Africa (SA) is considered a leader in corporate reporting (Schwab & Sala-i-Martin, 2014). The South African Companies Act of 2008 requires the formation of an AC for all public interest entities (*Companies Act No. 71*, 2008). An AC is also required to comply with the King IV Code of Corporate Governance (King IV) to be listed on the Johannesburg Stock Exchange[1] (JSE) (IoDSA, 2016; JSE, 2017). Despite this, there have been numerous cases of corporate fraud in SA in recent years. Steinhoff, Tongaat-Hulett and VBS Bank are examples of SA corporate reporting scandals severely impacting the national economy and SA's reputation in global capital markets (Schwab & Sala-i-Martin, 2014).

As a result, external audit and audit committee effectiveness (ACE) have become the subject of much debate, as it is clear that the existence of an AC does not guarantee its goals will be achieved and fraud will be prevented (Sommer, 1991; Van der Nest, 2008; Kwakye, T. O., Owusu, G. M. Y., & Bekoe, R. A., 2018). The requirements for AC composition and functioning have become increasingly prescriptive on most stock exchanges in an attempt to reduce fraudulent corporate reporting and management abuse of power (Wu, 2012; Alhossini, Ntim & Zalata, 2021).

The definition of ACE developed by DeZoort et al. (2002a), together with the concept of social powers developed by Kalbers and Fogarty (1993), form the basis for evaluation of ACE in this study. Other existing literature on ACE, influence and team effectiveness (see Bailey (1983), Barrick, M. R., Stewart, G. L., Neubert, M. J., & Mount, M. K. (1998), Spira (1998), Turley and Zaman (2007) and Van der Nest (2008)), as well as applicable theories embodied in technical accounting literature (see De Villiers and Hsiao (2018) and San, A. N. C., Moorthy, M. K., & Lung, C. K. (2012)), have been used to supplement understanding of ACE.

[1] The JSE is the largest securities exchange in Africa. It is based in Johannesburg, South Africa, and provides a market platform for multiple classes of financial instruments to be exchanged.

1.2 Research problem

Corporate governance describes "the structures, processes, and institutions within and around organisations that allocate power and resource control among participants" (Davis, C. G., Thake, J., & Vilhena, N., 2005, p. 143). Corporate governance is a vital tool to help an organization to align with various stakeholder interests and carry out its operations in a fair and effective manner (Aguilera, R.V., Marano, V. and Haxhi, I., 2019).

ACs are an established structure within JSE-listed organisations which are given the power and resources to monitor the integrity of the financial statements and help provide strategic direction to the company. The effectiveness of ACs is nevertheless the subject of much debate. Prior literature and recent instances of fraud suggest that the mere existence of an AC does not guarantee its success and that fraud will be prevented (Sommer, 1991; Van der Nest, 2008; Kwakye et al., 2018; Weickgenannt, Hermanson & Sharma, 2021).

Despite the existing body of theoretical literature on ACs and ACE, ACE in practice is subjective, relative and difficult to measure (Wu, 2012; Alhossini et al., 2021). Owing to the critical role ACs can play in the prevention of corporate failures, it is important to gain a deeper understanding of ACs and their effects. This is a broad problem which will require incremental and consecutive research projects to address.

1.3 Research objective

It is the aim of this study to conduct a qualitative investigation into whether ACE is achieved, from the perspective of AC members, through the exploration of (1) the operationalisation of JSE ACs in SA and (2) AC members' experiences and perspectives of sitting on JSE ACs. This includes gaining an understanding of participants' opinions of their peers and ACE. This is a first step towards gaining a better understanding of ACE and the actual role ACs play in corporate governance in SA.

1.4 Significance of this study

An effective AC is essential for good corporate governance and aligning an organisation to stakeholder interests (Aguilera et al., 2019; Spira, 1998; Turley & Zaman, 2007; Van der Nest, 2008; IoDSA, 2016). Following a series of corporate scandals worldwide, there have been calls for ACs to meet growing societal demands (Sommer, 1991; Wu, 2012; Soliman & Ragab, 2014; Kwakye et al., 2018). Research aiming to begin a comprehensive study of actual ACE is vital for organisations, regulators and investors in their respective decision-making processes and in guiding the evolution of AC roles, functions and guidance (Aguilera et al., 2019).

While there is a body of qualitative research on corporate governance in general (see (Aguilera et al., 2019), Filatotchev & Wright (2011) and Shleifer & Vishny (1997)), most prior research on ACE, in particular, has been quantitative (Wu, 2012; Maroun & Atkins, 2014; Kayleen, 2019; Kapkiyai, C., Cheboi, J., & Komen, J., 2020). Additionally, most of the qualitative ACE research which does exist quantifies disclosures around ACs (Gendron & Bédard, 2006; Wu, 2012; Maroun & Atkins, 2014; Alhossini et al., 2021). Disclosure analysis is insufficient and inappropriate to evaluate ACE in practice because report disclosures (such as number of meetings) do not fully capture the diversity of AC methods and impacts, nor do they reflect the real actions and effectiveness of ACs (Gendron & Bédard, 2006; Turley & Zaman, 2007; Wu, 2012). The number of meetings, for example, does not communicate the nature of those meetings, nor the impact made by the AC as a result (Gendron & Bédard, 2006).

This study contributes to the corporate governance literature by providing detailed qualitative data of current AC members as well as corroborative evidence from the perspective of external audit partners, an internal auditor and corporate governance consultant, an accounting and governance standard regulator, and an accounting and governance academic. This approach provides insights into the subjective aspects of ACE (such as the commitment and motivation of AC members) which cannot be measured by quantitative methods.

1.5 Assumptions, limitations and delimitations

This research has been conducted on the assumption that ACs are vital for effective corporate governance and that the effectiveness of an AC is a product of the attributes and conduct of its members (Wu, 2012; Alhossini et al., 2021).

This research also assumes, as with prior research, that responses from interviews are honest and complete. In addition, because of the nature of qualitative research and the sample size, results from this study are not meant to be generalisable. As a consequence, findings should be used with caution in differing contexts.

A delimitation of this study is that only candidates operating in the context of JSE-listed companies were interviewed. Findings are relevant to those practising and researching in SA, as well as to provide uniquely South African data for use globally.

1.6 Organisation of this study

This paper consists of 5 chapters and is structured as follows: Chapter 2 reviews prior literature relevant to ACE and provides the theoretical background on which this study is founded. Chapter 3 details the method used to conduct this research. Chapter 4 provides the results of the study and discusses potential implications of the findings. Chapter 5 concludes the paper and provides areas for further research. The appendix contains documents relevant to this research process.

Chapter 2: Background

2.1 History and overview of ACs

According to agency theory, information asymmetry is brought about by the separation of ownership and control. While shareholders are the owners of a business, management are in control of its day-to-day operations (Jenson & Meckling, 1976; Filatotchev & Wright, (2011)). Because of this, management have greater access to information than shareholders do and may use this to their advantage (Gordon & Porter, 2009; De Villiers & Hsiao, 2018; Alhossini et al., 2021).

Management run the business on behalf of the shareholders and shareholders use the annual financial statements to monitor management performance from afar (Hopwood, 1987). This means that management have the opportunity to make decisions that enhance their own personal gain rather than execute shareholders' objectives (Jenson & Meckling, 1976; Bananuka, Nkundabanyanga, Nalukenge & Kaawaase, 2018; Alhossini et al., 2021). Managers report operational performance back to shareholders and so have incentive to manipulate accounts to represent their actions and decisions favourably (Whittington, 2008; Ravenscroft & Williams, 2009; Murphy, T., O'Connell, V., & Ó hÓgartaigh, C., 2013). ACs were initially created, inter alia, as a mechanism to protect shareholders against this abuse of management power (Kalbers & Fogarty, 1993; DeZoort et al., 2002a; Gendron & Bédard, 2006; Wu, 2012; Asiriuwa, Aronmwan & Uwuigbe, 2018; Alhossini et al., 2021).

In order to protect against management abuse of power, establishment of an AC is widely regarded as best practice for monitoring of controls and for governance (Van der Nest, 2008; Bananuka et al, 2018). In SA, the Companies Act No.71 of 2008 (herein referred to as "the Companies Act"), requires public companies and state-owned entities to appoint an AC, as well as if the company's Memorandum of Incorporation requires an AC to be established, or if the company's financial statements are required to be audited. It is also a requirement for companies to appoint an AC in order to be listed on the JSE (Van der Nest, 2008; Deloitte, 2014; IoDSA, 2016; JSE, 2017).

An AC is a sub-committee of a company's board of directors which is delegated the responsibility of monitoring the financial reporting process and ensuring accountability of an organisation (Van der Nest, 2008; Soliman & Ragab, 2014; IoDSA, 2016; Kwakye et al., 2018). According to the Companies Act, an AC has the duties (amongst others) to (1) nominate the external auditor; (2)

determine terms of engagement with and the fees to be paid to the external auditor; (3) approve and monitor any non-assurance engagements with the external auditor; (4) receive and deal appropriately with any concerns relating to the accounting practices, internal controls, auditing or content of the financial statements and (5) to perform any other monitoring functions as determined by the governing body (*Companies Act No. 71*, 2008).

Every member of the AC must be (1) a director of the company who is not involved in the day-to-day management of its operations (non-executive), (2) not be a prescribed officer or employee of the company or related entity currently or during the previous three years, (3) not be a material supplier or customer of that organisation and (4) not related be to any of the above (*Companies Act No. 71*, 2008).

Compliance with King IV is a JSE listing requirement which, similarly to the Companies Act, requires all AC members to be independent non-executive directors (IoDSA, 2016). Consequently, executives such as Chief Executive Officers (CEOs), Chief Financial Officers (CFOs) or Financial Managers (FMs) are not eligible AC members. Independent non-executive members are seen to be best suited to deal with corporate governance issues as they are not involved in the day-to-day operations of the company and are not remunerated based on company performance. This means that AC members may be able to maintain an objective mindset and are less susceptible to self-interested behaviour (Deloitte, 2014; IoDSA, 2016).

Nevertheless, despite the delegation of supervision over internal controls and the financial reporting process to the AC, ultimate responsibility for corporate governance and the financial statements remains with the governing body (*Companies Act No. 71*, 2008). The appointment of an AC is merely an internal mechanism established to enhance the monitoring capabilities of the governing body.

The Treadway Commission of 1987 and the Sarbanes-Oxley Act of 2002 in the U.S.A.; the Cadbury Report of 1992 and Macdonald Committee of 1992 in the U.K.; the Macdonald Commission of 1988 in Canada; and the Cooney (1989), Bosch (1991) and Lavarch (1991) Committees in Australia have all proposed ACs as a solution to the shortcomings of financial reporting revealed by corporate scandals in the 1980s (Sommer, 1991; Wolnizer, 1995; Gendron & Bédard, 2006; Wu, 2012). Because an AC is closely involved in ensuring the integrity of the financial statements, monitoring of internal controls and monitoring of the relationship with the external auditor, there is an intrinsic link between the existence of an AC and the quality of financial statements produced (DeZoort et al., 2002a; Asiriuwa et al., 2018). The existence of an

AC, however, does not guarantee its effectiveness, nor that the AC will effectively discharge its monitoring duties across all of the different departments of an organisation (Sommer, 1991; Van der Nest, 2008; Shleifer & Vishny, 2012).

Following a series of fraudulent financial reporting scandals (notably, Enron, Parmalat and WorldCom in the US, Satyam in India, as well as Transmile and Megan Media Holding in Malaysia), there have been increasing guidelines and legislative requirements relating to ACs globally (Gendron & Bédard, 2006; San et al., 2012; Wu, 2012; Lisic, Neal, Zhang & Zhang, 2016). All major stock exchanges around the world have increased their requirements around the structure and composition of ACs, especially on promoting independence of members (DeZoort et al., 2002a).

Nevertheless, it has been found that tightening formal guidelines have had little effect on enhancing the effectiveness of the ACs created (Lisic et al., 2016). It is suggested that an AC may be established by an organisation merely as a mechanism to signal to stakeholders that management is aligned with stakeholder interests and to fulfil regulatory requirements, rather than to fulfil their intended purpose of monitoring the organisation and its financial statements (Harrison, 1987; Spira, 1998; Gendron & Bédard, 2006; Weickgenannt et al., 2021).

As such, despite the intensifying interest in ACs and their corporate governance role in accounting research, it is insufficiently understood whether ACs are actually effective at discharging their delegated functions or not, and how best to promote ACE through regulatory requirements (Kalbers & Fogarty, 1998; DeZoort et al., 2002a; Turley & Zaman, 2007; San et al., 2012; Wu, 2012; Soliman & Ragab, 2014; Kwakye et al., 2018). This is because a largely quantitative approach has been utilised to study this field, which is inappropriate for evaluating a qualitative subject (Wu, 2012).

2.2 Determinants of ACE

The effectiveness of an AC is a function of the power and skills of its members (Kalbers & Fogarty, 1993; Rahim & Afza, 1993; Asiriuwa et al., 2018). DeZoort et al. (2002a) identify four fundamental determinants of ACE: (1) composition, (2) authority, (3) resources and (4) diligence. These elements are crucial for an AC to discharge effectively its delegated duties and to achieve governance goals within the entity. Composition, authority, resources and diligence are each discussed in detail in Sections 2.2.1 through 2.2.4. Section 2.2.5 provides other overall determinants of ACE that cannot be grouped into these four elements.

2.2.1 Composition

Composition relates to the skillset and characteristics held by AC members, such as their expertise, independence, integrity and objectivity (DeZoort et al., 2002a; Van der Nest, 2008). Considerations around requirements for financial expertise, independence, integrity, objectivity and the impact of diversity on effectiveness are discussed below.

Financial expertise and experience

Having the necessary technical skills, knowledge and experience relevant to achieving goals in a specific functional area has been found to be a critical element of ACE (Martin, 1978; San et al., 2012; Chen & Komal, 2018). It is also a recommendation of King IV (IoDSA, 2016). This is because members who are experienced in financial and audit matters are competent to perform the responsibilities required of AC members. Professional competence also creates a sense of trust in others within the organisation (DeZoort et al., 2002b; Song & Windram, 2004). Trust enhances legitimacy, which in turn, enables AC members to effect changes in an organisation (Suchman, 1995; Georgiou & Jack, 2011).

Wolnizer (1995, p. 60), however, argues that there is potential for “trained incapacity” to be caused by the financial specialization and common experiences of all members. As such, if all AC members are trained in the same way, it is likely that they will all have a very similar approach and perspective on matters (Kalbers & Fogarty, 1998). For example, if AC members are habituated to certain accounting practices, it is unlikely that they will ask managers for evidence to corroborate accounting method decisions or inputs (Wolnizer, 1995).

As a result, although financial literacy is an important component of ACE, a diverse complement of skills is needed on an AC. It has been found that not all members need financial expertise, as the broader range of perspectives from a diverse committee will compensate for the lack of financial skills of an individual (Song & Windram, 2004).

Independence, objectivity and integrity of AC members

Prior literature indicates significant benefits of having independent AC members and there are specific independence requirements in most corporate governance rules and principles around the world (DeZoort et al., 2002a; Wu, 2012; Soliman & Ragab, 2014; Kwakye et al., 2018).

In South Africa, King IV and the Companies Act require that all AC members are independent non-executives and provide specific guidance on independence requirements. For instance, members must be directors that are not involved in the day-to-day operations of the business, a significant provider of financial capital, a material customer or supplier, or related to any of these parties (*Companies Act No. 71*, 2008; IoDSA, 2016).

These independence requirements are intended to support the expected role of an AC because the members can operate from an objective viewpoint, without conflict of interest. This also allows the AC members to maintain a more removed strategic and monitoring perspective, rather than getting too involved in the operations of the business (Wolnizer, 1995).

Despite regulations around independence of AC members, their actual objectivity is difficult to regulate and measure (San et al., 2012). It is evident that formal independence requirements (such has holding no shares in the company) do not necessarily create objectivity (Wu, 2012; Kwakye et al., 2018). There is disagreement in academic opinion over the value of regulating AC member independence. Some studies (see Felo, A. J., Krishnamurthy, S., & Solieri, S. A. (2003) and Kalbers and Fogarty (1998)) have found that there is no direct relationship between the number of outside directors and the financial reporting quality, while on the other hand, others (see Song and Windram (2004)) found statistically significant evidence that board independence promotes ACE.

Additionally, there is debate around whether the attribute of independence or of influence is more important for an AC member to have (DeZoort et al., 2002a; Soliman & Ragab, 2014; Kwakye et al., 2018). This is because, despite the benefits of independence as detailed above, trusted AC members with a greater level of involvement in the entity may have a greater ability to substantively influence others to effect change within the organisation. A greater level of involvement can also enhance a member's understanding of the finer details of the entity's operations. (Turley & Zaman, 2007; He, X., Pittman, J. A., Rui, O. M., & Wu, D., 2017). Influence is discussed further as an integral part of authority in section 2.2.2.

Impact of diversity on effectiveness

A particularly relevant aspect of ACE in a South African context is the importance of diversity on the AC, not only in terms of skills and experience, but also, in terms of gender, race and age (Song & Windram, 2004; Zalata, Tauringana & Tingbani, 2018).

Findings on the impact of diversity have been inconclusive. Felix, R., Pevzner, M., & Zhao, M. (2019) found that ethnic diversity is associated with a lower incidence of misstatements, whereas Carter, D. A., D'Souza, F., Simkins, B. J., & Simpson, W. G. (2010) and Kamarudin, K. A., Ismail, W. A. W., & Alwi, M. (2014) found no link between ethnic diversity and indicators of ACE like instances of corporate fraud or financial performance. Mohammad, W. M. W., Wasiuzzaman, S.,

& Salleh, N. M. Z. N. (2016) found a positive correlation between ethnic diversity and earnings management, indicating that regulations over ethnic diversity alone are not sufficient to promote good corporate governance. Conversely, Waweru (2018) found a significant and negative relationship between AC diversity and earnings management.

Chijoke-Mgbame, A. M., Boateng, A., & Mgbame, C. O. (2020) found that there is a significant link between the number of female directors on the audit committee and the firm's financial performance, and Thiruvadi and Huang (2011) found that the presence of female directors on an AC decreases earning management by increasing negative discretionary accruals. On the other hand, Qi and Tian (2012) could not find a link between gender diversity on the audit committee and earnings management. Sultana, N., Cahan, S. F., & Rahman, A. (2020) found a weakening in the audit quality after gender diversity requirements were introduced in Australia because of the limited number of females eligible to hold non-executive directorships, resulting in females taking on too many posts. Carter et al. (2010), Kamarudin et al. (2014), and Kayleen (2019) all found no link between gender and indicators of ACE.

In terms of age, DeZoort et al. (2002a) identified that members with more experience make more consistent judgements. This has the implication that if ACE were to be analysed through the lens of consistency of AC judgements, older committees with more experienced members would be found to be more effective than are newer committees. Martin (1978), however, found that while age is often associated with skill and experience, members can also become inflexible and set in their thinking and methods, which decreases their effectiveness.

In a study conducted in 2002, it was found that there was very little diversity in ACs, with 94% of members being male, 86% of whom were over 50 years old (DeZoort et al., 2002b). Neverthless, with increasing regulations over diversity in terms of race, gender and age globally, this inequity is decreasing (Zalata et al., 2018).

Contrary to most research, Song and Windram (2004) have found that multiple directorships held by AC members positively impact ACE. This is because of the increased exposure to other boards and experience the members gain in business and corporate governance, bringing diversity to their own board in this way. Song and Windram (2004) noted an increase in ACE despite the potential time constraints imposed by holding multiple directorships. The ideal number of directorships, however, is not clear (Song & Windram, 2004).

The second element contributing to ACE, or lack thereof, is the authority AC members exert. This element is discussed further in Section 2.2.2.

2.2.2 Authority

Social power can be defined as "the ability of one party to change or control the behaviour, attitudes, values, opinions, objectives and needs of another party" (Rahim & Afza, 1993, p. 611). The ability to influence other people operating in the organisation is essential to achieve desired governance outcomes, such as the integrity of financial reports and internal controls (San et al., 2012).

Authority is the ability of an AC to influence the operations and governance outcomes of an entity (Van der Nest, 2008). The ability to exert social power depends on the relationships AC members have with employees, as social networks influence the behaviour of people within an organisation (Martin, 1978; He et al., 2017). The credibility of members and their agency in the organisation will substantively affect their ability to effect change Turley and Zaman (2007).

The formal delegation of authority and the personal power of AC members are discussed further detail below.

Formal delegation and personal power

In order to influence employees and operations, an AC needs formal authority to affect changes, as delegated by the board of directors and bestowed by legislation (Raven & French, 1958). AC members need the sanctioned ability to punish or grant reward to others in the organisation in order to carry out its function (Martin, 1978; Kalbers & Fogarty, 1993; Cohen & Holder-Webb, 2006; San et al., 2012; Wu, 2012).

Nevertheless, formal authorisation is pointless if AC members lack the personal ability to sway opinions of others. In order to influence the outcomes of an organisation substantively, committee members need the ability to persuade others, based on their own personality, charisma and reputation. Conversely, charisma alone is ineffective without permission to act. As such, AC members need both formally delegated power as well as personal persuasive power in order for an AC to exert authority (Kalbers & Fogarty, 1993; San et al., 2012).

Social cohesion and interpersonal relationships are also important dynamics in team effectiveness. A single disagreeable member can make the entire committee less effective (Barrick et al., 1998). There is, however, the danger that the group will become less likely to raise and argue differing points of view if members are close due to a prevailing sense of loyalty. Wolnizer (1995, p. 60) referred to this potential danger as “groupthink”[2] (Wolnizer 1995, p. 60).

Interpersonal relationships, in conjunction with overall authority, will also affect the AC’s access to information (Martin, 1978; DeZoort et al., 2002a; Turley & Zaman, 2007; San et al., 2012). Access to resources, such as time and information, are discussed further in Section 2.2.3.

2.2.3 Resources

It is critical for the effective functioning of an AC that it has access to relevant information on a timely basis in order to act on its mandate. If employees trust the AC members, the AC is more likely to obtain relevant information from them. This will, in turn, directly affect an AC’s ability to have an impact on decision-making processes and have its resolutions faithfully executed (Martin, 1978; DeZoort et al., 2002a; Turley & Zaman, 2007; San et al., 2012). Without access to relevant resources and information when these are needed, an AC cannot act. It cannot identify or evaluate risks, put relevant controls in place, or determine appropriate actions to take in order to meet its responsibilities. As a result, institutional support is paramount for an AC to operate effectively (Kalbers & Fogarty, 1993; Turley & Zaman, 2007).

That ACs should be comprised of independent non-executives (as discussed in Section 2.2.1), can also pose limitations on an AC’s access to information. Due to the fact that members are removed from operations and activities, they are necessarily dependent on management, internal auditors and external auditors to provide them with the information that they need.

The last component of ACE is diligence. This is because AC members will need the diligence to rigorously work through and act on the information that they receive in order to achieve ACE.

2.2.4 Diligence

Diligence is the incentive, motivation and perseverance of AC members to achieve the governance duties and goals of the AC (Gendron & Bédard, 2006; Van der Nest, 2008). The effectiveness of a team is, to a large extent, determined by the level of involvement of its members. As such, diligence is regarded as the most important facet of ACE because it brings together all the other elements (Kalbers & Fogarty, 1993; DeZoort et al., 2002a). Additionally,

[2] Wolnizer (1995, p. 60) defines “groupthink” as the conscious or subliminal danger that group loyalty poses to moral and objective judgement.

when members are conscientious, this creates the sense that an AC is ready and well prepared to safeguard shareholder interests (Barrick et al., 1998; San et al., 2012).

Although there have been a number of studies into AC diligence and the effect that diligence has on ACE, there exist very few conclusive results from this research (Wu, 2012). Most studies use the number of AC meetings as a proxy for AC diligence (DeZoort et al., 2002a). The diligence of AC members and its effects is a subjective matter, and the number of meetings does not communicate the nature of those meetings, which is very important for determining diligence and effectiveness of ACs (Gendron & Bédard, 2006). A quantitative approach to evaluate a qualitative characteristic of effectiveness decreases the reliability of findings, and so it is possible that using the inappropriate method to study diligence has cause the inconclusive results (Wu, 2012; Alhossini et al., 2021).

ACs perform their responsibilities through both formal and informal structures, as well as the potential factors that motivate AC members according to prior research are discussed below (Turley & Zaman, 2007; Wu, 2012).

Formal processes

Formal processes are the minimum requirements ACs are expected to comply with such as requirements about membership, composition, charters, and meetings (Turley & Zaman, 2007). These aspects form the basis for much of empirical research data collection because they are easily observable.

Meetings and documentation are intended to create a “sense of serious purpose” by enabling transparency and accountability of AC processes (Wu, 2012, p. 166). The formal rituals of ACs make members feel they are effectively discharging their responsibilities and signal this to stakeholders (Gendron & Bédard, 2006). All the same, it is debated whether this “sense of seriousness” alone can create accountability of the AC (Wu, 2012, p. 166). While observable formal structures signal to constituencies that the AC is fulfilling its roles, real effectiveness is attributable to internal processes which cannot be directly linked to external structures (Kalbers & Fogarty, 1998; Lisic et al., 2016; Alhossini et al., 2021).

Informal processes

Informal processes are the processes established in an organisation outside of formal requirements as a result of the norms, values and expectations of the individuals operating within that organisation. Examples of informal processes are discussions with management and external auditors outside of formal meetings, unannounced visitations to inspect day-to-day operations and casual conversations with employees. These processes are rarely externally observable but are likely to be significant in the way issues are resolved and managed in the organisation. If the effect of these informal processes is not captured, it may limit a researchers' understanding of how governance is achieved (Turley & Zaman, 2007; Alhossini et al., 2021).

The involvement and commitment of AC members to go beyond the bare minimum of formal requirements is essential in order to achieve true ACE (Barrick et al., 1998; DeZoort et al., 2002a). From interviews with AC members of listed companies conducted by Gendron and Bédard (2006, p. 234), it was found that

> *[I]n many cases [diligence] really comes down to the integrity of the people who are operating in that system and the degree to which they are personally committed to ensuring that the process works.*

Motivating factors

AC members are potentially motivated by both reward and negative consequences (Cohen & Holder-Webb, 2006; Wu, 2012, p. 177). It is noted, however, that studies have found that AC members do not consider their remuneration in fulfilling their delegated roles, and an incentive mechanism does not contribute to the effectiveness of the AC function (Song & Windram, 2004; Cohen & Holder-Webb, 2006). Aspects other than monetary gain, such as damage to personal reputation, were found to be the most important motivating factors for AC members. (Srinivasan, 2005)

2.2.5 Other determinants

ACE is a complex and subjective topic. All the nuances of and factors contributing to ACE cannot be reduced to a single academic framework. Consideration of the composition, authority, resources and diligence of AC members is not a comprehensive assessment of ACE. This framework provides a basis with which to explore and analyse the effectiveness of AC members in this study. In addition to this the historical context and members' perceptions of their own effectiveness should be considered. These elements are considered in further detail below.

Historical context of organisation

Evaluation of ACE should be based on an organisation's historical context (Spira, 1998; Turley & Zaman, 2007; Wu, 2012). This is because the definition and extent of ACE will change over time, along with the organisation. If an organisation has experienced a serious control failure, this will change the extent and nature of implementation and monitoring of controls in the future, the need for strong corporate governance structures may become more apparent. As such, more credibility may be accorded to the AC, enabling them to be more effective. On the other hand, an organisation which has not experienced such a control failure may have less stringent monitoring requirements, and so the AC is regarded as effective even though it is achieving less(Turley & Zaman, 2007).

Members often refer to the AC and its effectiveness chronologically, comparing how things used to be done with how processes are now carried out (Spira, 1998). The maturity of an AC determines, to a large extent, their responses, level of involvement and openness of communication (Spira, 1998). An immature AC will typically deliver emphatic messages and adopt strong stances but are less experienced and capable of substantively dealing with issues (Spira, 1998). More mature committees may communicate with more sophisticated coding, and so may be more ambiguous in its messages, but is more able to deal with real problems (Bailey, 1983; Spira, 1998). Very mature ACs often give messages so ambiguous that only members can understand what is meant because they have seen it and dealt with it all before (Bailey, 1983; Spira, 1998).

AC members' perceptions of their own effectiveness

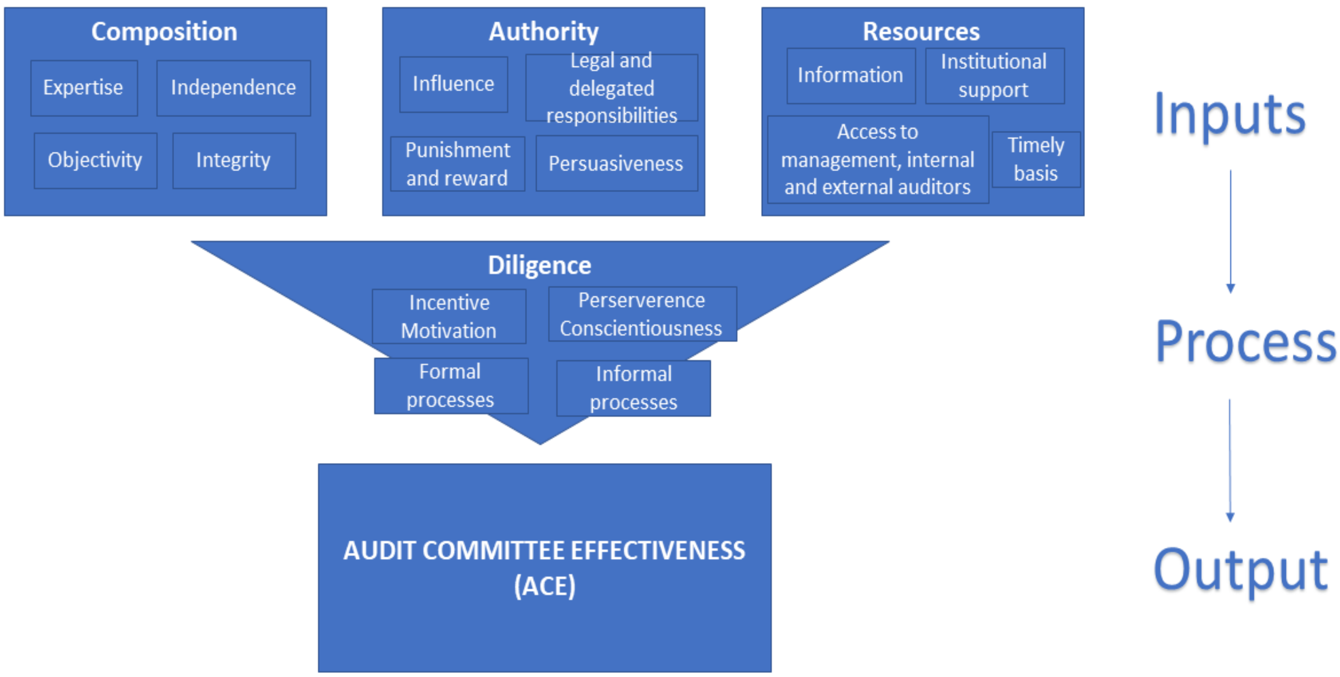
AC members themselves find it difficult to gauge their own performance because there is no defined benchmark or system to score their level of effectiveness (Gendron & Bédard, 2006). As a result, members tend to evaluate their effectiveness based on tangible outcomes achieved in the organisation (Lisic et al., 2016). Monitoring of internal controls is ranked as the most important aspect by AC members according to. This may affect this research in that AC members could place greater weight on oversight of internal controls in conveying their discharge of responsibilities (DeZoort et al., 2002a).

Gendron and Bédard (2006) warn that it is best to evaluate members based on an external set of indicators, rather than on their own definition of ACE. As a consequence, this research draws on this concept by developing a definition of ACE using existing literature to gauge the effectiveness of AC members interviewed, rather than directly asking the AC members whether they meet their own standards of effectiveness.

2.2.6 Summary of ACE determinants

Business functions are often analysed in terms of inputs, processes and outputs (Barrick et al., 1998). According to the model described in DeZoort et al. (2002a), composition, authority and resources are the inputs, diligence is the process, and ACE is the output in the business function of ensuring the integrity of financial statements. Figure 1 provides a summary of ACE determinants.

Figure 1: Determinants of audit committee effectiveness



Adapted from DeZoort et al. (2002a) and Kalbers and Fogarty (1993)

It is evident from the existing body of literature on corporate governance, ACs and ACE, that the need for ACE and the factors that have contribute to ACE are well understood. However, ACE cannot be comprehensively measured by the mere existence or number of its perceived inputs (Wu, 2012; Maroun & Atkins, 2014; Kayleen, 2019; Kapkiyai, C., Cheboi, J., & Komen, J., 2020).

As such, it is the aim of this study to conduct a qualitative investigation into whether ACE, as an output, is achieved, from the perspective of AC members themselves. As such, interviews were identified as the most appropriate tool to extract the necessary richness and depth of responses for the purposes of this study. The determinants identified in this literature review have been used as a framework to help corroborate or dispute the findings of previous research.

Chapter 3: Methodology

3.1 Research methodology

Most research on ACE has been quantitative, which might not adequately capture the inherently qualitative nature of ACE (Wu, 2012; Maroun & Atkins, 2014; Kayleen, 2019; Kapkiyai, C., Cheboi, J., & Komen, J., 2020). To contribute to this field, an interpretive qualitative design was used to explore and evaluate perceptions of AC operationalisation and effectiveness, as well as highlight the interpersonal and social construction of everyday decisions and actions with respect to ACE (Holland, 1998; Parker, L. D., Guthrie, J., & Linacre, S., 2011; Creswell, 2013). This qualitative research methodology also provides results which are of interest and value to those in the business profession (Parker et al., 2011). This methodology offers the possibility of deeper insights into the subject than would have been possible in a quantitative study (Holland, 1998; O'Dwyer, Owen, & Unerman, 2011).

3.2 Data collection instrument

This research relies on semi-structured, open-ended interviews. This was to allow interviewees provide detailed insights into the operation and effectiveness of an AC, as well as highlight what they perceived to be relevant issues. This approach allowed the interviewees to provide a detailed account of experiences, knowledge, ideas and impressions not already known to the researcher (Holland, 1998; Alvesson, 2003).

The interview agenda (see Appendix B) was developed based on prior literature, with specific attention to ACE. Interview questions were derived from an understanding of the components of ACE from DeZoort et al. (2002a) and social power as set out by Kalbers and Fogarty (1993), supplemented by other corporate governance and team effectiveness literature. Key themes arising from the literature were identified and consolidated. A separate discussion point (as presented in Appendix B) was created to address each key theme. Sub-questions were created by expanding on the central concepts identified in prior literature and used by the researcher as prompts when the researcher was not satisfied that the theme initiated by the agenda point had been explored fully (Rowley, 2012). These sub-questions were not included in the interview agenda given to participants to prevent rehearsed responses (Qu & Dumay, 2011).

Pilot interviews were conducted with three accounting academics to ensure that the interview agenda was not leading, biased or incomplete (Rowley, 2012). The research supervisors were present for all three pilot interviews. This was to help the researcher identify any gaps in the questions asked, as well as to provide feedback on how the interview process could be improved. Changes that were found to be necessary from the pilot interviews were appropriately addressed before the commencement of the main interviews (Rowley, 2012).

3.3 Populations and sampling

This study was conducted primarily by interviewing AC members on the boards of a JSE-listed companies. A member from a JSE-listed company was selected because of the public interest listed companies attract, and a South African stock exchange was chosen because this study aims to gain a uniquely South African perspective on ACE.

In addition, a sample from each of the following populations was selected: (1) external auditors, (2) internal auditors and (3) accounting and governance regulators. While this research evaluated the perceptions of AC members of ACE, it was necessary to include some measures to corroborate or dispute the opinions of AC members of their own effectiveness.

By the nature of their appointment and positions, AC members, external auditors, internal auditors, regulators and accounting academics have financial literacy and experience. Purposeful sampling was used to select interviewees based on their position as AC members, external auditor, regulator or internal auditor, respectively (Rowley, 2012; Creswell, 2013). This purposeful selection of interviewees with appropriate qualifications and experience in governance and financial reporting assisted in ensuring that data obtained were of high quality and applicable to the research questions being investigated (O'Dwyer et al., 2011). The largest sample drawn was from the population of AC members because the focus of this study is to gather and evaluate the opinions of AC members.

Sample size was small (10 interviews in total), in accordance similar qualitative studies (Rowley, 2012; Wu, 2012). While this small sample size means that results cannot be generalised, the rich dataset enhances the validity of results. This is because only candidates who are knowledgeable and experienced in the subject matter of ACs were interviewed (Ryan, B., Scapens, R. W., & Theobald, M., 2002; Leedy & Ormrod, 2010).

Table 1 provides details of each population and the selected sample sizes. See Appendix D for further information on each respondent and the length of each interview.

Table 1: Populations and sample sizes				
Code	**Population**	**Description**	**Reason for inclusion**	**Sample**
AC1 – AC6	AC member	Members active on at least one JSE-listed entity's AC.	This research aims to explore the operationalisation and effectiveness of ACs in SA from the perspective of AC members in JSE-listed companies.	6
EA1	External auditors	Engagement partner and IFRS technical partners on audits of JSE-listed companies.	External auditors work closely with ACs to provide assurance over the financial statements. Including these interviews provided the informed opinion of an external party to enhance the validity of findings.	2
IA1	Internal auditor and corporate governance consultant	Experience as a chief audit executive for a JSE-listed company and 3rd party provider of ACE evaluations to JSE-listed companies.	The experiences of a corporate governance consultant provided another informed perspective to corroborate or dispute the findings from interviews with AC members. In addition, many years of experience in providing of effectiveness evaluations of ACs for JSE-listed companies provides an informed perspective of ACE in practice.	1
R1	Regulator	FRIP, IASB, IRBA, JSE and SAICA representative. Expert witness in corporate legal cases.	The views of a regulator were used to corroborate or dispute the responses of other populations from the perspective of those involved in the setting and governing of regulations over ACs.	1

3.5 Data collection

Interviews were performed during the period of September to December 2020 and lasted between 60 to 90 minutes each (Rowley, 2012). Because of the Covid-19 pandemic, all interviews were conducted and recorded using the online platform Microsoft Teams as meetings in-person could not be arranged (Jones & Abdelfattah, 2020).

Potential interviewees were identified and contacted via e-mail. A convenient date and time were arranged with willing participants and the interviewee's preferred virtual platform was confirmed. All interviewees chose Microsoft Teams. Interviewees were provided with an information sheet detailing the background of this research (Appendix A) and the interview agenda (Appendix B) prior to the interview in order to gain an understanding of the topic and purpose of this study (O'Dwyer et al., 2011). Participants were not, however, provided with detailed interview questions. This was to prevent rehearsed responses (Qu & Dumay, 2011).

The researcher began each interview with a casual conversation, to establish rapport with the interviewee (Alvesson, 2003; O'Dwyer et al., 2011; Al-Yateem, 2012). A conversational tone was then maintained throughout the interview so that interviewees felt relaxed and comfortable to express their opinions and to include relevant information. Prior to commencing with the interview questions, all participants were also encouraged to give as much detail and as many examples as they felt comfortable with, for the researcher to obtain richness of data (Al-Yateem, 2012).

Every interviewee was, at the outset, assured of the confidentiality of their personal information and that of their organisation. Each interviewee was also informed of their right to withdraw from the interview at any time without providing explanation (Rowley, 2012; Creswell, 2013). Additionally, each interviewee was informed that he or she would be given the opportunity to review the transcript for accuracy and completeness after conclusion of the interview (Alvesson, 2003; Al-Yateem, 2012). Ethics clearance was obtained from the University of the Witwatersrand prior to any interviews being held (Appendix C).

The order of interview questions was allowed to differ from interview to interview to facilitate the natural progression of each interview. The researcher refrained from interrupting interview participants so that a deeper level of detail could be provided. Focus was maintained on the research objective by guiding the participant back to the topic of discussion when necessary (Gendron, 2009). Interviewees were asked to re-phrase issues where necessary to prevent ambiguities and rehearsed responses (Alvesson, 2003). The researcher utilised the interview agenda to ensure all interview questions were fully explored in each interview.

With the permission of the participant, interviews were recorded using the recording function on Microsoft Teams (O'Dwyer et al., 2011). The researcher transcribed the recordings using Microsoft Word. All data files were stored on a password-protected computer and frequently backed up on Google Drive (also password-protected). Only the researcher and research supervisors had access to this content.

3.6 Data analysis

Interviews were transcribed and analysed as they were conducted. Once all interviews were completed, the researcher reread all interview transcripts multiple times to gain a holistic view of their contents (O'Dwyer et al., 2011; Rowley, 2012). Prior literature was used to analyse and interpret the text using an inductive thematic approach (Glaser & Strauss, 1967; Strauss & Corbin, 1990; Vollstedt & Rezat, 2019). This approach facilitated the exploring of ambiguities around the subject of ACE (Böhm, 2004; Vollstedt & Rezat, 2019).

Detailed analysis of transcribed interviews was done using a formal process of data reduction, data display, and conclusion drawing and verification (Rowley, 2012; Creswell, 2013). Open, axial and selective codes were used to conduct the analysis (Strauss & Corbin, 1990).

Open codes were utilised to break down the data to identify and categorize themes (Vollstedt & Rezat, 2019). These codes were developed with reference to the content of the transcripts (*in-vivo* coding), rather than with reference to relevant theories (theoretical coding). This was in order for the researcher to remain open to new ideas and to avoid imposing theories or frameworks on responses (Böhm, 2004). An iterative process was followed where Atlas.ti was used to code each transcript on a line-by-line basis.

Additional codes developed as new interviews were coded. These were incorporated into previously coded transcripts to ensure consistent coding. This process helped to develop a diverse range of codes with which to understand the data. It was ensured that the number of interviews performed was sufficient to achieve data saturation, so that no further themes or relationships could be identified or further developed (O'Dwyer et al., 2011; Vollstedt & Rezat, 2019).

After all interviews had been completed and coded using open codes, axial codes were then utilised to group and analyse relationships between open codes (Böhm, 2004). These axial codes were established with reference to relevant literature and supplemented by issues raised in interviews to ensure that all relationships and phenomena were identified (Vollstedt & Rezat, 2019).

Finally, selective coding was utilised to integrate the relationships identified in axial coding into the central theme of ACE. Data collected from interviews were grouped and organised in relation to this core concept, and the results were used to generate systematic and coherent conclusions on AC perceptions of ACE (Böhm, 2004; Vollstedt & Rezat, 2019).

Throughout the process of coding, memos and diagrams were created and linked by the researcher to the relevant data for the purposes of fully understanding extracting core themes found in the transcripts (Glaser & Strauss, 1967). These memos were later used to develop and prove findings in regard to AC perspectives of ACE (Böhm, 2004).

3.7 Validity, reliability and ethics

Interviews can be used as a powerful means to gain insight (Al-Yateem, 2012). All interview questions and sub-questions were piloted with senior researchers to ensure that the questions were objective, non-leading, relevant and are not biased (Gendron, 2009; Rowley, 2012).

Nevertheless, the Hawthorne effect can threaten the reliability of responses from interviewees (Al-Yateem, 2012). This is because a participant may modify his or her behaviour or responses if he or she are aware he or she is part of a study (Knapp, 1998; Al-Yateem, 2012). The formal structure of a recorded interview can make the interviewee uncomfortable and less likely to relate important information or his or her honest point of view, which may in turn negatively affect the quality of the data collected (Al-Yateem, 2012).

People tend to present themselves to other in the best possible light, especially when participants are made more aware of their responses and what they disclose because the interview is being recorded (Al-Yateem, 2012). Interview participants are susceptible to subject reactivity and social desirability bias. Subject reactivity is the effect of the research process on interviewees, and social desirability bias is the effect of asking for highly sensitive or personal information which participants may be unwilling to disclose because they want to present themselves favourably (Davis et al., 2010; Al-Yateem). This can be relevant in an AC context because they are talking about their own diligence because participants may feel pressured to make themselves look conscientious.

However, the benefits of interviewing as a tool to explore concepts and gain new insights warrant its use with controls put in place (Al-Yateem, 2012). The potential threats to validity of the interviews were mitigated by giving the interviewee the opportunity to withdraw from the interview at any time without explanation, and to modify their responses in the transcript after the interview had taken place (Clifford & Maisto, 2000; Al-Yateem, 2012; Creswell, 2013). Participants were also assured of the confidentiality of their information and responses before the commencement of each respective interview (Rowley, 2012; Creswell, 2013).

Quantitative and qualitative research place different levels of importance on validity (Leedy & Ormrod, 2010). In accordance with prior qualitative research of a similar nature, internal validity is of little importance to this study because it did not aim to establish or evaluate a causal relationship between specific AC member characteristics and ACE (Slack & Draugalis Jr, 2001; Holland, 2005; Tremblay & Gendron, 2011; Creswell, 2013). External validity was similarly of little importance because, as is typical of qualitative studies with a small sample size, the results of this research are not intended to be generalisable (Onwuegbuzie, 2000; Slack & Draugalis Jr, 2001). It was not the purpose of this exploratory study to establish conclusive empirical results but rather to provide basis for further in-depth research.

On the other hand, contextual validity was relevant to this research (Ryan et al., 2002; Skinner, 2013; Stange & Glasgow, 2013). This was because understanding the context in which an AC operates was vital to evaluating its effectiveness (Spira, 1998; Turley & Zaman, 2007; Wu, 2012). To ensure contextual validity this study incorporated some important techniques. Firstly, in collection of sufficient data, interviews were of appropriate length to allow interviewees to generate complete descriptions and explore all facets of the issue being addressed (Leedy & Ormrod, 2010; Rowley, 2012). This ensured that sufficient evidence was collected on each issue so that the data could be triangulated (Ryan et al., 2002; Leedy & Ormrod, 2010). Secondly, by following up with respondents and sending them transcripts of their interviews for review, respondent validation was acheived (Leedy & Ormrod, 2010; Rowley, 2012).

Through the use of semi-structured interviews a focus on the research question was maintained and validity of the findings of this study was ensured (Leedy & Ormrod, 2010; Rowley, 2012). Although the use of interviews introduced potential bias and subjectivity, this is an inherent characteristic of qualitative research and not, in itself, a threat to validity and reliability (Creswell, 2013). The interview questions were open-ended and non-leading, which minimised the risk of repetitive responses and increased the validity of the study (Rowley, 2012).

It is an inherent limitation of this research that perceptions of ACE may evolve, and so evaluation of whether those requirements are being met may change accordingly. As a result, the findings of this study are only relevant for the period in which it is conducted. Nevertheless, this does not detract from the usefulness or validity of the findings in the current financial climate.

Chapter 4: Results and discussion

This section sets out results from the interviews, grouped under the four components of ACE as per the framework set out by DeZoort et al. (2002a). Section 4.1 discusses interviewees' observations on the composition of ACs, Section 4.2 addresses their authority, Section 4.3 addresses the access ACs have to relevant resources and Section 4.4 addresses the diligence of AC members. Finally, Section 4.5 discusses results in terms of ACE overall.

4.1 Composition

Financial skills, experience and business understanding

Respondents had mixed views on the financial competence of JSE AC members in practice. Some were of the opinion that ACs do not have the level of financial skills required to be effective (AC1, AC6, EA1, EA2, IA1, R1):

> *You'll be surprised to find out that there was a number of audit committees that didn't have enough basic financial experience… which was quite shocking (IA1).*

Other respondents, however, were of the opinion that the necessary skills and experience are present. These interviewees believed it was only the rare exception that a member did not meet the required standard of competence (AC2, AC3, AC4, AC5):

> *Most of the committees that I've seen and that I've worked with certainly have the skills and they certainly have the experience. I mean, there is the odd exception, but most of them can read financial statements, they understand it, they can ask the right questions, they really have the toolkits to do the job (AC2).*

It is interesting to note that it was the non-AC interviewees and the more self-critical AC-interviewees (AC1 and AC6) that were of the opinion that ACs might not possess the necessary financial skills. This may indicate that those with an external or more objective viewpoint were more willing to be realistic and this is an area ACs may need to improve on.

Nevertheless, respondents corroborated existing research that not all AC members need to be experts in accounting for an AC to be effective (Gendron & Bédard, 2006), as an AC is the function of the collective skills and experience of its members (Barrick, M. R., Stewart, G. L., Neubert, M. J., & Mount, M. K., 1998): "You don't necessarily have to be a chartered accountant in order to be a good audit committee member" (EA1). Confirming the work of Wolnizer (1995), Gendron & Berdard (2006) and Song & Windram (2004), it was highlighted by interviewees that having a diverse range of skills and experience on the AC may be more important than all members having financial expertise (AC1, AC2, R1):

> *Having a blend of different skills with different life experiences is much better than having three people [that] have only seen life in the same way. So, having 3 ex-audit partners on an audit committee is not a very powerful thing (AC1).*

Despite this, all interviewees unanimously admitted that basic financial skills are essential for members to be able to understand and interrogate the information they are given, confirming the work of Kalbers & Fogarty (1993), San et al. (2012) and Chen & Komal (2018). This is because if the basic financial literacy is not present, it becomes too easy for management "to pull the wool over [the AC's] eyes" (IA1).

Diversity of skills, experience and demographic

Although interviewees had mixed views on whether all AC members have the required level of financial competence, interviewees are of the consensus that ACs in SA do, at least, have a good balance of different skills and experience (AC1, AC3, AC4, AC5, AC6):

> *I'm very comfortable that the balance actually works out very well, that you get questions from different perspectives and different levels of experience. We may be a bit overweight with the people in the numbers at the moment, but I think, given the individuals and their experience and their history, it works well for us (AC4).*

Additionally, respondents confirmed the work of Song & Windram (2004), Mohammed et al. (2015) and Zalata, Tauringana & Tingbani (2018) that diversity in terms of race and gender may lend the AC a broader perspective and so contribute to ACE (AC3, AC5, AC6). This is because "people [that] have different experience in different contexts… are likely to ask different questions" (AC6).

It was noted by respondents that, in SA, there is a shortage of historically disadvantaged professionals who have the skills and experience necessary to serve on the AC of a JSE-listed company. As a consequence, some may be appointed "for what diversity they bring to the board" (AC3) without necessarily having the technical skills or experience to serve on an AC (AC3, AC5, AC6):

> *In the context of South Africa, it's quite challenging, because there's a need to improve representation and diversity, and you don't necessarily find people with a different background who are easily able to go onto audit committees (AC6).*

Overall, there seems to be a “limited pool of directors” available for independent non-executive positions in the JSE (EA1). This seems to cause a notable difference between the quality of ACs of smaller as compared with larger JSE-listed entities. This is because the larger entities can usually attract better, more experienced directors than the smaller entities can (AC1, AC2, AC3, EA1, EA2):

> *There’s a big difference. Generally, in the large listed [entities] you get competent people because [the larger entities] can pay. Their non-executive fees are significantly higher than the smaller listed [entities]… That's what money buys you (EA2).*

Exposure to directors of other large listed companies appears to enhance the skills and competency of these directors, supporting the findings of Lin (1995). The more they interact with other top directors, the more their skills improve, as AC members gain experience of seeing how a large company is successfully governed (AC2, EA1, EA2). As a result, larger JSE-listed entities may have more effective ACs than those of smaller ones (AC1, AC2, AC3, EA1, EA2).

Nevertheless, despite the above, AC interviewees were satisfied that their committees had diverse demographical representation and that this contributes to ACE (AC3, AC4, AC5, AC6): “we've got fantastic diversity and the people that are there – across the board – really, really add a lot of value” (AC6). As discussed above, the skills and experience of AC members are critical aspects of ACE. Members’ independence plays a similarly crucial role ACE (DeZoort et al., 2002a). This factor is discussed in further detail below.

Independence

All respondents indicated that independence requirements are very important, confirming prior literature (DeZoort et al., 2002a; Wu, 2012; Soliman & Ragab, 2014; Kwakye et al., 2018). Respondents reflected that controls over ensuring independence of AC members have increased over the last 15 years, in line with increasing regulatory stringency (AC2, AC5, R1). For example, where it used to be common practice for the AC to go on hunting trips with management, most ACs no longer take part in such events, largely due to the intensification of independence requirements (AC3, AC5, R1). This change has been in response to the major corporate scandals in South Africa in recent years (AC2, R1).

As an example of AC independence, EA2 stated that when external audit has conflicts with management, the AC will usually side with external audit. This may demonstrate independent thought by the AC because they are willing to take a stance against management. To illustrate the point, AC6 compared his experience of listed ACs to SOE ACs:

> *In the listed space, I must say the audit committee chairs that I interacted with have always supported the auditor... In the public sector – I'm talking our government sphere – there, I've had some instances where the audit committee will side with management which then becomes ugly (AC6).*

Although independence requirements seem to be met by JSE ACs, according to interviewees, there was some conflict over whether or not these requirements are appropriate (AC1, AC2, AC5, AC6, EA1, IA1, R1). This sentiment aligns with research conducted by DeZoort et al. (2002a), Soliman & Ragab (2014) and Kwakye et al. (2018).

King IV suggests 9 years as the maximum tenure before independence may be impaired (IoDSA, 2016). All respondents were, however, of the opinion that there should be no definitive limit on length of tenure. This is because “independence is a state of mind, it's not your term of office” (AC5):

> *It's very bespoke. So, I would rather focus – and I know it's very difficult to introduce qualitative criteria – but I would rather focus on the qualitative. So, is the person demonstrating independent thought? Does the person possess the right skills? And are they doing their homework before meetings? Ask those questions rather than say, ‘You've been here for 9 years, you have to go’ (AC1).*

It is also important that the AC members are given a chance to develop a thorough understanding of the business through experience working with it because it is not possible to understand a complicated business with various subsidiaries “overnight" (AC5):

> *That's always the problem with non-execs… because… they meet four to six times a year, and they obviously prepare for the meetings, but they [are] not involved in the day-to-day activity of the company, so they react based on what they read and what they see and what they hear. Whereas if you've got people that are not independent, generally a shareholder, I think they are a lot more involved sometimes in the company, so they will know a lot more about the day-to-day activity and because of that they can… be a better form of input (AC6).*

While this might be seen as a conflict of interest, non-AC members had similar opinions, which makes it less likely that AC members were disguising an underlying desire for job security.

The following section discusses the authority of AC members. If an AC does not have the power to act in an organisation, the composition of that committee will not make a difference to ACE.

4.2 Authority

Legal authority and rights within the organisation

The role of the AC, as perceived by the interviewees, is consistent with formal requirements (Principle 8 of King IV and Section 94 of the Companies Act) (AC4, AC5, IA1, R1). Respondents believe that these formal responsibilities have not changed over time but have been made clearer to AC members by regulators in the last 10 years:

> *I think the responsibilities of audit committees have been made clearer to members, either by stock exchanges or by regulators. The formalised responsibilities appear to have become more onerous, but to my mind they've actually always been that onerous. It's just that maybe people didn't always realise what they were taking on when they were on audit committees (AC6).*

Despite the formal guidance from King IV, the Companies Act and formal AC charters, many respondents believe that AC members do not properly understand their mandate as an AC (AC1, AC2, IA1, R1).

> *[AC members] need to have read the JSE listing rules themselves, they need to have read the King Code, and if it's insurance, they need to have read all the Prudential Standards and Insurance Act themselves. I would take you a bet, that if you took the listed insurance companies and you did [a] polygraph of the audit committee members, less than 10% would have read those documents themselves… And if you asked them any in-depth questions around the Companies Act, they wouldn't [even] know where to get a copy (AC1).*

As a result, AC members end up relying on the information management give to them because further inquiry is not facilitated or explicitly required (IA1):

> *No one is saying 'You can't [perform further inquiry]', but [AC members] are not going to unless it's facilitated... the AC needs to be more demanding about the information they get and how happy they are with that, [as well as] if they need something more" (IA1).*

Because some members are unclear about their responsibilities, a common issue for ACs is "scope creep"[3] (IA1). General risk management is often "lumped in" with the AC's responsibilities if the organisation has not established a separate risk committee (IA1). This is a problem because there often is not enough time for the AC to focus on all areas which need attention.

> *The audit committee need to learn to say no [to additional responsibilities] … In order for the AC to remain effective, it needs to be mindful of what it's taking on… But they don't say anything, they just take it on and then you end up with something being missed because they don't allocate properly (IA1).*

It is often difficult for AC members to strike a balance between thoroughly understanding the entity and becoming too involved in day-to-day decision-making. It is important to maintain a strategic stance rather than adopting an operational one (AC1, AC2, AC3, AC5, AC6, IA1, EA2, R1). This is because (1) it "creates distrust and takes away a lot of accountability, [because] if you start telling people how to do their job, you can't hold them accountable if it goes wrong" (AC2), (2) the AC end up "marking [their] own homework" because they review their own operational decisions (AC2), and (3) the role of an independent, removed, external AC member is left unfilled because the members can no longer be objective (AC2).

The complexity of the business impacts the level to which an AC member should be delving into the operations of the business. The more complex the business, the more input AC members need to give to understand the operations:

> *[It] depends on the industry and the type of business… I would certainly think that the more complex the business, the more effort you have to put in to understand the business (AC4).*

Distinguishing where to draw the line between strategic and operational roles seems to be difficult for all non-executive directors. This may be because many have previous experience in executive roles which makes is easy to revert inadvertently to how they functioned as executives (AC2, AC3, AC4, AC6). The AC members interviewed battled to determine whether they were personally striking the balance correctly. AC3 related that "it is an art rather than a science… it is always something that I grapple with". AC4 had similar sentiments:

> *[It] depends on the individual. I try to maintain that distance, [but also] because of your detailed knowledge that you have of the businesses you can obviously ask more detailed*

[3] "Scope creep" occurs when AC members take on responsibilities outside of those mandated by the Companies Act, King IV and the company charter.

questions. I think that there's a fine line between getting involved in day-to-day operations and just asking pertinent questions, and I hope I stand outside of that line.

Nevertheless, AC interviewees believed that many AC members do “get this balance quite well” (AC2). AC4 and AC5 stated that they “haven't seen that happen [members overstepping the line] at all” (AC4). To demonstrate how they personally maintain monitoring roles, AC5 related an example of when they were asked to perform an operational task which they refused to take on:

I've said to management before, ‘I'm not doing that, that's operational – you do it and come back to me and I'll tell you if I think it's okay, but I'm not going to do it’. I can't think of any exceptions where I have had an audit committee member who's been sucked into doing operational stuff. You may give operational advice in a board meeting... You may suggest this is what management should be doing, but you don't go do it (AC5).

The non-AC interviewees have seen a mixture of both happening in practice. There are those who get the balance right and those who stray too far into an operational role: “I've seen both – [some] audit committees really become very, very involved and sometimes a bit too much, then I've also seen it where they sometimes get [the balance right]” (EA2).

It is up to the individual to make sure that he or she strikes the correct balance (AC5, EA2). All interviewees asserted that a large portion of an individual’s ability to deliver value cannot be reduced to their qualifications or past experiences (corroborating the stance taken by Raven & French (1958)). The soft skills of AC members, such as their ability to exert power over others, greatly impact the AC’s ability to deliver value to an organisation. The personal attributes of AC members discussed in further detail below.

Personality of AC members

There is a consensus that the AC chair sets the tone for how the AC interacts with management (AC2, AC3, AC4, AC5, EA1, IA1, R1). For example, if the chair is deeply committed to his or her role and to remaining “fiercely independent”, the rest of the AC members almost always follow suit (R1). It was also deemed incredibly important for the AC chair to have strong leadership skills, and experience in chairing a committee, for the entire AC to be effective (AC1, AC2, EA2).

It was the perception of interviewees that AC chairs take independence requirements seriously and usually have the skills and competence to perform their role (AC2, AC4, IA1, EA2):

> *What you find [is] a lot of the chairs are actually ex-audit partners… that left auditing firms and then became non-exec. And they get appointed as audit committee chairs, and generally those people are in high esteem… they know what they're doing (EA2).*

AC chairs should also have the ability to encourage members to participate in meetings (Gendron & Bédard, 2006). This seems to be the case in practice. All AC chairs interviewed spoke of how they "welcome that people raise questions" (AC4) and that they actively encourage other members to provide input (AC2, AC4, AC5, AC6). Despite getting irritated at times at their committee members for asking "stupid questions", AC5 relates that it is important to let the members ask them:

> *I think it's actually quite important that you hold your tongue [when other members ask stupid questions] and let your committee members have their say. And they do have different point of views and very often, if you are short and you don't listen to them, you can come to the wrong conclusion... Very often you find that type of interrogation, where a person doesn't quite understand what's going on so they ask questions which they may think are stupid, actually evolves to be pretty important questions (AC5).*

Because the AC Chair is the focal point of the committee, it seems that AC members tend to place reliance on the AC Chair. Responses indicate that the Chair is expected to communicate with management and stay in touch with the organisation on an informal basis on behalf of the committee (AC3, AC4, AC5, AC6). This means that the other members might not perform any additional work that may be necessary because they expect the chair to do it:

> *I think if you feel that you need to do groundwork, you should do it, but most of the time you should be talking to the chairman of the audit committee and checking that it hasn't been done already (AC6).*

That a member should have an "inquiring mind" (EA1) was identified as essential for effectiveness. This aligns with prior studies (Kalbers & Fogarty, 1993; Wu, 2012; Lisic et al., 2016). It is important for members "not [to take] things at face value" (EA1).

An AC is dependent on information from management, external auditors, internal auditors and other people within the organisation (DeZoort et al., 2002a). This means that members should apply a healthy level of scepticism over the integrity of the material they are given (AC1, AC2, AC5, EA1, IA1, R1). It is important that all AC members perform their own inquiries and not just rely on the chair to do it (R1).

The quality and amount of information received is – to a large extent – a function of human interaction (Kalbers & Fogarty, 1993). As a result, it is essential that AC members possess emotional intelligence to obtain the information they need:

> *I would say, at the most, 50, 60 percent of what you do is technical skills, technical experience. The rest is all around human nature, emotional intelligence, understanding of people, what you need to do to get people over the line with decisions… emotional intelligence and maturity makes up, I almost want to say, the most marked part of what you do (IA1).*

AC2 believed about 50% of AC members possess the required levels of emotional intelligence, and that this proportion has not changed over time. Non-AC interviewees, on the other hand, could not generalise the personality or personal attributes an AC member typically has: “It's a mix” (EA2). The inability to generalise may also indicate a relatively even split, because there seems to be no obvious trend either way.

An AC member must know how to go about obtaining the information he or she needs from various sources, and how to ask the right questions to satisfy his or her responsibilities. This will enable them to form their own opinion based on well-founded evidence (IA1, EA1):

> *If you are scared of offending somebody, then you shouldn't be on the audit committee because obviously you can ask tough questions in a polite way and so on, but you mustn’t sit there quietly because you’re scared of offending somebody. You need to, at least, be willing to ask the questions, and ask the tough questions, and be willing to dig if you're not satisfied with the answer (AC3).*

Board meetings are usually fast paced in order to get through a full agenda. “Stupid questions” can often illicit irritation from other board members and they may be reluctant to give an answer because it is perceived to be wasting time (AC1, AC2). Even though it is usually taken for granted that an AC member will know the answer to these sorts of questions by virtue of his or her position, this is not always the case. And, as it happens, very often there are other people present at the meeting who were wondering about the same thing (AC2, AC5). AC1 related an experience of how asking “stupid questions” in the boardroom was poorly received by the rest of the board:

> *I think I said something along the lines of, ‘is it just me or doesn't anybody understand the numbers that are given to us?’ Something clumsy like that. And I can remember telling my wife afterwards, it felt like being in a lift where you just farted or something. It was very uncomfortable (AC1).*

Personal fortitude to “stand your ground” is especially important for new appointees (AC1). This is because precedents are set which are then difficult to break: “At first people brush you off, and if you back off then, you will never get answers to your questions” (AC2). It seems that, over time, members are able to build legitimacy and trust, and based on this, can then ask the same “stupid questions” without being dismissed. AC1 related how the uncomfortable atmosphere relaxed over time as he or she built a reputation in the company: “over time, spending time with the different people, I came to have a more comfortable relationship in the boardroom” (AC1).

Unfortunately, many AC members do not ask the “stupid questions” because they are too timid or because “people are very scared to look dumb” (AC2, AC3, AC5). This decreases the potential for ACs to be effective because the ego of an AC member stands in the way of them asking the questions that they need to in order to get to the right answer. Timid members do, however, tend to approach the chairman of the committee after the meeting to ask their questions or express their grievances (AC5). This means that the AC chair can act on any issues brought up where necessary:

> *I have found that yes, they do withhold [questions in the meeting], but then they usually will come to you after the meeting and ask you, ‘I didn't quite understand that’, which is very useful (AC5).*

The support AC members receive for their requests and the questions they ask will depend largely on the organisational attitude towards corporate governance. If the board is committed to sound corporate governance and receptive to the input an AC has to give, it results in a substantive and positive impact on the organisation (Spangler & Braiotta Jr, 1990). Organisational culture is discussed further below.

Organisational culture

The full endorsement of the board greatly increases the productivity of an AC. Conversely, if the board is dismissive of corporate governance practices and unreceptive to the AC, the ability of the AC to effect change within the organisation can be severely hampered (AC1, AC2, AC6, EA1, IA1). This aligned with finding of prior research (Spangler & Braiotta Jr, 1990). The reputation and recognition of an AC member in board meetings seems to play a major role in their effectiveness:

> *[Your reputation] is very evident from the responses you might get to a question and the support you get for asking the question. So if you ask a question and it's treated very superficially in the response and the chairman moves the meeting on to the next point without allowing sort of further debate on it, you get the feeling that it was a bad question*

and you really should be more careful about asking questions next time around. As opposed to if you ask a question and it gets broad support from other non-executives [and] management treats it seriously – maybe even have a follow up action – you now know you are a well-recognised contributor to the meeting (AC1).

The AC, in turn, also seems to have “a very important role” to play in setting the organisational culture of corporate governance, “especially around financial controls and the control environment” (AC2). Responses indicate that the AC is regarded as an important committee that is “in charge… sometimes even more so than the board itself" (IA1). As a result, the attitude the AC takes towards corporate governance filters through the ranks of an organisation. If the AC is uncompromising in terms of requirements for internal controls, the rest of the board is more likely to take the systems for internal control more seriously and those systems are more likely to be implemented across the organisation to proactively prevent failures in corporate reporting:

As soon as you start emphasising [corporate governance] and as soon as you start chasing corrective action, suddenly the people that head up those businesses start taking it seriously… and that changes the culture because if you are willing to be the ‘bad cop’, and if you don’t need people to like you, then you actually help the finance guys and the management team a lot because they can blame you. They can say ‘Well, you don’t feel so strongly [about it], but the audit committee wants it’, and it helps them [to implement governance practices] (AC2).

In practice, however, respondents are of the opinion that many ACs are not taken seriously because of their lack of business acumen and poor questioning skills (AC1, R1). This may indicate that poor ACE may be a self-perpetuating cycle because ACs cannot be effective without the support of the organisation and the organisation is unlikely to support the AC if it is perceived to be ineffective:

I sat on the other side of an audit committee table when I was the financial director of [a large listed company] … And although I would say as management, we respected the individuals… [in terms of] business acumen, they were not in touch with all the aspects at all. We used to, as management, award ‘the best question’ we received each year and compare notes and the best one I can remember was [when] one of the audit committee members asked, ‘are there any frauds we don't know about?’… I guess you could say there was a level of scepticism from management about the audit committee's ability to understand and do their job, other than as a tick box exercise. So, I guess you do get that, and that must be a lot (AC1).

Responses do, however, indicate that the attitude of JSE-listed companies towards corporate governance has “changed very significantly” for the better, over the last 5 to 10 years (AC2, EA2). The experience of AC interviewees is that management has not been obstructive in recent years (AC3, AC4). For example, AC6’s experience has been that management are very open and willing to help:

> *There have often been times when you ask questions which might not be in the materials and, in my experience, management have worked very hard to give you the information that you asked for. I am absolutely sure that there are many companies which might not have that culture, but certainly the organisations I've been involved in they have been [supportive] … If I found on a board that I haven't had the information that I need, I've asked for it. And I've never had anybody tell me I can't have it (AC6).*

This is indicative of the increasing regard for the importance of corporate governance (Song & Windram, 2004). Respondents attribute this improvement to the succession of corporate scandals in South Africa and globally in recent years, and the consequent reworking of governance standards:

> *It's all the new corporate governance structures; King, King I, King II. All the focus is on corporate governance. I mean, corporate governance was hardly a word I understood 15 years ago and you know, [laughing] now it's all about ‘corporate governance’ and ‘sustainability’ and ‘ESG’. We never used to speak that lingo. So I think a lot would probably be to do with King and the implementation of King and Sarbanes Oxley (AC5).*

Owing to the improvement in governance regulations, boards seem to be nervous that they will not be able to defend themselves in the case of a scandal (AC1, AC2, AC5, AC6). Before KPMG’s and Steinhoff’s failures, many boards were “very arrogant about governance” (AC2). In contrast, boards have now “come to respect and apply good corporate governance rules”, which has had a positive influence on ACE (AC2).

The internal operations of the AC can also be improved. From IA1’s experience of providing third party evaluations of ACE to the boards of JSE-listed companies, boards are open to candid evaluation of their AC function. This is because they are eager to receive recommendations on how to improve ACE. On the other hand, the same eagerness to improve was completely absent when it came to evaluations of individual AC members themselves, as opposed to the committee as a whole. It was very difficult for IA1’s team to obtain honest evaluations from members about themselves because they could be held personally accountable for any shortfalls. Individuals often became aggressively defensive in interviews out of fear of damage to their reputation or the loss of their job.

> *Boards aren't really ready for [individual evaluations], as much as they should be, they aren't... Nobody really likes to be told what they're doing badly... That's just the normal human reaction to that, but as a collective, it's an easier process to work through (IA1).*

This indicates that, while boards are taking corporate governance seriously and are committed to improving internal practices on an overall level, individual members are not willing to be held personally accountable. This significantly hampers progress towards ACE.

Finally, it seems as though the founding principles and the culture of SA ACs are very similar to UK ACs. This may indicate that SA ACs are at least on par with ACs from other countries:

> *They both have very similar processes ... South African businesses where I've been on the board, I think the audit committees have generally been forensic. They've been challenging. But I can say exactly the same for the UK and other audit committees... I've been really comfortable that the cultures are actually quite similar (AC6).*

Even if an AC has the power to influence decisions in an organisation, they will not be able to make decisions without access to the relevant information. As noted in this section, AC members need to become more demanding about access to information (IA1). Respondents believed that this is relevant because regulators tend rely on the AC to review documentation (AC6). Section 4.3 discusses the access JSE ACs have to the information and resources they need.

4.3 Resources

Reliance on management

An AC's main source of information is executive management (Gendron & Bédard, 2006; Turley & Zaman, 2007; Wu, 2012; Kapkiyai et al., 2020)). Considering this, all interviewees noted that ACs should not accept information received from management at face value because it may be a biased source of information. Responses nevertheless indicate that, in practice, AC members are heavily reliant on what they receive from executives, without performing further investigation themselves (AC1, AC5, EA1, IA1, R1):

> *[AC members] should be doing things like visiting, themselves, different parts of the business and get a good understanding of what's going on, on the ground, to be more effective. Because there is a disconnect; they are very reliant on what management feed them. And I think sometimes they are not getting the right information (IA1).*

Although it is necessary for AC members to place a level of trust in management, overreliance can decrease ACE because management are given the opportunity to hide information or influence lines of inquiry without the AC knowing (AC1, AC5, IA1, EA2, R1). This finding supported those of Gendron (2009).

> *If management [want to] get their way, the best way to do it is not to present the problem to the board or the audit committee. I mean [they] control information that's being presented to the audit committee… Management are always more informed than the audit committee, they have more knowledge of the business and the detail of what's being discussed and so they can use that to push a line of inquiry down or a person down in the discussion (AC1).*

Despite this, AC members seem to be aware of and accept their reliance on management as their source of information. For this reason, they find it important to accept only appointments for companies where they feel they can trust management (AC1, AC3, AC5):

> *You do rely on them to a large extent – particularly where you are the chairman – to support you and to understand the issues at hand. So before accepting [an] appointment to an audit committee, I think you must do your due diligence (AC5).*

Responses indicate that the better, more informed committees are able to ask more questions because they have a wide base of material to draw from. It seems that these committees start with gaining a more holistic view of an issue before drilling down on the details in their questions as they are able to identify and prioritise the most important issues to home in on. As a result, they are likely to enter the meeting with an open mind. This means they may be able to take in all points of view before forming their own opinion, which they can then defend robustly based on the evidence they have gathered (EA1, R1).

The less informed members tend to enter meetings with their minds already made up. As a consequence, it seems that they ask minimal questions, if they participate in the meeting at all (EA1). Less informed members also tend to get "lost in the detail" (EA1) of inconsequential matters because they haven't seen the bigger picture and so are unable to prioritise the important issues (EA1, IA1): "they get so wrapped up in the agenda and the business of the day, they are not really trying to take a step back and see the bigger picture" (IA1).

Additionally, it seems that AC members engage with the data they are given but give very little consideration to the integrity of that data (AC1, R1). Internal and external audit are expected by the AC to verify the information on their behalf: "There's a lot of trust being put in the fact you've got internal audit and you've got external audit; [so they assume] it must be right" (AC1). Diligence of AC members is discussed in Section 4.4. Access to internal and external assurance providers is discussed in further detail below.

Access to internal and external audit

Internal audit can be an excellent source of information if it functions well (Sarens, G., De Beelde, I., & Everaert, P., 2009): "[internal audit is] certainly key to having a consistent approach to control, governance, and independence. Without that the business is hopeless" (AC4).

The value of information from internal audit, however, can be decreased by the fact that they are employed by management (IA1). This conflict of interests means that internal audit can be influenced by management in order to keep their jobs (AC3, IA1, R1). The internal audit interviewee related how this impacted decisions in practice:

> *I did have situations… where the CFO will review the reports before it goes into the audit committee pack of the internal audit, and he would prefer that some of the information is toned down a bit before it reaches the audit committee… It's a very difficult situation because ultimately you're being paid by and reporting to the CFO, so you also want to keep them happy and agreeable (IA1).*

Often, management attempt to "tone down" issues in the AC packs so that they won't be "taken to task" by the AC, with the intention that they will sort out the problem without the AC having to find out about it (IA1). This dynamic "plays out in many organisations" (IA1). The AC should develop a relationship with the internal audit function and develop controls to ensure it receives uncensored reports (IA1).

AC interviewees related that they have experienced lack of independence in the internal audit function: "Once or twice I've felt maybe [internal audit] aren't as honest about certain things and have maybe airbrushed a few things to an extent" (AC3). Nevertheless, AC respondents stated that this is a rare occurrence (AC3, AC4). Overall, AC interviewees believed that internal audit is a valuable and independent resource:

> *I think [internal audit] maintain quite a good balance; they can act independently… They're not influenced by management in terms of the scope of the work that they do [or] finding something. We're comfortable that those are independent viewers, but knowledgeable viewers (AC4).*

This opinion was in direct contradiction of non-AC interviewees. Non-AC interviewees felt that the internal audit function is often "pathetic" (IA1) because they do not perform adequate work and cannot act independently from management (IA1, R1). This may indicate that ACs do not fully appreciate the scope and execution of the work of internal audit and, as such, how much reliance they should be placing on it.

Both internal and external audit have meetings with the AC without management present (IoDSA, 2016). Nevertheless, respondents indicated that the value of these meetings may be diminished because the issues and agenda for the meeting will usually be discussed and decided upon with management prior to the meeting (EA1, EA2, IA1, R1):

> *[For] audit committees, after the audit, you will table a report… and that will always be discussed with management before the meeting because, you don't want to go in there and say stuff that management is not aware of (EA2).*

While meeting agendas are pre-approved by management, it is up to the auditor to disclose to the AC what is of relevance. While EA2 makes very certain that they do this, it cannot be expected that all external auditors will act in the same way:

> *I've had many a fight with management because I put something in my audit committee report that they don't like… It can get unpleasant, especially if there are things that that they don't want you to say… but they can say their say to the audit committee and the audit committee can obviously decide what they want to do about it. They can hear our version, they can hear management's version, and they can make a decision (EA2).*

As a result, the benefit to be gained from assurance providers is likely to depend on the individuals providing the assurance (AC1). This is demonstrated by the conflicting opinions on the value of external audit. Some believed external audit to be a beneficial resource to the AC (AC4, AC5, AC6), whereas others had a poor opinion or were ambivalent about the benefit of external audit (AC1, AC3).

AC4, AC5 and AC6 were very comfortable that their ACs had valuable relationships with external audit because they "give you views on what's going on in the world around you" (AC6):

> *It's important to sit with the external auditors [because] they have a great deal of knowledge… I try and sit with the external auditors four, five times a year, formally. And I don't hesitate if I've got something that worries me – I find it's a great source of information – to just pick up the phone (AC5).*

AC3 was undecided on benefit of insights from external audit for making decisions: "I've frankly had mixed experiences in that regard. In some cases, absolutely, yes. In some cases, no, I've been disappointed with the level of insight and understanding of the business" (AC3).

On the other hand, AC1 (a former external audit partner), had a very low opinion of the value of external audit. This is because external audit uses a tick-box approach and teams are typically comprised of young and inexperienced trainees who do not know what to look for:

> *This is coming from an ex-auditor, and so I'm being a little self-critical here. I have a very low opinion of the value of external audit… I used to have to sign financial statements and the work was being done by very young, inexperienced people… people are literally flung from varsity into the business world… [And] with the rise of IRBA, [audit firms] are now doing their job in a way that satisfies IRBA's requirements, rather than [in a way] that satisfies anybody else's requirements. It's very form-filling, evidence-gathering, to prove you have evidence as opposed to evidence-gathering to try and find out something that might be going wrong (AC1).*

The value of information included by external audit in their AC report may be hindered by the external auditor's self-interest, similarly to internal audit. This is because they are threatened by the loss of the client if they go against management's wishes. Respondents also related that important information is often not addressed by the external auditor because the auditor is too busy marketing themselves for re-appointment the following year: "part of the reason [they compile audit reports] is so they can say how marvellous they are and how well thought-out their audit is" (R1).

There has been a marked improvement in the relations between ACs and external audit from 10 years ago. AC5 elaborated on the change from their time as an external audit partner to current times, now as an AC member:

> *I think that side of governance has evolved. Nowadays, I think you'll find the audit committee Chairman and the audit partner having a very close relationship, whereas 10 years ago, it probably wasn't that close… the audit committee chairs were not going out of their way to make sure they had a meeting with you, the audit partner; they relied more on their feedback in the formal audit committee meetings… I think nowadays there's more of a formal corporate governance relationship where the audit committee chairman will make sure he sits with the audit partner and understands what's happening in the audit (AC5).*

Overall, responses indicate that JSE ACs may be heavily dependent on internal and external assurance providers to assure the integrity of the information they receive because of time constraints: "you do have to rely very heavily on other assurance providers, either internal audits or the external auditors" (AC6). It is essential that AC members use the information provided by assurance providers in conjunction with their own understanding of the business to develop expectations. Over reliance on assurance providers may also indicate a lack of enthusiasm of the AC to initiate their own enquiries (AC1) (discussed further in Section 4.4). The factors causing time constraints are discussed in further detail in the next section.

Time constraints

Non-executive directorships typically do not demand as much time as executive positions (AC1, AC3, AC6, EA2). This means that AC members should have enough time to perform any required work to understand the business and its current operations: “the demands on your time are not great and you have plenty of time to do discretionary work around your role" (AC1). Time constraints do arise, however, when AC member accept too many appointments. This can severely hamper the member’s ability to deliver value:

> *There are a lot of really good people that serve on audit committees with very good skills; they know what they are talking about. And sometimes they are just so overstretched [that] they can’t spend enough time. And what you do – if you don’t spend the time – is you have to accept management’s explanations because you didn’t have time to sufficiently interrogate… You can’t argue with somebody if you don’t have the facts and if you don’t have the full picture and if you haven’t spent the time to understand it (AC2).*

In general, between 3 and 5 board positions were given as the maximum number of directorships an AC member should hold. This is because the number of board positions an AC member holds will also impact his or her depth of understanding because of practical constraints on time and attention. This supported the findings of Sharma & Iselin (2012). The appropriate number depends on the size and complexity of the businesses, as well as when in the year the meetings and year-ends take place (AC3, AC4):

> *It's a combination of how complex the businesses are… and how well-spaced the meetings are. If you had them all one upon the other and they are quite complex businesses, then the limit is low. But if they are well spaced, some not so complex, then the limit would be quite a lot higher. But there's definitely a limit (AC3).*

Responses indicate that most AC members of JSE-listed companies should have enough time to perform their duties, because most hold 3 to 5 directorships. This aspect of ACE has greatly improved over the last 10 years, because AC members commonly used to sit on 10 to 12 ACs (AC5, EA2):

> *Ten years back you would find certain people that will sit on 10, 12 audit committees… Now you see maybe they are on 3 or 4 or 5. So I think people have just learned that you*

just cannot sit on so many because it's impossible – you cannot know 12 [individual] businesses (EA2).

Nevertheless, there are usually periods of intense pressure in preparation for AC meetings. Although these meetings typically occur only 4 to 6 times per annum, the volume of information to get through in preparation for these meetings is substantial, and respondents related that their ACs are usually given 1 to 2 weeks to get through it all (AC1, AC2, AC3, AC4, AC5, AC6):

At [a large listed company], there's a huge amount of volume to get through. And so leading up to those meetings, I make sure my diary is clear a week before because there's a huge amount of volume to get through, and it's far more complicated and technical [than smaller, unlisted companies] (AC3).

As a result, all interviewees spoke of the importance of good executive summaries. These should not be too summarised nor too voluminous. Most of the AC respondents were of the opinion that good executive summaries are provided (AC2, AC3, AC4, AC6). Nevertheless, for large listed companies, there will always be many areas to address, and so the volume of information can only be reduced to a certain extent:

There is a huge amount of volume, and I'm not quite sure how it can be reduced to be honest. It's a complex business. In the case of [a large listed firm], I'm not sure how we can get less because its complex. There are various moving parts in that business, and different products and so on (AC3).

Due to the large volume of information that needs to be given attention, prioritisation skills are essential (AC1, AC2, AC5, AC6):

There's a balance – you can never go into every last detail on anything. You've got to have the ability to work out what's key and what's important versus what's less important… If you focus on things on the margin to the expense of the really big issues that you need to get right in the company, then you're not really going to be able to get a view on whether the financial statements are correctly reflecting what's going on in the business (AC6).

Both AC and non-AC interviewees believed that their peers often do not possess the prioritisation skills required:

[Their] understanding of materiality and what's important and what's not important is sometimes questionable and they'll go on about insignificant, immaterial matters. They want information from management on areas where – if they were using their judgment –

> *they could have come to their conclusions without [giving] management a whole lot of non-value adding work (AC5).*

EA2 demonstrated the poor prioritisation skills of AC members with the following example:

> *There is one audit committee… their final [meeting] always is about five hours because they turn through every single page of the annual report. They go page by page, which is… a complete waste of time because everybody can get it beforehand, they can give their input, everybody can say their things for 20 minutes and move on (EA2).*

There were mixed opinions on whether sufficient time is given for AC members to prepare for meetings or not. This could indicate that some interviewees had better prioritisation and time management skills than others. AC2 and IA1 found that although the time given to AC members to read board packs has significantly increased, the time allocated is still insufficient. On the other hand, AC3, AC4 and R1 felt that board packs are now distributed well before meetings to give members enough time to read them, as long as they are prepared to work long hours to prepare. Some material is even sent well in advance, such as generic disclosure notes, which can be settled beforehand (AC3).

Nevertheless, respondents are of the opinion that there has been a definite improvement in access to information over the last 10 to 15 years (AC3, EA2, R1). Management used to deliberately conceal information or give AC members insufficient time to examine it. For example, executives used to give the AC the board pack five minutes before the AC meeting, and withdraw the pack immediately after, leaving AC members entirely insufficient time to interact with the content or come to any conclusions (R1).

Given sufficient time and adequate access to resources, members will additionally need the diligence to work through and interrogate large volumes of information to come to conclusions and enact changes within an organisation. Section 4.4 discusses the enthusiasm and commitment of AC members to fulfil their role.

4.4 Diligence

Level of involvement

Diligence is the component which brings all other components together to create ACE (Kalbers & Fogarty, 1993). An AC with ideal composition, authority and access to resources will not be effective unless its members have the diligence to utilise these factors to fulfil the AC function (DeZoort et al., 2002a).

Findings suggest that AC members do take their formal responsibilities seriously (AC3, AC6, EA2): "My sense is that audit committees have always been committees which take their responsibilities quite seriously" (AC6). Nevertheless, different ACs seem to have inconsistent understandings of the extent of enquiry necessary to fulfil those obligations. This is perhaps because of the poor understanding AC members have of their mandate as discussed in Section 4.2.

Three distinct categories of AC members were identified: (1) those who apply a "checklist approach" (AC1), (2) those who challenge the results given to them, but are reliant on the material that is given to them, and (3) those who challenge the results as well as the source of the information provided to them.

The first category of members are those who do what is formally expected of them but follow a "checklist approach to governance" (AC1). According to responses, it is uncommon that AC members are unprepared for meetings (AC3, AC5), yet are only "superficially involved with the company" (AC1). An AC member in this category will, for example, "want to make sure that the financial statements were tabled, tick; want somebody to confirm… that they've made sure they comply with IFRS, tick" (AC1).

This "checklist approach" may cause a lack of scepticism because the AC members are unlikely to question or challenge the information that is given to them (AC5). It is clear to see how corporate failures might be enabled if ACs sign off the financial statements based solely on representations from management that the financial statements are compiled in compliance with IFRS, without any further investigation. Respondents attribute corporate failures largely to AC members operating in this category:

> *If you work back in South African history, [XXX is] probably one of the best examples of tick-box governance… [The former audit committee chair] is a nice guy and he's very knowledgeable about corporate governance.... Had he known the information necessary, I'm sure he would have acted properly upon it (AC5).*

Although corporate governance standards have improved as a result of recent corporate scandals, there is a risk that regulations are becoming too rigid and prescriptive, which may contribute to creating this "checklist approach" as a result (AC5, AC6, R1):

> *You have your King committee checklist, and you will find that in audit committees and board meetings there are a lot of things... that they want you to confirm… And [so] you, as a chairman, say 'Does anybody know of any legal matters?' and everyone says 'No', and*

> *'Are you happy that you're responsible for the governance of IT?', and everybody says 'Yes', and 'Do you understand that you're responsible for the integrated report?', and everybody says 'Yes'… Sometimes I sort of think [it's] just too much on the checklist side of things (AC5).*

Responses indicate that there is a lack of involvement on the part of AC members (AC1, AC4, AC5, AC6, IA1, R1). AC1 and R1 believed most AC members fall into the first category which follow a checklist approach. As an example of this, AC1 claimed that "if you tested audit committee members, I think maybe less than one third will have read the financial statements from beginning to end, once, ever" (AC1). The outgoing AC chair that AC1 replaced used to take an entirely tick-box approach to performing his duties:

> *I took over from a guy there who was a former audit partner at another audit firm and a really good guy, but he would have fitted into the first box [the checklist approach], so he used to add up the financial statements that they gave him. He checked whether they added up, as opposed to exercising his mind properly, as to which numbers could be wrong or inspecting the inputs, which is surprising but not uncommon (AC1).*

The second category of AC members are those who are "more challenging in their views but are still very reliant on what is given to them" (AC1). As discussed in Section 4.3, it seems that AC members are very reliant on management for the data they receive and internal and external assurance to ensure the integrity of that information on their behalf (AC1, R1):

> *There are some very, very good questions there about the results that were coming out of that data, but I don't think anybody on the board was properly focused on the data coming through to them… There's a lot of trust being put in the fact you've got internal audit and you've got external audit; [so they assume] it must be right (AC1).*

A breakdown of ACE does not typically arise from a lack of skill, but rather from poor understanding of the business itself (AC1, AC2, AC3, AC4, AC5, IA1, R1). There was a recurring theme in interviews of the need for AC members to do their own digging in terms of understanding the operations and drivers of the numbers in the board pack. This is so that members get a better idea of whether the data they receive is reasonable or not and where to perform further enquiries (AC1, AC2, AC5, EA1, IA1, R1). According to respondents, members in the first and second category do not perform this digging of their own accord (AC1, EA1, IA1, R1).

There are no legal constraints on how much digging AC members can do, other than ensuring they maintain their independence (IoDSA, 2016). AC interviewees were not aware of any constraints placed by management on this process (AC1, AC3, AC4). As a result, "the only constraint would have been the amount of time and the extent of the process that you could put in place" (AC1). It is up to the AC members to initiate the processes that they need to satisfy themselves that they are performing their function:

> *[We] are entitled to and we certainly have freedom to have any contact with management as we go, outside of the board [meetings]. You are entitled to and are even encouraged to set up your own meetings with whichever people in management you need to, to get to grips with anything that you need to get your head around (AC3).*

The AC interviewees related ways in which they carry this requirement out, indicating that at least some digging is being performed. For example, AC1 related his own time spent with different employees of the business:

> *I spent a lot of time irritating the actuaries within [a large listed company] sitting them down and getting them to run through their main products and show me the cash flow movements year on year and then trying to understand how that related to their analysis of surplus or accounting interpretation of the results (AC1).*

AC3 similarly described the steps he typically takes to ensure integrity of numbers, especially regarding areas of management judgement:

> *I would try to make sure that that valuation has been done by [a] professional valuator. And I would then also ask the external auditors to apply their minds to those valuations so in areas that I think there may be areas of judgment, which requires some further independent verification. I would ask for that myself or make sure that the auditors include it in their audit plans (AC3).*

It often takes persistence from members to keep pushing a line of inquiry until they get the answers they need, or "the whole answer" (AC1). AC1 likened it to being a "bulldog" around the matter, because often, "you need to go through a few iterations to get the information that you needed to get to actually have the truth of the matter lead before you" (AC1):

> *If you don't get responses that you find to be satisfactory, then you need to keep on asking questions. At some point, you either going to have to get to an answer that you that you're happy with or an outcome that you're happy with, or you need to take it further. And I think that's quite important (AC6).*

AC1 provided an example of how this persistence is achieved in practice:

There was a problem in the [XXX] operation. And [management said] 'here's our analysis of it'. And you can say, 'hold on please won't you give me the actual reports that was delivered in [XXX] to the audit committee there'. Or 'let me speak to the chairman of the audit committee in [XXX] and find out what he understands by it'. That's the type of, call it, 'regressive inquiry' to get answers you need (AC1).

The third category is made up of those members who utilise their authority and capabilities to obtain all the information they need, instead of relying on others. According to respondents, they challenge the information provided to them, as well as its source: "if you only trust the information fed to you, you are putting yourself at risk" (AC1).

Members need to keep up to date with their understanding of operations or "feel the pulse" of the business (R1): "It's important that they actually know what the business is like – if you're in a mine, that you actually visit the mine to see what protocols are actually employed in there" (R1). This is because the operations are constantly evolving and there are always new priorities and considerations which come up, which requires the AC to constantly keep rechecking internal operations and controls (AC1, AC5, R1):

I still find, 'gosh, is that how it actually works? I always thought it works like this'. So you are always learning new things, you are always getting a deeper understanding of the business. The business changes, they go into different ventures, they go into different distribution channels... You're learning the whole time (AC5).

Informal interactions and processes outside of formal meetings form a vital part of an AC's understanding of operations (Gendron & Bédard, 2006): "The audit committee is a formal discussion, but actually it's something which operates throughout the year in an informal way as well" (AC6). It is the responsibility of the individual AC members to "build that relationship with management" (AC5). Committee members need to engage proactively with people and physically observe the business to obtain the information they need (IA1, R1):

If I was… to sit in my office and wait for people, or not [even] wait, but call people into my office, for me to talk to them and get information, then I would see nothing of what was happening in the rest of the organisation. As opposed to being able to go out and walk through the business – whether it's through the offices, whether it's through the mines, whether it's through the factories – and just look and see what is happening. It gives you a better sense of what is driving the numbers that ultimately are in the board packs (R1).

In practice, AC visits to operations which do take place are usually formally pre-arranged, which means that the operational staff make sure that everything is tidy and operating smoothly on that day. As a result, AC members do not get an accurate picture of operations from formal AC visits (R1). Additionally, responses indicate that most ACs tend to place reliance on the AC Chair to carry out informal processes on behalf of the committee (AC1, AC3, AC4, AC5, AC6).

AC3 related how he will schedule informal meetings to get his "head around" certain issues, such as preparing for the impact the new IFRS 17 standard will have on the business. These informal processes conducted by AC3 in their capacity as the AC chairman (AC3):

> *I then schedule time with the appropriate people after the meeting or well in advance. Like IFRS 17; I've seen it coming, I want to make sure that I understand the implications for various parts of [the company]. So I've – well in advance now – been engaging with some of the technical team to understand the background a bit better and therefore to understand where there are areas of judgment required and why we should or shouldn't go in one or other direction. So… it's as things crop up you know you will then proactively follow up on something with management… And in that capacity [of chairman], I would fairly frequently – probably once or twice a quarter – have a call with some of the senior actuarial staff there to discuss some technical actuarial stuff. (AC3).*

These additional meetings typically happen once or twice a quarter because of the size and complexity of the listed company in question. Other smaller and less complicated businesses will need fewer additional informal meetings because there is less material and less complexity to gain clarity on (AC3).

AC4 related similar experiences where he will meet informally to gain clarity before formal meetings take place. This does not happen often, however, in AC4's experience, which may either indicate that ACs are not diligent enough to arrange the meetings, or, in the case of AC4, who was a former executive of the same company, there is no clarity needed on any of the material (AC4).

AC members also related how they will attend the meetings of other committees or those of subsidiary companies to gain a broader understanding of the issues and operations of the business and stressed the importance of doing so to enable greater ACE (AC4, AC5):

> *The level of understanding, and therefore confidence and trust in the process, is far deeper in the listed company where... you go to the strategy meetings as well. I think that's particularly important, because then that obviously can highlight risks, which you should understand as an audit committee member and how the operations are going, what direction they're going in (AC5).*

AC4 mentioned that he or she attends the Social and Ethics Committee meetings and meetings of subsidiary companies in his or her capacity as Chairman:

> *I attend our Social and Ethics Committee meetings, so that if there are any issues raised at that table that it's also picked up [at our meetings] … It is much easier to get closer to the business by attending some of the smaller committee meetings, where a lot of detailed issues are discussed. So, you tend to learn much quicker if you attend those meetings, than to rely on, almost a watered-down, discussion at a group level (AC4).*

Responses from non-AC interviews were conflicted. EA2 found that "you'll find some of the audit committee members will actually spend time at the company, not just in meeting times, but other times as well, just to make sure they fully understand what's happening in a company". R1 and EA2, on the other hand, were of the opinion that "the hard questions are not being asked all the time", and that important lines of inquiry are not being pursued:

> *Sometimes I think they don't challenge enough on certain things. They tend to accept quite a lot of what management says. And I think that's unfortunately why, to a big degree, we [have had] the corporate scandals (EA2).*

In some cases, it cannot be expected that the AC will pick up on the issue (R1). Nevertheless, a breakdown of ACE is not usually caused by fraudulent intent but rather by lack of diligence and commitment to personally obtain evidence to satisfy themselves that their role as an AC member has been fulfilled (AC2, R1):

> *I haven't served on an audit committee yet, or got onto an audit committee, where I thought my predecessors were crooks, that they consciously have hidden the truth, that they colluded with management – and I'm not saying they are not, maybe some of them are – but the ones that get caught out are the ones that were sitting there and actually sleeping on the job (AC2).*

Non-AC interviewees believed that about half of JSE AC members show the requisite level of involvement:

> *I would probably say half of them are, half not. I've seen people that are very committed and that really take the job seriously, they really make a difference in those meetings. And then others are just not as capable and competent and proficient (EA2).*

From evaluating the boards of JSE-listed companies, IA1 has seen some innovation around how to promote its board members' understanding of the business. For example, some companies will have board meetings at different operational locations so that members are forced to observe the day-to-day activities of the business. However, this was the exception. In general, AC members are not encouraged or required to have operational experience which means that most AC members do not go about obtaining it (IA1, R1).

Another innovation is the use of WhatsApp as a channel for informal interaction. AC2 is a member of WhatsApp groups comprised of the board members who each post updates on operations, priorities, concerns and outcomes. If AC2 has not been present or in touch for a few weeks at the company, he or she sends a message to the CFO to get an update on what has been happening. This technological change shows an improved level of involvement which is likely to increase ACE. The motivating factors behind the level of AC members' involvement is discussed further in the following section.

Motivating factors

In terms of legal liability, members of the AC are grouped together with all the other members of the board, and can be held jointly or severally liable (*Companies Act No. 71*, 2008). The AC is a statutory committee for listed companies in terms of the Companies Act which is tasked with the monitoring of financial records and controls. This may put the AC at a slightly higher legal risk than the rest of the board in instances of corporate fraud (IA1).

Nevertheless, successful instances of prosecution of a director in South Africa are extremely rare. Consequently, responses indicate that legal liability is not considered to be a central motivating factor for AC members. This is because it is very unlikely that there will be substantial legal consequences (AC1, AC2, AC3, AC4, AC6, EA2, R1):

> *It's not to say that I'd disregard the threat of being sanctioned and not being seen as fit and proper. But whether that was there or not wouldn't change my approach to how I do it (AC3).*
>
> *I don't think that changing regulations or stock exchange requirements necessarily make the difference. It might make the regulators feel good, and it might make the stock exchanges feel good, but that's not what makes the difference (AC6).*

On the other hand, protection of personal reputation was identified by respondents as a strong motivating factor for AC members. AC members have their reputation and standing to maintain both inside and outside the organisation (AC1, AC2, AC3, EA1). As discussed in Section 4.2, responses indicate that members will refrain from asking certain questions if they think it will make them look "stupid" (IA1, AC2, R1). Respondents also unanimously indicated that personal reputation is “extremely important, more important than formal sanction” (AC3). When asked why they carry out their duties diligently, most responded as AC1 and AC2 did

> *It's your reputational damage. Because it's not just reputation in terms of getting a job. I mean it's reputation in the car park at the school where your kids go. It's your social circle. It's… a very big driver in terms of doing the right thing (AC1).*

> *People don’t want to be part of a company that got it wrong. You know, do you really want to be known as the person that chaired the [XXX] audit committee when they had the failure (AC2)?*

Reputation is held in high regard because the person’s livelihood and personal standing is at stake. Any association with a corporate failure will probably cause a member to lose all of their directorship posts. Additionally, it seems that AC members are unwilling to accept the public disgrace of being associated with a corporate failure.

Despite this, the AC members interviewed were motivated to work diligently to a large extent by their own values and interest in the work (AC1, AC2, AC3, AC4). AC1 discussed that becoming a non-executive director is a way for retired executives to “keep in touch with business industry, have a purpose and maybe protect a bit of their capital through their fees they earn" (AC1). AC2 only accepts appointments to ACs that provide an adequate “challenge” (AC2). AC3 claimed that “I suppose it’s my own professional integrity that is more important to me [than any other factors]”.

Respondents believe that this is particularly relevant because it is unlikely that regulation can cause people to act ethically. Regulation can only put measures in place to minimise the likelihood of unethical action (AC6, R1). The intrinsic motivation of interest and personal integrity is a strong indication of increased ACE because this makes it much more likely that the member will endeavour to “do the right thing” (AC6):

> *You can't actually regulate for people to do the right thing. You either have people who understand their obligation to do the right thing and they do the right thing, or you don't… You can try and clarify all these things [through regulation], but ultimately you almost **can't** regulate for good behaviour (AC6, emphasis in original).*

Nevertheless, responses from interviewees indicated that AC members are very rarely there just to collect fees, especially for larger listed firms (AC1, AC4, AC6): "I don’t think it’s the case. I mean, certainly not on [a large listed organisation’s] board... I wouldn’t generalise that to say that that’s a general trend. It may happen, but certainly not in our case” (AC4). EA2 corroborated this opinion:

> *If I look back over the years maybe in the earliest years of 2005, 6, 7, [just being there to collect fees] was a lot more prevalent. I think what's happened now because of all the corporate scandals because of all that everything has happened globally in companies you don't see that anymore. The people that take up those positions do not just come there and collect the money and move on. Especially under the listed space – maybe in the public sector it might be different – but definitely in the listed space, those people are there for a reason, ask questions, they challenge, and they do what they need to do (EA2).*

Section 4.1 to 4.4 have discussed findings on the separate components of ACE. The following section discusses interviewees perceptions of ACE from a holistic point of view. Chapter 5 concludes this study by summarising and integrating all findings on ACE.

4.5 Overall

There is a consensus that ACs are not as effective as they should be but there has been an "overall improvement" (AC1) in ACE from 10 to 15 years ago (AC1, AC2, AC5, AC6, EA1, EA2, IA1, R1). Most attribute this to companies learning from the corporate failures in recent years in South Africa (such as Tongaat Hulett and Steinhoff) and abroad (such as Enron and Worldcom) (AC1, AC2, AC3, AC5, AC6, IA1, EA2, R1). AC3 is of the opinion that, while ACs are not as effective as they should be, they are still more effective than if there was no AC at all:

> *I think throughout, the ones that I've been involved with have been effective, sometimes more effective, depending on the composition of the committee. So sometimes I think they're now more effective than they were. Never not effective, but now more effective than we were because so-and-so has come on, and so-and-so has left… Are we as effective as I'd like it to be? No. Are we more effective than if there was no committee? Yes (AC3).*

AC members are also getting positive feedback from Chief Executives:

> *More and more I hear comments like "we are so pleased to have such a strong audit committee" and "we appreciate your independent advice" and "thank you very much for what you've done over the years". You hear that far more than you used to hear, and I think it's truthful. And I have found, over the years, that your chair and your CFO… will very often phone you with their problems, as an independent –just to be a sounding board. So I think it has improved over the years (AC5).*

AC members attribute the improvement in ACE to recent corporate failures and the consequent revision of corporate governance standards and regulations:

I think [ACs] are effective. I think overtime that they've probably become more effective because their responsibilities and exposures have grown. They do tend to be far more thorough than they used to be… I get irritated by King and all these corporate governance things, but I think that has driven the process to a degree, [and] the bad experiences out there in industry; all these huge frauds [like] the Tongaats and Steinhoffs… I think have made audit committee members more focused… The JSE puts pressure on you. The Financial Conduct Authority is putting pressure on you. The regulators are putting pressure on you. Companies Act responsibilities [have] grow[n], so there's a lot more pressure to make sure that you are being independent and giving valuable advice. So I think audit committees have improved. I think they definitely have improved. (AC5).

Nevertheless, despite the perceived improvement in governance standards, there is the risk that they are becoming too prescriptive, which may be creating a "tick-box" attitude in AC members (*AC5, AC6, R1):*

Maybe – I'm sticking my neck out – to the extent that it's overdone now. I think it's a bit overdone and is quite a risk of it becoming a little bit tick-box. As opposed to value-adding in a lot of instances (AC5).

Non-AC interviewees were of the opinion that "there is a lot of room for improvement" and that ACs should be in a "continuous learning process" (EA2).

AC members also have an overall positive opinion of their peers' independence and capabilities as AC members (AC2, AC4, AC5, AC6): "In general, I find that the members of my Audit Committees have been fiercely independent. Very skilled people and they do add value" (AC5).

There is also a broad spectrum of subject matter to be covered by an AC of a JSE-listed company, and an AC may not be as effective in one area as it is in another, because "there are trade-offs, even when you work in two or three or ten extra meetings, you can only do that much" (AC2). This is because ACE is a function not only the capacity of the AC but also that of management (to provide the information and focus on areas that need attention). ACs also seem to go through "cycles" of being more and less effective, depending on the members on the AC and what issues they are facing (AC2). Nevertheless, AC2 has a very positive opinion of ACE overall:

Every audit committee is different and every audit committee has got cycles [in which they are] more and less effective, depending on what's on the table and depending on [who] we've got sitting around the table, [but] generally I must say I think the audit committees I've served on have been mostly effective, somewhere between 60 and 90% effective (AC2).

In contrast, the opinions of other respondents were less positive, indicating that the AC member might have an over-optimistic or skewed perception of their own profession. From R1's extensive experience in regulating accounting and corporate governance, as well as in dealing with the legal ramifications of corporate failures in practice, R1 is of the opinion that ACE should definitely have improved over the last 10 years because of the increasing regulation over ACs and corporate governance in general but these structures do not seem to have helped.

Chapter 5: Conclusion

5.1 Summary and findings

This research seeks to explore the operationalisation of ACs of JSE-listed companies, as well as AC members' perspectives of ACE in practice. As befits the qualitative methodology employed, this study was intended as first step towards gaining a deeper understanding of ACE and the actual role ACs play in corporate governance in SA, rather than a definitive determination of the effectiveness of ACs listed on the JSE.

A summary of results is presented in Sections 5.1.1 through 5.1.5 below.

5.1.1 Composition

It was found that although basic financial understanding is needed, an extensive background and qualifications in finance are not necessary for AC members to be effective. This confirms the work of Kalbers & Fogarty (1993), San et al. (2012) and Chen & Komal (2018). Respondents had conflicting opinions on whether the requisite level of financial skill is met. Nevertheless, AC members do tend to be former executives or audit partners and so have the necessary skills and experience to fulfil the duties of an AC member. Breakdowns in ACE often result, however, from a lack of understanding of the individual business, and specifically its ESG environment.

All interviewees were of the opinion that having an enquiring mind, the ability to form an opinion and defend it, and emotional intelligence are more important for ACs to be effective than are technical accounting knowledge. "Courage of convictions" seems to be present in AC members and it is estimated that 50% of AC members have the levels of emotional intelligence required to support ACE. In particular, the AC Chair serves as the focal point of an AC and the general opinion is that most AC chairs possess the skills and competence to serve their role.

Most companies listed on the JSE have diverse boards in terms of age, race, gender and experience, and respondents were of the opinion that this contributes to ACE (corroborating the studies conducted by Song & Windram (2004), Mohammed et al. (2015) and Zalata, Tauringana & Tingbani (2018)). The transformation agenda in SA, however, does put pressure on the capacity of historically disadvantaged individuals because of the dearth of eligible candidates which has a negative impact on ACE.

It is interesting to note that there seems to be a notable difference between the quality of ACs of larger listed firms and those of smaller listed firms. This is attributed to the limited pool of top non-executive directors for whom the smaller entities cannot afford to pay, resulting in poorer ACE in smaller companies as compared to ACE of larger ones.

AC members tend to take independence requirements very seriously (corroborating studies conducted by Lisic et al. (2016) and Weickgenannt et al. (2021)). This aspect has greatly improved over the last 10 to 15 years and is attributed to reform caused by the major corporate scandals in SA and the world in recent years. There is still the concern that, if directors become too removed from the company in protecting their independence, they become over-reliant on information from others because they gain no evidence first-hand.

5.1.2 Authority

Notwithstanding legal requirements in the Companies Act and guidance from the King IV report, AC members seem to be confused as to the extent of their responsibilities. AC members do seem to strike the correct balance of obtaining sufficient information without crossing over into an operational role, but there is an increased risk that AC members are now becoming too involved in fear of the consequences of corporate failure such as those we have seen in recent times. Failure to say no to “scope creep” is also leaving ACs with insufficient time to address all areas they are responsible for.

The efficacy of an AC depends largely on the culture of corporate governance within an organisation, and ACs have a large influence on how corporate governance practices are perceived. As many ACs of JSE-listed companies are not being taken seriously by their respective organisations, this indicates that the AC is not exerting their authority in the organisation to meet their responsibilities and adapt the organisational culture. This finding aligns with the study conducted by Lisic et al. (2016). AC members are also failing to ask the “stupid questions” and make “unpopular decisions” that are crucial to the effective functioning of an AC.

There has been a noted improvement in the general regard for corporate governance in the JSE-listed space due to recent corporate scandals. As a result, boards do seem to be committed to improving ACE at the overall committee level. Individuals, on the other hand, are not as committed to improving, because they can be held personally responsible for inadequacies.

5.1.3 Resources

AC access to resources is poor which severely negatively impacts the ability of an AC to be effective. ACs are heavily reliant on management for their information which is an inherently biased source. Assurance providers over this information, internal and external audit, are of limited use to the AC because both internal and external audit are hindered by their own agendas to retain their jobs or audit fees and because AC interactions with internal and external audit are mediated through management to a large extent. These findings corroborate the research conducted by (Gendron & Bédard, 2006; Turley & Zaman, 2007; Wu, 2012; Kapkiyai et al., 2020)).

Nevertheless, there does seem to be a general trend of improvement over the last 10 years in regards to an AC's access to resources, most particularly in the time given by management to ACs to read the board pack before meetings.

5.1.4 Diligence

Results from prior research on the diligence of AC members have been inconclusive (Wu, 2012; Alhossini et al., 2021). This study has found, that AC members do take their responsibilities seriously. Where it used to be more common, 15 years ago, it is now rare for a member to be on an AC just to collect the fees. Accordingly, members are usually prepared for meetings.

Nevertheless, AC members tend to see fulfilling their duties as a checklist exercise and perform no more than what is formally mandated. While some committees do perform informal processes, only the Chair of the AC will typically carry these out. This causes a major downfall of ACE because members are missing the "will" or "enthusiasm" to obtain and critically analyse information (IA1). Failure to prevent corporate scandals is not often the result of lack of qualifications or fraudulent intent on the behalf of AC members. It is instead the result of ACs following a "tick-box approach" instead of setting about doing the actual work they feel they need to do to satisfy themselves that their mandate has been adequately fulfilled.

Legal liability has not been found to be a motivating factor for AC members. The desire to protect personal reputation in private and public domains, however, has been found to be a strongly motivating factor for AC members to pursue ACE. In addition, personal reputation in private board meetings, specifically, has been found to directly impact the ability of a AC member to be effective because it affects the willingness with which others in the organisation will assist the AC member and give them answers to their questions. Interest in the profession and personal integrity have also been found to be strongly motivating factors, indicating ACE is increased.

5.1.5 Overall

All interviewees are of the opinion that ACE cannot be generalised. Each audit committee is different. Nevertheless, the content from their interviews provided basis for some preliminary findings in regards to the ACE of JSE-listed ACs.

There is a general consensus that ACs are not as effective as they should be but ACs have seen an "overall improvement" (AC1) in ACE from 10 to 15 years ago. AC members attribute the improvement in ACE to recent corporate failures and the consequent revision of corporate governance standards and regulations. As such, while ACs are not as effective as they should be, they are still more effective than if there were no AC at all.

Despite the perceived improvement in governance standards, there is the risk that they are becoming too prescriptive, which may be creating a "tick-box" attitude in AC members.

AC members also have an overall positive opinion of their peers' independence and capabilities as AC members (AC2, AC4, AC5, AC6): "In general, I find that the members of my audit committees have been fiercely independent. Very skilled people and they do add value" (AC5).

There is also a broad spectrum of subject matter to be covered by an AC of a JSE-listed company, and an AC might not be as effective in one area as it is in another because there are "trade-offs" which inevitably arise from the volume of subject matter to get through. This is because ACE is a function not only the capacity of the AC but also that of management to provide the information and focus on areas that need attention. ACs also seem to go through "cycles" of being more and less effective, depending on the members on the AC and what issues they are facing.

In conclusion, this research has found that the levels of effectiveness of ACs of JSE-listed companies are poor. Although AC independence seems to be taken very seriously and upheld rigorously, this indication of ACE is reversed by the lack the skill and courage of convictions of its members. ACs typically have access only to biased sources of information, and assurance providers over this information provide limited value. ACs tend to rely on the information given to them without performing any extra inquiry or exploration themselves because this is not specifically required of them. As a result, ACs of JSE-listed companies perform only a tick-box function which achieves little more than signalling to shareholders that corporate governance requirements are being met.

Nevertheless, it must be noted that respondents have seen a definite improvement in ACE over the past 10 to 15 years, specifically regarding AC independence and in management giving ACs sufficient time to read the board pack before board meetings.

5.2 Limitations and areas of further research

A limitation of this research is that it only considers ACE of JSE-listed ACs. Qualitative assessment of ACE in other jurisdictions and stock exchanges can be considered for further research to gain a more global understanding of ACE and how it differs from country to country and on smaller and larger stock exchanges.

Another area needing further exploration is how to distinguish where involvement and enthusiasm in performing non-executive strategic roles (such as serving on an AC) cross over into an operational, and accordingly, inappropriate, role. The role firm size and nature has to play in the scope and level of involvement required from members should also be considered.

Following on from this, this study has ascertained a notable difference in AC quality between smaller and larger listed firms on the JSE, but it was outside of the scope of this research to delve into this aspect in depth. (1) The relationship between firm size and ACE, (2) reasons behind any discrepancy and (3) how to address the gap, all warrant the attention of further research exploration, especially from a qualitative viewpoint.

Lastly, in South Africa and world-wide, the agenda of transformation is currently at the forefront of social, economic and political discourse. It is vital that further research is conducted into how more historically disadvantaged individuals can be incorporated into an effective AC, and how diversity of its members contributes to ACE.

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Appendices

Appendix A: Information sheet for participants and consent form

INFORMATION SHEET FOR PARTICIPANTS

Ethics clearance number: **SOA-2020-07-14**

Title: Audit committee effectiveness: perspectives from South African audit committee members of JSE-listed companies

Dear Sir/Madam

My name is Kita von Willich and I am doing my Masters in Commerce (Accountancy) at Wits University in Johannesburg. As part of my studies I have to undertake a research project. I am evaluating the effectiveness of audit committees from the perspective of audit committee members.

We would like to invite you to participate in this research project. You should only participate if you want to; choosing not to take part will not disadvantage you in any way. Before you decide whether you want to take part, it is important for you to understand why the research is being done and what your participation will involve. Please take time to read the following information carefully and discuss it with others if you wish. Ask us if there is anything that is not clear or if you would like more information.

- This research seeks to understand the experiences and perceptions of audit committee members, of both themselves and their colleagues, in relation to audit committee effectiveness.
- If you agree to participate, a time will be scheduled for an interview that is expected to take between sixty and ninety minutes to complete.
- There are no material risks posed by participating. Your identity and place of employment will be kept confidential. No personal information will be collected from you.
- There are no right or wrong responses – this research is only interested in your own experiences and impressions.
- Interviews will be audio recorded, subject to your permission. The interview will be transcribed and kept on file by the researcher but your identity and that of your employer and/or clients will be kept confidential and will not be referred to directly in the final research report.
- You will not receive any compensation for participating in the research. There is no direct benefit from participating or not participating in the research.
- Should you be interested, a copy of the final report will be available to you on request.

It is up to you to decide whether to take part or not. If you decide to participate you are still free to withdraw at any time and without giving a reason. In addition to withdrawing yourself from the study, you may also withdraw any data/information you have already provided up until it is transcribed for use in the final report.

If this study has harmed or offended you in any way, you can contact the University Human Research Ethics Committee (non-medical), telephone +27(0)11 717 1408, email hrec-medical.research@wits.ac.za/ Shaun.Schoeman@wits.ac.za. If you require further advice and/or information, the researchers can contacted using the details below:

Details	Researcher 1	Researcher 2	Researcher 3
Name	Kita von Willich	Dannielle Cerbone	Wayne Van Zijl
Email address	Kita.VonWillich@wits.ac.za	Dannielle.Cerbone@wits.ac.za	Wayne.VanZijl@wits.ac.za

Yours sincerely

Kita von Willich

CONSENT FORM FOR PARTICIPANTS IN RESEARCH STUDIES

Please complete this form after you have read the Information Sheet and/or listened to an explanation about the research.

Title of Study: Audit committee effectiveness: perspectives from South African audit committee members

Ethics clearance number: SOA-2020-07-14

Details	Please tick or initial
I agree that my participation will remain anonymous	
I agree that the researcher may use anonymous quotes	
I understand that if I decide at any time during the research that I no longer wish to participate in this project, I can notify the researcher involved and withdraw from it immediately without giving any reason. Furthermore, I understand that I will be able to withdraw my data up to the point of submission of my responses.	
I understand that the information I have submitted will be published in a thesis and/or publication and that I can request a copy of the final article.	
I understand that my personal information will not be collected. My identity and that of my employer and/or clients will be kept confidential and will not be referred to directly in the final report.	
I agree that the information I provide may be used anonymously in other research projects	
I consent to my interview being recorded/to may data being used in the research/my questionnaire being included in the final results.	

Participant's Statement:

I ____
Agree that the research project named above has been explained to me to my satisfaction and I agree to take part in the study. I have read both the notes written above and the Information Sheet about the project, and understand what the research study involves.

Signed **Date**

__________________________ ______________________________

Appendix B: Interview agenda

The following discussion points will be used in the interviews with the participants; the interviews will be transcribed and the data analysed subsequent to the interviews being conducted.

Discussion points

1. The roles and responsibilities of audit committees.

2. The level of influence that audit committee members have in the organisation and the financial reporting process.

3. Expertise, experience and personal characteristics of audit committee members and how these factors impact audit committee efficacy.

4. Access to resources and information from internal and external sources.

5. Incentives, motivations and level of commitment of audit committee members.

Appendix C: Ethics clearance

UNIVERSITY OF THE WITWATERSRAND, JOHANNESBURG

SCHOOL OF ACCOUNTANCY ETHICS COMMITTEE

CONSTITUTED UNDER THE UNIVERSITY HUMAN RESEARCH ETHICS COMMITTEE (NON-MEDICAL)

CLEARANCE CERTIFICATE **PROTOCOL NUMBER: SOA-2020-07-14**

PROJECT TITLE **Audit committee effectiveness: perspectives from South African audit committee members of JSE listed companies**

INVESTIGATOR	**Kita Von Willoh**
SCHOOL/DEPARTMENT OF INVESTIGATOR	School of Accountancy
DATE CONSIDERED	27 July 2020
DECISION OF THE COMMITTEE	Approved unconditionally
RISK LEVEL	**MINIMAL RISK**

EXPIRY DATE At the latest must meet n + 2 rule as outlined by the CLM Faculty for final submission of research report.

ISSUE DATE OF CERTIFICATE 31 July 2020 **CHAIRPERSON**

_04___/__08___/__2020___

(Professor Nirupa Padia)

cc: Supervisor: Dannielle Cerbone & Wayne Van Zijl

DECLARATION OF INVESTIGATOR

To be completed in duplicate and ONE COPY returned to the Chairperson of the School/Department ethics committee.

I fully understand the conditions under which I am are authorized to carry out the abovementioned research and I guarantee to ensure compliance with these conditions. Should any departure to be contemplated from the research procedure as approved I/we undertake to resubmit the protocol to the Committee.

PLEASE QUOTE THE PROTOCOL NUMBER ON ALL ENQUIRIES

Appendix D: List of interviewees

Audit committee members of JSE-listed companies		
Identifier	**Background**	**Approximate interview length**
AC1	Professional independent non-executive director serving on and chairing ACs of JSE-listed companies. Former external audit partner. Former CEO and as CFO of JSE-listed companies reporting to ACs. CA(SA) qualification.	90 minutes
AC2	Professional independent non-executive director that has serving on and chairing ACs of JSE-listed companies, as well as working closely with international regulators on corporate governance of listed companies. CA(SA) qualification.	90 minutes
AC3	Qualified actuary serving on the AC of a JSE-listed company and Actuarial Subcommittee. AC chair of private, unlisted companies. Former CEO of a large JSE-listed company.	70 minutes
AC4	Qualified actuary serving on and chairing ACs of a JSE-listed company and its unlisted subsidiaries. Former CEO.	90 minutes
AC5	Chairman of JSE-listed AC and AC of an unlisted trust. Former external audit partner. CA(SA) qualification.	80 minutes
AC6	Qualified actuary serving on and chairing ACs of a JSE-listed companies, as well as ACs in the UK. Experience as CFO of JSE-listed companies, preparing financial statements and reporting to ACs.	60 minutes

Non-AC interviews		
Identifier	**Background**	**Approximate interview length**
EA1	IFRS technical partner on audits of JSE-listed companies. IIRC and IoDSA corporate governance representative.	90 minutes
EA2	External audit engagement partner with over 20 years of experience in auditing JSE-listed companies.	60 minutes
IA1	Experience as a chief audit executive for a JSE-listed company and 3rd party provider of ACE evaluations to JSE-listed companies.	90 minutes
R1	IASB, JSE, IRBA and SAICA representative. Expert witness in corporate legal cases. Former external audit partner.	90 minutes