The roles, responsibilities and characteristics of audit committee in China

Z. Jun Lin
Hong Kong Baptist University, Kowloon, Hong Kong
Jason Z. Xiao
Cardiff University, Cardiff, UK, and
Qingliang Tang
The University of Western Sydney, Penrith South DC, Australia

Received 20 January 2006
Revised 19 May 2006,
30 October 2006
Accepted 15 May 2007

Abstract

Purpose – The purpose of this paper is to investigate the perceptions of the roles, responsibilities and basic characteristics of audit committees (ACs) in the current business environment in China, from the perspectives of investors/creditors, independent directors (AC members), company officers and auditors.

Design/methodology/approach – The study is conducted through a questionnaire survey of the four groups of stakeholders with two forms of survey instruments being distributed to randomly selected survey subjects. The data collected from the returned questionnaires are analyzed at both the aggregate and sub-sample levels.

Findings – The study finds that various groups of stakeholders have generally accepted the ceremonial roles and responsibilities of ACs in terms of lifting the image of good corporate governance, enhancing communication between board of directors (BoD) and auditors, and mediating conflict between management and auditors. However, the more concrete AC oversight roles and responsibilities for improving internal control, rules compliance, sound corporate financial reporting and auditing processes have not been fully recognized at present, particularly by company management and independent directors. In addition, the study reveals that actual AC operations in practice are ineffective even though a large portion of Chinese listed companies have set up ACs.

Originality/value – The paper should assist readers to understand the recent development of corporate governance and stock market reforms in China and generate some policy implications that can be applied to other countries as well, emerging economies in particular.

Keywords Audit committees, Corporate governance, Non-executive directors, Stock markets, China

Paper type Research paper

Introduction

The Chinese authorities have introduced the independent director system and audit committees (ACs) to listed companies in recent years in order to improve corporate governance and promote stock market reform in China. Following the implementation of the *Standards of Corporate Governance for the Listed Companies* issued by the China Securities Supervisory Commission (CSRC) in 2002, AC establishment has

The authors are grateful to the two anonymous reviewers and the Journal Editor for their valuable comments and suggestions on the prior versions of this paper.

Accounting, Auditing & Accountability Journal
Vol. 21 No. 5, 2008
pp. 721-751

0951-3574
DOI 10.1108/09513570810872987

become increasingly popular in practice (Shanghai Stock Exchange (SHSE, 2003); He, 2004). Nonetheless, there is a lack of study on AC's roles, responsibilities, and actual operations in China; although much greater study efforts have been evidenced in the USA, the UK and other western countries over the last two decades.

We investigated the perceptions of various stakeholders, i.e. investor/creditors, company management, independent directors (AC members) and external auditors, over AC roles, responsibilities and desirable characteristics under the current corporate governance environment in China. Through a questionnaire survey, our study results reveal that a majority of respondents agreed to the ceremonial roles of ACs, e.g. to improve corporate governance structure and lift the image of good corporate governance. However, the respondents, overall, have not fully recognized other more substantial AC roles such as enhancing audit quality, reducing a company's illegal acts or irregularities, and preventing fraudulent financial reports. Similar pattern is found in the respondents' perceptions of AC responsibilities. In other words, the respondents were more in favor of AC responsibilities in appearance but their acceptance of the AC responsibilities in respect of overseeing management financial performance, compliance with regulations or rules, and monitoring auditor independence and audit process, remains at a relatively low level. In addition, most respondents agreed on the existing requirements on AC composition, size, and member qualifications, which are in line with the recent regulations prevailing in the USA, the UK and other western countries. However, the Chinese respondents were generally less supportive of the requirements on AC-related disclosure and reporting. This study has further analyzed the between-group commonality and difference in the perceptions shared by different groups of stakeholders. We found, in general, that company management respondents held greater reservations on AC roles, responsibilities and desirable characteristics, in contrast to other groups of respondents.

This study has also examined AC operations in practice. The study results demonstrate that even though a large portion of Chinese listed companies (62 percent of the responding companies) have set up ACs according to the CSRC's new corporate governance standards, the majority of ACs did not function effectively and actual AC operations in China are far behind the standards in the USA, the UK and other western countries. In particular, most ACs in Chinese listed companies held no or few meetings with a very short meeting duration during a year. The ACs in the Chinese listed companies are rarely involved in the decisions of appointing auditors or determining audit fees, and keep little contact with internal and external auditors. Our study findings provide empirical evidence that, at present, AC is a ceremonial decoration rather than an effective oversight function for corporate governance in the Chinese listed companies. Thus, we further analyzed the factors leading to ineffective AC operations in China, such as the deficiency in corporate governance structure of the listed companies, the constraints of the two-tier board system, the poor qualifications of AC members and their insufficient commitment to AC duties, and the lack of clear and stringent legal requirements on AC responsibilities or obligations. The study findings should generate some policy implications to market regulators in China and other countries.

The paper consists of six sections. We discuss AC development contextual to the emerging Chinese stock market and briefly summarize prior studies on AC roles, responsibilities and desirable characteristics in the western literature, as well as the recent market regulations in the USA and the UK in the next section, in order to provide a relevant conceptual framework for this study. The research questions are illustrated in another section, followed by the description of sample and data collection process. Then, the study results and further analysis and discussion are presented, respectively, in the next two sections. Finally, a brief section of conclusion ends the paper.

Study background

Stock companies reappeared in China in the mid 1980s and two stock exchanges, i.e. SHSE and Shenzhen Stock Exchange (SZSE), were reopened in 1990 and 1991, respectively, after more than 30 years of suspension, to facilitate public listing and trading of stock securities. The stock market has expanded rapidly since then in pace with the rapid progress of economic reforms and business restructuring[1]. Nonetheless, the corporate governance practices and market regulation system in China remain below the standards prevailing in the western world. In particular, due to the long-lasting state ownership and the planned economy that were introduced right after the founding of The People's Republic in 1949, the majority of Chinese listed companies were originally state-owned enterprises (SOEs), or they were carved out from parent SOEs and went public with IPO packaging. Therefore, there are generally three types of ownership shares for a listed company in China, i.e. the "state-owned shares" (representing the state's equity holding in a listed company), the "social-legal-entity shares" (equity shares held by other SOEs or social institutions), and the "Public shares" that are held by public investors (both institutional and individual). Under current regulations, the state-owned shares and social-legal-entity shares, normally accounting for two-thirds of the total shares of a listed company, are not tradable[2]. Thus, public investors holding the tradable shares are in fact the minority shareholders for most Chinese listed companies.

Under such an equity structure, the operations of most Chinese listed companies are in fact subject to frequent interventions of their parent SOEs or government agencies holding a dominant chunk of equity shares. Senior company officers are appointed by, and responsible to, their parent SOEs or the government agencies in charge. In an environment without effective market regulation and investor monitoring, company management, or even the controlling shareholders, have frequently pursued their own self-interest even at the expense of other stakeholders. For instance, a considerable number of Chinese listed companies were merely engaged in raising capital from the stock markets while their management would have to manipulate earnings numbers and profit distribution through related party-transactions, insider trading, and even fabricated transactions and fraudulent accounting records (Huang, 2001; Wu, 2001; SHSE, 2003). In particular, notorious corporate scandals and accounting shams were exposed continuously since the late 1990s, which had brought about significant losses to public investors and led to a confidence crisis in the stock market. As a result, substantial retreats appeared in the Chinese capital market since the early 2000s with the trading volume and market index declining substantially and continuously[3].

The Chinese Government has to introduce a series of reforms to restore investor confidence in listed companies and the stock market. The reforms aim at improving corporate governance and enhancing the quality of corporate reporting in order to curb corporate frauds and prevent continuing capital outflows in the emerging

Chinese capital market, as well as to mitigate the outcry of public investors. Market regulation has been strengthened to enhance the monitoring of the management's accountability to shareholders and other stakeholders. Although the Chinese Government has initially incorporated the German-styled two-tier board system of corporate governance structure in *The Company Law*, e.g. each company will have a BoD and a supervisory board (SB) with the latter being empowered to supervise the operations of BoD and senior management as well as the corporate financial and accounting affairs (*The Company Law*, 1993, 1999; CSRC, 1997). The SBs, with their members being nominated by shareholders and employee unions, had often failed to exercise effective supervision under the existing equity structure dominated by parent SOEs or government agencies in charge (Wu, 2001; SHSE, 2003; Xiao *et al.*, 2004). Hence, the Chinese stock market regulator, i.e. the CSRC, decided to adopt some corporate governance practices from the USA and the UK as a supplement to the SB system. The CSRC officially introduced the independent directors system in 2001 and required all Chinese listed companies to appoint at least one-third of independent (non-executive) directors by June 30, 2003 (CSRC, 2001)[4]. In addition, the CSRC strongly recommended the listed companies set up some special committees under BoD in order to enhance its oversight of management performance and corporate accounting and financial reporting. The *Guidelines* requires that independent directors recommend to BoD on the appointment and dismissal of external auditors. A company can set up an AC to fulfill this role with independent directors serving as a majority in its membership (CSRC, 2001; He, 2004). Later, in the *Standards on Corporate Governance for the Listed Companies* being implemented in 2002, the CSRC has more specifically recommended a listed company establish four subcommittees under BoD, e.g. strategic development committee, AC, nomination committee, and salary and remuneration committee. In particular, an AC should mainly consist of independent directors and at least one member should be an accounting expert[5] while the convener of an AC should be an independent (non-executive) director (Article 52, CSRC, 2002). Furthermore, *The Standards* defined the AC's roles and responsibilities as the following (Article 54, CSRC, 2002):

- to make recommendations on the appointment and change of external auditor;
- to supervise the internal audit system and its implementation;
- to coordinate the communication between internal and external auditors;
- to review corporate accounting information and disclosures; and
- to review the company's internal control programs.

Beside the new regulations, however, there is a lack of studies on AC roles, responsibility and operations in China. In particular, there is no evidence on the acceptance of ACs by various stakeholders. In order to promote effective functioning of the AC system in Chinese listed companies, an empirical study on AC-related issues contextual to the corporate governance environment in China is not only necessary but also worthwhile.

AC setup is common in corporate governance structure in many western countries adopting the unitary board system. Although the existence of ACs can be dated back to the late nineteenth century or even earlier in the UK and the USA[6], the popularization of ACs in the business world started in the 1980s and early 1990s in the industrialized countries (Birkett, 1986; Bradbury, 1990; Collier, 1993, 1996; Vanasco, 1994; Porter and Gendall, 1998; Raghunandan *et al.*, 2001). Following increasing numbers of corporate failures or accounting scandals, the market regulatory bodies in the USA (Treadway Commission Report, 1987), the UK (Cadbury Committee Report (CC, 1992)), Canada (*McDonald Commission Report* (Canadian Institute of Charted Accountants (CICA, 1987))), Australia and New Zealand, had all mandated listed companies to form an AC under BoD as a mechanism to ensure the quality of corporate financial reporting and auditing processes in the last two decades (Institute of Internal Auditors (IIA, 1993); Menon and Williams, 1994; Porter and Gendall, 1998; Blue Ribbon Committee (BRC, 1999); Carcello and Neal, 2000; Beecher-Monas, 2003). Since then AC has become a regular setup in most listed companies in those western countries under Anglo-Saxon influences (KPMG Peat Marwick Thorne, 1991; Menon and Williams, 1994; Collier and Gregory, 1996; Spira, 1999a, 2002; Rezaee *et al.*, 2003). Another boost to AC establishment and operation by stock market regulators in the western world has been evidenced since the early 2000s (Institute of Charted Accountants in England and Wales (ICAEW, 2001); National Association of Corporate Directors (NACD, 2002); Financial Reporting Council (FRC, 2003); Ontario Securities Commission (OSC, 2003); Australian Stock Exchange (ASE, 2003); Lansing and Grgurich, 2004; Hansell, 2005).

Although ACs existed in practice for a long time, the perceptions of AC's roles evolved continuously. There were varied views on AC's roles in the western literature before 2000s, but a relative consensus has emerged in recent years following the promotion of AC function in corporate governance by market regulators and professional bodies. The early advocators argued that an AC is mainly to review the financial statements prepared by the management before being tabled to BoD. Later AC's roles were extended to enhance auditor independence or to ensure the quality of financial reporting and auditing process (Mautz and Neumann, 1970; CICA, 1981; Bradbury, 1990; Abdolmohammadi and Tomasko, 1992; ICAEW, 1997; BRC, 1999). In other words, an AC will serve as a link between BoD and the external auditor and mediate potential conflicts or disputes between the management and auditors, thus enabling auditors to perform their job more independently (KPMG Peat Marwick Thorne, 1991; CC, 1992; Collier, 1993; Vinten, 1995; Carcello and Neal, 2000). Nonetheless, AC roles have expanded substantially in the last two decades. For instance, as required by the Treadway Commission Report in the USA (1987), ACs should oversee companies' internal control and co-ordinate the work of internal and external auditors (IIA, 1993; Guthrie and Turnbull, 1995; BRC, 1999). Later, AC's roles were further expanded to include monitoring of the management's financial performance or accountability and the internal controls as well as to be a means to enable non-executive directors to oversee the ethical behaviors of the management in respect of compliance with regulations and company codes of conduct (DeZoort, 1997, DeZoort *et al.*, 2002; ICAEW, 1997, 2001; Spira, 2002). After the notorious corporate scandals in recent years, such as Enron, WorldCom, Adelphia, and Tyco, ACs have further been seen as a useful mechanism of corporate governance (NACD, 2002; Spira, 2002; Cohen *et al.*, 2002; FRC, 2003; Securities and Exchange Commission (SEC, 2003)), i.e. ACs will enhance BoD's oversight of management performance and financial reporting processes, thus providing additional protections to shareholders and public investors or creditors (DeZoort *et al.*, 2002; Hemraj, 2003; Abbott *et al.*, 2004; Pergola, 2005).

Many studies have examined AC responsibilities but their conclusions are somewhat varied (Abdolmohammadi and Tomasko, 1992; Collier, 1996; Guthrie and Turnbull, 1995; DeZoort, 1997; Lee and Stone, 1997; Spira, 2002). More recent studies sponsored by market regulators in the USA and the UK have put an emphasis upon AC responsibilities for improving corporate governance in order to increase investors' confidence in corporate financial reports. For instance, New York Stock Exchange (NYSE) and National Association of Securities Dealers (NASD) jointly sponsored the Blue Ribbon Commission on Improving the Effectiveness of Corporate Audit Committee in 1998. The BRC (1999) report stressed that AC's primary responsibility is to enhance the credibility of financial reporting processes and audited financial statements (NACD, 2000, 2002; Joint Committee on Corporate Governance (JCCG, 2001); Beasley and Salterio, 2001). After the debacles of Enron and other large corporate scandals in the early 2000s, ACs have been further scrutinized by the market regulators and empowered with more specific responsibilities in respect of monitoring the implementation of good corporate governance practices and ensuring credible financial reporting processes (Klein, 2002a, b; SEC, 2003; Hemraj, 2003; Morrison, 2004). To date, ACs are widely expected to shoulder the following responsibilities in the western world (ICAEW, 2001; NYSE, 2002; SEC, 2003; FRC, 2003; OSC, 2003):

- to review management programs and monitor compliance with codes of business conduct;
- review internal control procedures to prevent or detect fraudulent activities or irregularities;
- to assist BoD to exercise oversight of companies' financial reporting processes;
- to monitor the independence of external auditors with an oversight responsibility for the appointment and dismissal of auditor, and to determine the types of audit service and related remuneration for auditors; and
- to review proper functioning of internal auditing and coordinate the work of internal and external auditors.

Although the importance of AC has been increasingly recognized by market regulators, it is still a very controversial issue in respect of the effectiveness of AC operations in practice. Quite a number of studies conducted in the western world yielded mixed results. Some studies report that a well functioning AC system will lead to the improvement of corporate financial reporting and the decrease of earnings management or financial frauds, as well as the increase of unqualified auditor reports (Wild, 1996; Carcello and Neal, 2000; DeZoort and Salterio, 2001; Klein, 2002b; Sharma, 2004; Bedard *et al.*, 2004). Others indicated that ACs had in fact mainly played a "symbolic or ceremonial role" while many stakeholders felt that the AC system was ineffective in general in respect of overseeing independent audits and financial reporting processes (Spira, 1999a; Macintosh *et al.*, 2000; Cohen *et al.*, 2002; Beecher-Monas, 2003; Davidson *et al.*, 2004). Such study findings have prompted market regulators in many western countries to continuously impose more restrictive requirements on AC in recent years (NYSE, 2002; SEC, 2003; FRC, 2003; OSC, 2003; ASE, 2003, Lansing and Grgurich, 2004; Hansell, 2005).

Most studies contended that the effectiveness of AC function depends upon a series of AC characteristics such as its composition, size, members' qualification, and actual

AC operations (ICAEW, 1997, 2001; Lee and Stone, 1997; Beasley and Salterio, 2001; Klein, 2002a, b; Carcello and Neal, 2003; Abbott *et al.*, 2004). An important factor that will ensure AC's effectiveness requires AC members to be highly independent or free from the influences and pressures of the management (Vicknair *et al.*, 1993; Teoh and Lim, 1996; Carcello and Neal, 2000; Abbott *et al.*, 2000). Thus, AC members should all be outside or non-executive directors so they can avoid the conflict of interest and exercise effective monitoring of the management's accountability (ICAEW, 1997, 2001; Kalbers and Fogarty, 1998; Spira, 1999b; Cotter and Sylvester, 2003; Sharma, 2004). In fact, a focus of recent corporate governance reforms in the western world, the AC reform in particular, is on AC composition. For instance, NYSE and SEC in the USA now require that all AC members be independent directors (NYSE, 2002; NACD, 2002; SEC, 2003)[7]. Similar requirements have been imposed or recommended in the UK (FRC, 2003), Canada (OSC, 2003) and Australia (ASE, 2003).

Many studies argue that AC members' knowledge/expertise or experience is directly associated with AC effectiveness (Beasley and Salterio, 2001; DeZoort and Salterio, 2001; McDaniels *et al.*, 2002; Bedard *et al.*, 2004). Since the AC's main task is to oversee corporate financial reporting and auditing processes, its members should possess sufficient expertise to understand the issues to be investigated or discussed by ACs. It is hard to expect an effective AC functioning if AC members are laymen to accounting and financial reporting. Therefore, NYSE's recent listing rules specify that AC members must be "financially literate" and at least one member should be a "financial expert." Similar requirements have been reiterated by the Sarbanes-Oxley Act that went into effect in 2002[8]. Some recent empirical studies confirmed that there is a significantly positive stock price reaction if new AC members possess financial expertise, or the stock markets would reward firms that appoint financial experts to their ACs (DeZoort and Salterio, 2001; McDaniels *et al.*, 2002; Davidson *et al.*, 2004). In addition, aggressive earnings management is negatively associated with the financial and governance expertise of AC members (Bedard *et al.*, 2004).

Some researchers report that the AC size is another influential factor. Although AC size is affected by the size of BoD and the company, a large AC may not necessarily result in more effective functioning as more members in an AC may lead to unnecessary debates and delay the decisions (Kalbers and Fogarty, 1996; Yermack, 1996; Scarbrough *et al.*, 1998). Therefore, the current requirement on AC size laid down by the market regulators in the USA and the UK is a minimum of three members (NACD, 2002; ICAEW, 2001; OSC, 2003), while some empirical studies have found that the normal AC size in the USA and the UK is about three to five (Carcello and Neal, 2000; Raghunandan *et al.*, 2001; Spira, 2002; Davidson *et al.*, 2004).

Doubtless, the effectiveness of ACs depends, to a large extent, upon their actual operations or activities, such as the frequency, duration, and content of AC meetings (Teoh and Lim, 1996; Collier and Gregory, 1998; Beasley and Salterio, 2001; Ng and Tan, 2003; Abbott *et al.*, 2004). A few studies reported that ACs in US and UK companies held meetings on an average of four to six times per year with the average duration of three to four hours per meeting (KPMG Peat Marwick Thorne, 1991; McMullen, 1996; Collier and Gregory, 1998; ICAEW, 2001). In addition, some studies contended that an AC should hold meetings with the management, internal and external auditors separately in order to exercise an effective oversight or monitoring role over the financial reporting and auditing processes

(IIA, 1993; Rezaee and Lander, 1993; DeZoort, 1998; Scarbrough *et al.*, 1998; Beattie *et al.*, 2000; Braiotta, 2003; Song and Windram, 2004).

Finally, the AC-related disclosure and reporting is a necessary element for assessing the effectiveness of AC function (Spira, 1998; ICAEW, 1997, 2001; Ng and Tan, 2003; Lee *et al.*, 2004). Relevant disclosures include a written charter or terms of reference specifying the AC responsibilities that have been endorsed or approved by BoD, and AC reports demonstrating how an AC has fulfilled the described responsibilities during the year. AC reports can serve as important tools to boost investors' confidence in good corporate governance, to improve the trust in financial reporting processes and lend more credibility to the audited financial statements (McMullen, 1996; Urbancic, 1996; Spira, 1999b; SEC, 1999; Rezaee *et al.*, 2003). Hence, it is generally recommended in western countries that an AC charter (or terms of reference) should be filed with the stock exchanges and be reviewed and disclosed publicly at least every three years, while AC reports should be included in the corporate annual reports or the proxy statements to discharge ACs and BoD of their accountability to shareholders (NYSE, 2002; NACD, 2002; SEC, 2003; FRC, 2003). However, some researchers argue that AC-related disclosure and reporting to the public is unnecessary as it may merely increase an AC's liability and call for more compensation for AC members, which may further produce difficulties for companies to recruit competent persons to serve as AC members (Teoh and Lim, 1996; Zaman, 2001; Klein, 2002a; Cohen *et al.*, 2002; Morrison, 2004).

Research questions

As highlighted earlier, ACs have become popular in China in recent years following the newly introduced rules by market regulators. However, the CSRC's recommendation on AC formation remains voluntary in nature and AC establishment is a relatively new phenomenon in corporate governance of Chinese listed companies. Whether or not the AC system can function effectively depends also upon the stakeholders' acceptance in practice. So an examination of the perceptions and practices of AC roles, responsibility and characteristics in the Chinese context should have positive implications for the improvement of corporate governance and financial reporting and auditing process in the country. Hence, we intended to investigate the views about what kinds of role can ACs play under the unique corporate government environment with a dominant state ownership and the coexistence of a two-tier board structure in Chinese listed companies. Therefore, the first research question can be stated as:

RQ1. What are the generally perceived roles of an AC under the current corporate governance environment in China?

As experienced in western countries, ACs should shoulder a series of responsibilities if they are to play a positive role in practice. At present, there is a wide range of AC responsibilities as advocated by different studies or recommendations in the literature. The problem is whether these responsibilities are applicable to the ACs in Chinese listed companies. Although the current standards or rules set by the CSRC have outlined some AC responsibilities, those requirements are not mandatory, so the AC responsibilities in Chinese listed companies may be affected by the perception of various stakeholders. In addition, the perceived responsibilities are also a reference for assessing the effectiveness of AC function. So the second study question is:

RQ2. What are the main responsibilities of an AC as perceived by the stakeholders under the current corporate governance environment in China?

Many studies and professional reports in the western world argue that AC characteristics may have a direct impact on effective operations of ACs (Beasley and Salterio, 2001; Carcello and Neal, 2003). This study has also planned to investigate what are the views of Chinese stakeholders in respect of some desirable AC characteristics such as its composition, size, member qualification, and reporting obligation. This is the third study question, i.e:

RQ3. What are the general perceptions of desirable characteristics that will ensure effective operation of an AC under the current corporate governance environment in China?

Obviously various groups of stakeholders have different interests in a listed company. For instance, investors, creditors, company officers, BoD members, and internal or external auditors may have varied perceptions or expectations of ACs. It is important to identify the commonality and difference in the views of various stakeholder groups before we can have a more insightful analysis of AC roles, responsibilities and desirable characteristics. The fourth study question is thus stated as:

RQ4. Is there any significant difference, and to what extent, in the perceptions of various stakeholder groups in respect of AC roles, responsibilities and desirable characteristics under the current corporate governance environment in China?

Although ACs have been adopted as a new mechanism to improve corporate governance and financial reporting processes as recommended by the Chinese market regulators in recent years, actual AC operations or functioning effects remain unclear so far. Thus, an investigation of the current AC practices in Chinese listed companies will not only generate direct evidence to evaluate AC effectiveness but also provide some empirical input for improving the newly introduced AC function in China. The last study question is therefore stated as the following:

RQ5. What is the actual AC operation in practice under the current corporate governance environment in China?

Sample and data

Questionnaire survey was conducted to collect data. The design of the survey instrument incorporated the main study findings on AC in the literature and the recent development of AC operation as required by market regulators in the USA, the UK, and other western countries. Three sections of survey questions were developed with respect to AC roles, responsibilities, and characteristics, respectively, in the survey instrument. Nine and ten questions are included in the first and second sections, respectively, while eight questions are listed in the section of AC characteristics. Each question is designed with an answer expressed in a five-point likert scale: “1” indicates “completely disagree” and “5” represents “completely agree” while “3” denotes a neutral opinion[9]. The fourth section of survey questions (only for the long version of survey questionnaire) is designed to investigate the present practices of AC operation in the listed companies[10]. Only a yes or no answer was designed for this section as "yes" indicates the specified AC practice has been adopted while "no" indicates no adoption. In addition, a fifth section is designed for the long version of the survey instrument, including some open-ended questions for respondents to fill in data regarding the actual size of independent directors and AC membership, the frequency of AC meetings during a year (including the meetings with internal and external auditors) and the average duration of AC meetings in the responding companies. Finally, a profile section is included in the survey instrument to collect the background data of the respondents such as education, work experience, and gender, etc. A pilot test was conducted on a small scale in a business conference held in Shenzhen, China, before the finalization of the survey instrument.

Survey subjects consist of various stakeholder groups of listed companies, taking into consideration sample representativeness and data availability. First, public investors and creditors were targeted. Since public investors and creditors form a huge population, a sampling technique was applied to select the target survey subjects by the surrogate of financial analysts, funds managers and loan officers, which is commonly applied in prior research in the literature. Thus, 200 copies of the survey questionnaire (short version) were sent to randomly-selected financial analysts working at securities firms, investment funds managers, and loan officers at commercial banks or other financial institutions based on the data sources from *China Securities Yearbooks*. External auditors are the second group of survey subjects. The same version questionnaires (short form) were sent to the managing partners or Chief Accountants at all 73 CPA firms that are qualified by the CSRC to perform financial audits for listed companies in China[11]. Since the new *Standards* and *Guidelines* on corporate governance and AC requirements are applicable to listed companies, only those CPA firms performing auditing services to listed companies are included in our sample. By the end of 2004, 837 companies were listed at SHSE and 526 at SZSE, respectively. The sample firms were selected based on systematic sampling, i.e. picking every other company by the order of the stock companies in the list of stock codes, so the sample companies could be representative of all listed companies in the market. One questionnaire (long version) each was mailed to the company secretary (or BoD secretary) in 418 and 262 randomly-selected companies listed at SHSE and SZSE, respectively, through the assistance of some staff working at the two exchanges. According to the profile data from the returned questionnaires, respondents in this group are senior company officers including CEOs, deputy general managers, CFOs, Heads of internal audits, or company secretaries. Finally, the long-version questionnaires were distributed to 121 participants at a three-day training class for independent directors organized by SZSE[12]. For the mailing survey, a reminder was sent three weeks after the initial questionnaires were mailed out. *t*-Tests were run to compare the returned questionnaires received before and after the reminder was sent and no significant difference was found. Thus, the late response bias is insignificant.

A total of 272 questionnaires were returned. Excluding 13 questionnaires with incomplete data, as illustrated in Table I, the useable returned questionnaires and the response rates are 53 (26.5 percent), 35 (47.9 percent), 129 (18.9 percent), and 42 (34.7 percent) for the respondents of investors and creditors, auditors, company officers, and independent directors, respectively. For the responding listed companies, 60 (46.5 percent) are manufacturing enterprises, 28 (21.6 percent) are merchandising companies, 35 (27.1 percent) are servicing firms, and 6 (4.7 percent) are unidentified[13].

Table I. Survey sampling, response rates, and profile of respondents

Respondent group	Types of question-naira	Copies sent (sample size)	Useable returned copies (returned rate)	No. and percentage of respondents with university education	Average work experience of respondents (1) 5-10 years (2) > 10 years	Gender (male vs female)
Investors/creditors	Short version	200	53 (26.5)	45 (84.9)	(1) 29 (54.7) (2) 24 (45.3)	34:19
External auditors	Short version	73	35 (47.9)	31 (88.6)	(1) 3 (8.6) (2) 31 (88.6)	23:12
Company management	Long version	SHSE 418 SZSE 262	83 (19.9) 46 (17.5)	101 (78.3)	(1) 50 (38.8) (2) 79 (61.2)	91:38
Independent directors	Long version	121	42 (34.7)	35 (83.3)	(1) 6 (14.3) (2) 35 (83.3)	36:6
Overall		1,074	259 (24.1)	212 (81.9)	(1) 88 (34.0) (2) 169(65.4)	184:75

Notes: (1) Figures given in parenthesis are percentages; (2) Two types of questionnaire were used, i.e. short version vs long version. Two more sections of questions regarding the actual AC operation in the listed firms are incorporated in the long version; (3) Sampling criteria: for investor/creditor group, financial analysts, fund managers, and loan officers at 200 randomly-selected securities firms, investment funds and banks; for auditor group, all 73 CPA firms that are qualified by CSRC to perform audits for listed firms; for company management group, systematic sampling of all listed firms in SHSE (837) and SZSE (526) by selecting every other firm in the order of the stock codes of the listed companies; for independent director group, the incumbent independent directors who participated in a training class organized by SZSE; (4) Average work experience is presented as the number and percentage of respondent who have work experience of 5-10 years and more than ten years, respectively; (5) Among the 129 responding listed companies, 60 (46.5 percent) are manufacturing enterprises, 28 (21.7 percent) are merchandise enterprises, and 35 (27.1 percent) are serving enterprises, while 6 (4.7 percent) are unidentified. The industry distribution of our sample is relatively consistent with that of all listed companies. In addition, no significant difference was found between the mean scores for the 83- and 46-companies listed at SHSE and SZSE, respectively, based on *t*-test results

The industry distribution of the sample companies is relatively consistent with that of all listed companies in China. Among all respondents, 81.9 percent have completed university education; 34 percent of them had work experience of 5-10 years and 65.3 percent had work experience of more than ten years. Thus, most respondents are mature and experienced and their views should be reasonably reliable and representative. For the gender classification, 71.1 percent of the respondents are male and 28.9 percent are female.

Results

Overall comparison

Descriptive statistics for the questions listed in the first three sections of the survey instrument are presented in Table II. Questions in each section are presented in the order of the importance ranking based on the mean scores of the responses. As indicated on Panel I of Table II, the respondents, overall, agreed that the three most important roles that an AC can play are "to lift the image of good corporate governance" (Mean = 4.50, SD = 0.637), "to serve as a communication link between BoD and external auditor" (Mean = 4.10, SD = 0.637), and "to promote sound corporate governance practices" (Mean = 4.03, SD = 0.613) in order, followed by "to strengthen internal audit" (Mean = 3.68, SD = 0.682) and "to reduce BoD's risk exposure" (Mean = 3.39, SD = 0.948). However, the main AC roles as advocated in western literature, such as "to prevent fraudulent financial reports" (Mean = 2.98, SD = 0.858), "to reduce firm's illegal act or irregularities" (Mean = 3.10, SD = 0.804), and "to enhance audit quality" (Mean = 3.14, SD = 0.875) were perceived as the three least important AC roles by the Chinese respondents. For a reliability test, the nine questions regarding the AC roles have a Cronbach $\alpha = 0.824$.

Panel II of Table II presents the descriptive statistics relating to the general perception of AC responsibilities. Among the ten listed responsibility items (Cronbach $\alpha = 0.664$), the top five responsibilities as perceived by the Chinese respondents, in general, are "co-coordinating internal and external audit work" (Mean = 4.15, SD = 0.585), "mediating conflicts between firms' management and external auditor" (Mean = 4.14, SD = 0.581), "supervising the implementation of sound corporate governance" (Mean = 3.97, SD = 0.599), "supervising internal audit work" (Mean = 3.78, SD = 0.803), and "monitoring internal control programs" (Mean = 3.59, SD = 0.789). These perceptions are generally consistent with the mainstream views shared by various stakeholders in western countries. However, the responsibilities of "overseeing rule compliance" (Mean = 3.30, SD = 0.798), "overseeing external audit process" (Mean = 3.25, SD = 0.829), and "monitoring auditor independence" (Mean = 3.15, SD = 0.833), received lower importance scores.

Regarding the desirable characteristics that may affect AC operating effectiveness (Cronbach $\alpha = 0.856$ for the eight questions), the Chinese respondents agreed that three of the most important features are relating to AC composition, i.e. "at least one accounting expert should be included in an AC" (Q3.1, Mean = 4.10, SD = 0.768), "an AC should have at least three members" (Q3.3, Mean = 3.93, SD = 1.026), and "an AC should be chaired by an independent director" (Q3.4, Mean = 3.57, SD = 1.029). In addition, most respondents generally agreed that an AC should report to BoD (Q3.2, Mean = 4.03, SD = 0.757), and to the annual shareholders' meeting (Q3.5, Mean = 3.34, SD = 1.068). Nonetheless, the respondents did not feel the disclosure

Table II. Descriptive statistics of the overall and subgroup comparisons

	Overall ($N = 259$)	Auditors ($N = 35$)	Investigators and creditors ($N = 53$)	Independent directors ($N = 42$)	Senior management ($N = 129$)	ANOVA F-(p-) value
I. Roles of audit committee ($\alpha = 0.824$)						
1.1 Lift image of sound corporate governance	4.50 (0.637)	4.57 (0.558)	4.30 (0.774)	4.86* (0.354)	4.45 (0.625)	6.974 (0.001)
1.2 A link between the board and auditor	4.10 (0.637)	4.71** (0.458)	4.06* (0.663)	4.40 (0.544)	3.84* (0.537)	27.543 (0.000)
1.3 To promote good corporate governance	4.03 (0.613)	4.09 (0.742)	4.17 (0.643)	4.33* (0.570)	3.85 (0.517)	8.777 (0.000)
1.4 To strengthen internal audit	3.68 (0.682)	4.03 (0.891)	4.02 (0.537)	4.05 (0.379)	3.33* (0.564)	30.260 (0.000)
1.5 To reduce the board's risk exposure	3.39 (0.948)	3.94 (0.906)	3.34* (0.999)	3.79 (0.606)	3.14* (0.933	10.504 (0.000)
1.6 To strengthen internal control	3.19 (0.732)	3.37 (0.646)	3.55 (0.774)	3.67 (0.526)	2.84* (0.618)	26.427 (0.000)
1.7 To enhance audit quality	3.14 (0.875)	2.86* (1.033)	3.87 (0.708)	3.83 (0.490)	2.70* (0.620)	53.428 (0.000)
1.8 To reduce illegal act or irregularities	3.10 (0.804)	3.03* (0.822)	3.47 (0.932)	3.74 (0.627)	2.75* (0.573)	27.060 (0.000)
1.9 To prevent fraudulent financial reports	2.98 (0.858)	2.71* (0.987)	3.26 (0.923)	3.52 (0.890)	2.77* (0.656)	12.880 (0.000)
II. Responsibilities of audit committee ($\alpha = 0.664$)						
2.1 Coordinate internal and external audit work	4.15 (0.585)	3.83 (0.664)	4.43* (0.572)	4.05 (0.439)	4.15 (0.560)	8.838 (0.000)
2.2 Mediating conflict between management and auditor	4.14 (0.581)	4.40 (0.651)	4.19* (0.483)	4.45 (0.504)	3.95* (0.549)	12.893 (0.000)
2.3 Supervising sound CG implementation	3.97 (0.599)	4.69** (0.583)	4.08 (0.583)	4.00 (0.383)	3.71* (0.487)	35.046 (0.000)
2.4 Supervising internal audit work	3.78 (0.803)	4.83** (0.514)	4.04 (0.587)	3.86 (0.472)	3.36* (0.717)	53.829 (0.000)
2.5 Monitoring internal control programs	3.59 (0.789)	4.20 (0.632)	4.36 (0.623)	3.21* (0.606)	3.22* (0.589)	61.427 (0.000)
2.6 Responsible for truthful financial reporting	3.42 (1.014)	4.75** (0.490)	4.081 (0.730)	2.50* (0.773)	3.09** (0.734)	89.456 (0.000)

(*continued*)

Table II.

	Overall ($N = 259$)	Auditors ($N = 35$)	Investigators and creditors ($N = 53$)	Independent directors ($N = 42$)	Senior management ($N = 129$)	ANOVA F-(p-) value
2.7 Monitoring management financial performance	3.35 (1.009)	4.60** (0.497)	4.23 (0.697)	2.76* (0.726)	2.84* (0.705)	102.845 (0.000)
2.8 overseeing rules compliance	3.30 (0.798)	3.37** (0.690)	3.85 (0.662)	3.88 (0.633)	2.86* (0.646)	43.642 (0.000)
2.9 Overseeing external audit process	3.25 (0.829)	2.14* (0.550)	3.42 (1.046)	3.79 (0.520)	3.32 (0.573)	40.301 (0.000)
2.10 Monitoring auditor independence	3.15 (0.833)	3.20 (0.797)	3.40 (0.768)	4.07** (0.407)	2.74* (0.679)	43.919 (0.000)
III. Audit committee characteristics ($\alpha = 0.856$)						
3.1 A C should include an accounting expert	4.10 (0.768)	4.94 (0.236)	4.19 (0.833)	4.79 (0.470)	3.62* (0.487)	82.004 (0.000)
3.2 AC should report to the board	4.03 (0.757)	4.40 (0.812)	4.23 (0.824)	4.31 (0.643)	3.76* (0.647)	12.957 (0.000)
3.3 AC should have at least three members	3.93 (1.026)	4.80 (0.406)	4.60 (0.531)	4.71 (0.457)	3.16* (0.833)	111.064 (0.000)
3.4 AC should be chaired by an independent director	3.57 (1.029)	4.34 (0.802)	3.71 (0.738)	4.98** (0.154)	2.84* (0.610)	150.368 (0.000)
3.5 AC report to annual shareholders' meeting	3.34 (1.068	4.09 (0.981)	4.28 (0.662)	3.02* (0.897)	2.85* (0.902)	44.744 (0.000)
3.6 AC responsibilities s/b disclosed publicly	3.04 (1.278)	4.94 (0.236)	4.13 (0.921)	2.36* (0.727)	2.29* (0.754)	170.232 (0.000)
3.7 AC report included in annual report	2.67 (1.503)	4.91** (0.284)	4.23 (0.933)	1.83* (0.581)	1.70* (0.714)	305.056 (0.000)
3.8 All AC members should be independent directors	2.64 (1.052)	3.23 (1.114)	3.30 (0.845)	3.43 (0.991)	1.96* (0.592)	62.490 (0.000)

Notes: (1) Subgroup mean(s) with * and/or ** indicates the group mean(s) differs from that of other subgroups at a statistically significant level of 0.05 based on the results of simultaneous tests of ANOVA with Turkey HSD test, Duncan test and Scheffe test; (2) Each question, in truncated form, is designed with a five-point Likert scale, "1" represents completely disagree and "5" indicates completely agree, while "3" denotes to a neutral opinion; (3) Questions are listed based on the order of mean scores for each question within the specified categories, numbers in the parentheses under the mean scores are standard deviations; (4) One-way ANOVA is run based on the mean scores of the four subgroups and the F- and p-values of ANOVA test indicate that at least one group's mean score differs significantly from that of other groups at 0.01 level of an AC charter (or terms of reference) is important (Q3.6, Mean = 3.04, SD = 1.078) while there is a relatively negative view of the requirement for including AC reports in annual corporate reporting (Q3.7, Mean = 2.67, SD = 1.503), and the requirement of AC membership of all independent directors did not receive sufficient support (Q3.8, Mean = 2.64, SD = 1.052).

Subgroup comparison

To investigate whether there are different perceptions of AC roles, responsibilities, and basic characteristics among various groups of stakeholder, we have further examined the subgroup data from the perspectives of investors and creditors, auditors, company officers, and independent directors, respectively. Table II also lists the mean scores of the four subgroups of respondent for their answers to the survey questions. One-way ANOVA of subgroup means was run with the F-values and p-values listed as well. Apparently, the ANOVA statistics indicate that there is a significant difference in the mean scores of the four subgroups of respondent for every question listed in the survey instrument (at the significance level of < 0.01), i.e. at least one group's view differs from that of other groups of respondent on each survey question at the statistically significant level. To further analyze the between-group variances, we ran ANOVA with Turkey HSD tests, Duncan tests and Scheffe tests simultaneously. The additional variance tests, based on the significance level of 0.05, reveal the following differences between the perceptions of the four subgroups of respondents.

AC roles. As indicated by Panel I in Table II, all four groups were relatively consistent in supporting the AC's role of lifting the image of good corporate governance (Q1.1), while the independent directors are more in favor of this AC role compared to the other three subgroups. For the AC role of serving as a communication link between BoD and external auditors (Q1.2), the independent director group expressed a relatively stronger supportive view, although the company officer group's mean score is relatively lower. A similar pattern of views is found for the AC role of promoting sound corporate governance practices (Q1.3) as the mean score of the company officer group is lower than that of other subgroups of respondent at the statistically significant level. While the investors/creditors, auditors and independent directors all agreed on the AC's role in strengthening internal audit (Q1.4), company officers were, much less supportive in this regard. In addition, auditors and independent directors held relatively stronger supportive views toward AC role in reducing BoD's risk, in contrast to investors/creditors and company officers (Q1.5). Company officers were not in favor of the AC's role in strengthening internal control (Q1.6) as the group mean was lower than 3, while other three groups of respondent expressed a relatively supportive view (with their group means > 3). On the AC's role in reducing illegal acts or irregularities (Q1.8), company officers held the greatest reservation, while the independent directors were relatively more supportive. It is interesting to note that investors/creditors and independent directors tended to agree with the AC's role in enhancing the quality of external audit (Q1.7) but the auditors and company officers, relatively, held an opposite view. Finally, the investors/creditors and independent directors were relatively supportive of the AC's role in preventing fraudulent financial reports (Q1.9) but the company officers and external auditors tended to disagree.

AC responsibilities. As indicated in Panel II of Table II, the AC responsibility for coordinating internal and external audit work was generally agreed by all respondents although the auditor respondents were less enthusiastic (Q2.1). The four groups of respondents were relatively consistent in demonstrating a supportive view towards AC's responsibility for mediating the conflict between management and external auditors (Q2.2) while independent director and auditor groups are in favor to a greater extent. When auditor respondents strongly agreed on the AC responsibility of supervising the implementation of sound corporate governance practices (Q2.3), the other three groups of respondents were generally supportive as well, although the company officer group mean is relatively lower. Nonetheless, auditor respondents agreed strongly that ACs should be responsible for supervising the internal audit work (Q2.4), while company officers were less supportive. In addition, the auditors and investors/creditors agreed on the AC responsibility of monitoring internal control programs (Q2.5), but the other two groups of respondent were close to neutral on this regard. Again, auditor respondents agreed strongly that the AC should be responsible for truthful financial reporting (Q2.6). The view was generally echoed by investors/creditors but not by the company officers and independent directors. The auditors and investors/creditors agreed strongly that the AC should be responsible for monitoring management financial performance (Q2.7), however, the company officers and independent directors tended to disagree with their group means below the neutral point of 3. On the AC's responsibility for overseeing rule compliance (Q2.8), investors/creditors and independent directors expressed a moderate supportive view but company officers held a relatively negative view. Although AC's responsibility for overseeing the work of external audits received relatively weak support from the respondents, the auditor group expressed a strong disagreement (Q2.9). Although, the independent directors agreed that an AC should be responsible for monitoring auditor independence (Q2.10), the view was not shared by other groups of respondents as the company officer respondents held even a relatively negative view in this regard.

AC characteristics. Regarding the requirements for AC composition and size, the auditors, investors/creditors and independent directors groups shared relatively consistent and supportive views, such as that an AC should include at least a member with accounting expertise (Q3.1), an AC should include at least three members (Q3.3), an AC should be chaired by an independent director (Q3.4), and all AC members should be independent directors (Q3.8). However, company officers were less supportive of these requirements, or somewhat disagreed with the requirement for full AC membership of independent directors and the chairmanship of an independent director. In addition, distinct differences exist in the views of AC-related disclosures. For instance, auditors and investors/creditors strongly agreed that ACs should report to the shareholders meeting (Q3.5), the AC charter (or terms of reference) should be publicly disclosed (Q3.6), and the AC reports should be incorporated in annual corporate reports (Q3.7), while both company officers and independent director groups disagreed or were less supportive. Finally, the four groups of respondent were relatively consistent in support of the requirement that the AC should report to BoD (Q3.2), although the group mean of company officer respondents was relatively lower than that of other three groups.

AC operations in practice

The long version of the survey questionnaire includes some questions to solicit the views or self-assessments of AC effectiveness in actual operation. Only the respondents of company officer and independent director were requested to answer these questions since they have the first-hand experience with AC operations in the listed companies. The responses of 129 company officers and 42 independent directors were summarized in Table III.

First of all, 106 respondents answered that their firms had established ACs while 65 indicated no AC establishment (Q4.1). This means about 62 percent of Chinese listed companies have now set up ACs. Among those 106 responses with AC establishment, 104 (98 percent) indicated that their ACs had included a member with accounting expertise (Q4.2), and 98 (92.5 percent) answered that ACs in their companies were chaired by independent directors (Q4.3). Among those firms with AC setups, 61 (57.5 percent) respondents indicated that their AC members were nominated by the management (Q4.5), 101 (95.3 percent) were nominated by BoD (Q4.6) and 103 (97.2 percent) were appointed at the annual shareholders' meeting (Q4.7).

Regarding AC disclosure and reporting, only nine respondents (8.5 percent) confirmed that their firms' AC charters (or terms of reference) were publicly disclosed (Q4.4). Although 93 respondents (87.7 percent) indicated that ACs in their companies had reported to BoD (Q4.9), the ratio was much lower (24 respondents (22.6 percent)) in respect of AC reporting to the annual shareholders meeting (Q4.10), and almost all companies' AC reports were not included in their annual reports (Q4.11). It is worth noticing that only 31and 29 out of 106 respondents (29.2 and 27.4 percent, respectively)

Questions	Yes	No
4.1 Has an AC been set up in your firm?	106 (62)	65 (38)
4.2 Does the AC include an accounting expert?	104 (98)	2 (2)
4.3 Is the AC chaired by an independent director?	98 (92.5)	8 (7.5)
4.4 Has AC charter been disclosed publicly?	9 (8.5)	97 (91.5)
4.5. Are AC members nominated by management?	61 (57.5)	45 (42.5)
4.6. Are AC members nominated by the board?	101 (95.3)	5 (4.7)
4.7. Are AC members appointed by ASM?	103 (97.2)	3 (2.8)
4.8. Are audit fees determined by AC?	29 (27.4)	77 (72.6)
4.9. Does AC report to BoD?	93 (87.7)	13 (12.3)
4.10. Does AC report to annual shareholders meeting?	24 (22.6)	82 (77.4)
4.11. Has AC report been included in annual reports?	6 (5.7)	100 (94.3)
4.12. Did executive directors participate in AC meetings?	8 (7.5)	98 (92.5)
4.13 Did senior management members participate in AC meetings?	71 (67.0)	35 (33.0)
4.14. Does AC nominate auditor?	31 (29.2)	75 (70.8)
4.15 Is AC membership overlapping with that of SB?	0 (0.0)	106 (100.0)
4.16. Has a standing office for AC?	11 (10.4)	95 (89.6)
4.17. Is there a full-time secretary to AC in your firm?	15 (14.2)	91 (85.8)
4.18. Is the AC functioning effectively in your firm?	31 (29.2)	75 (70.8)

Notes: (1) Figures given in parentheses are percentages; (2) For question 4.1, the data are based on 171 responses from the long version of survey instrument sent to company officers and independent directors who have first-hand experience of AC operation in their companies; (3) For questions 4.2-4.18, the percentages are calculated based on the 106 responses that have indicated AC setups in the responding companies

Table III.
Survey results on actual AC operations in Chinese listed companies

indicated that ACs in their companies were involved in nominating external auditors (Q4.14) and determining the audit fees (Q4.8). Although non-independent directors were rarely participating in AC meetings of the responding companies (Q4.12), 71 respondents (67 percent) indicated that senior company officers had participated in their companies' AC meetings (Q4.13). In addition, only 11 (10.4 percent) and 15 (14.2 percent) out of the 106 respondents, respectively, indicated that their companies had set up a standing office or a full-time secretary for their ACs (Q4.16 and Q4.17). Overall, only 31 out of the 106 respondents (29.2 percent) agreed that ACs in their companies had functioned effectively (Q4.18).

Table IV presents relevant data regarding the open-ended questions on actual AC operations in the respondents' companies. The frequencies and average numbers were calculated based on the 106 responses with AC establishment for the actual AC size and composition. A majority of the responding companies (69/106 = 65.1 percent) have three members in their ACs with the largest size of seven members (Q5.1). The average AC size of these companies is around 3.55 persons at present. A great majority of those responding companies' ACs include two to three independent directors (28/106 = 26.4 percent and 69/106 = 65.1 percent, respectively), with an overall average of 2.82 independent directors per AC (Q5.2). Compared to average AC size, the data suggest that not all AC members in the responding companies are independent directors at present. About 30 out of 106 respondents (28.3 percent) indicated that the ACs at their companies had held no meeting at all during a year (Q5.3) while the rest of the ACs had only met once (41/106 = 38.7 percent) or twice (29/106 = 27.4 percent) per year as the overall average is only 1.10 meetings per year (Q5.3). For those 76 responding companies that answered their ACs had met at least once per year, the duration of most AC meetings was no more than two hours (Q5.4), with the overall average of 1.56 hour per AC meeting. Interestingly, a great percentage of ACs among the 106 responding companies had not even met once with their companies' external and internal auditors (74/106 = 69.8 percent and 62/106 = 58.5 percent, respectively). Overall, on average, those companies' ACs had met 0.33 and 0.65 time per year, respectively, with their external auditors and internal auditors.

Analysis and discussion

Our study results provide a very interesting picture of ACs in Chinese listed companies at present. As indicated by data in Table II, the Chinese respondents, overall, perceived that the most important AC roles are related to the promotion of sound corporate governance and a lift of good corporate governance image. Owing to the market regulator's new requirement for AC formation since 2001, various stakeholders in China have gradually accepted the need for ACs as a useful corporate governance mechanism. However, the Chinese respondents have not formed a consensus on AC's other roles. In particular, the importance of AC roles in enhancing audit quality, reducing companies' illegal acts or irregularities, and preventing fraudulent financial reports were perceived as less important by the respondents. The perceptions deviate from those recommendations advocated by many studies in western countries that have emphasized positive AC oversight roles in enhancing the quality of financial reporting and external auditing as well as AC's expanding role in strengthening internal control or internal audit to ensure companies' compliance with business regulations or rules. The survey results reveal that the AC function remains a new

Table IV. Statistics on AC activities in Chinese listed companies

Questions/frequency (percent)						Average
5.1 Numbers of AC members in your firm?	3[69] (65.1)	4[15] (14.2)	5 [18] (17.0)	6[3] (2.8)	7[1] (0.9)	3.55 persons
5.2. Numbers of independent directors in AC of your firm?	1 [0]	2 (28) (26.4)	3 [69] (65.1)	4 [9] (8.5)		2.82 persons
5.3. Times of AC meetings per year at your firm?	0 [30] (28.3)	1 [41] (38.7)	2 [29] (27.4)	3[6] (5.7)		1.10 time/year
5.4. Average duration of each AC meeting at your firm? (total of 76 responses)	1 hour [22] (28.9)	1.5 hour [26] (34.2)	2 hour [16] (21.1)	2.5 hour [3] (3.9)	3 hour [3] (3.9)	1.56 hour
5.5. Times of external auditor being contacted by AC per year at your firm?	0 [74] (69.8)	1 [29] (27.4)	2 [3] (2.8)	3 [0]		0.33 time/year
5.6 Times of internal auditors being contacted by AC per year at your firm?	0 [62] (58.5)	1 [21] (19.8)	2 [21] (19.8)	3[2] (1.9)		0.65 time/year

Notes: (1) Figures given in parentheses are percentages; (2) Numbers inside brackets are the frequencies corresponding to the related questions; (3) Percentage inside parentheses, except for question 5.4, are based on 106 responses with AC setups in the responding companies; (4) Percentage inside parentheses for questions 5.4 are based on 76 responses with at least one AC meeting being held in a year practice for Chinese listed companies and the AC's important oversight roles in financial reporting and auditing process have not yet been fully recognized in China. Much should be done to educate various stakeholders in order to promote a proper AC function in the country.

It is worthy of notice that the respondents of investors/creditors and independent directors held generally a higher expectation of AC roles in contrast to auditors and company officers. This can be explained that independent directors, as they serve as the majority of AC members under the existing requirements, may like to have an emphasis upon AC roles in order to obtain a high status for the AC in the corporate governance structure. For investors/creditors, they may also prefer to see an AC function that can enhance BoD's oversight or accountability for corporate financial reporting and auditing processes. Nonetheless, company officers were generally skeptical about AC roles, particularly, in respect of reducing firms' illegal acts or irregularities, enhancing audit quality, and preventing fraudulent financial reports. This may indicate that the management of Chinese listed companies do not fully support the AC system so far. In particular, our survey results about current AC practices reveal that most Chinese listed companies would mainly treat AC setup as a response to the requirements issued by the CSRC and as an image of good corporate governance. Thus, most ACs that had been formed did not operate effectively, with no or few meetings in a year. Most ACs held no contact or communication with external and internal auditors. Even for those responding companies with AC activities (meetings), a majority of AC meetings was held with the presence of senior management officers, and with a very short duration. Such AC operations are much short of the standard practices in the USA, the UK and other western countries where the average of AC meetings is around four to six times per year with the average duration of 3.5 hours per meeting (Carcello and Neal, 2000; Abbott *et al.*, 2000; ICAEW, 2001). It is therefore hard to expect an effective AC function in China at present.

Regarding AC responsibilities, most of our respondents agreed that an AC should be responsible for mediating the conflicts between management and external auditor, monitoring the implementation of sound corporate governance practices, and coordinating internal and external audit work. These views are in line with the perceived AC oversight roles in financial reporting and auditing processes. However, corporate governance practice is immature in China and various stakeholders may have not fully recognized what should be an AC's oversight responsibilities over internal control, auditor independence, internal and external audits, and truthful financial reporting. Doubtless, the AC is a new corporate governance mechanism since it has only been introduced by the Chinese market regulators in very recent years. It may take time for various stakeholders to form reasonable expectations of AC roles and responsibilities.

Differences do exist in the perceptions of some AC's responsibilities among various groups of stakeholder. For instance, the respondents of auditors and investors/creditors highly expected that an AC should be responsible for ensuring truthful financial reporting, monitoring internal control and internal audit work, as well as overseeing management's financial performance and accountability. But both company officers and independent directors were less supportive of, or denied, these AC responsibilities. A fact is that, currently, ACs serve mainly as a ceremonial decoration for most Chinese listed companies and AC operations are far less than effective in practice. As a result, independent directors are reluctant to shoulder concrete oversight responsibilities over financial reporting and auditing processes. It may also indicate that independent directors, as AC members, may lack the ability to take up concrete oversight responsibilities for monitoring sound internal control and truthful financial reporting. On the other hand, company management may have made little commitment to support AC members in shouldering those responsibilities. Table II also reveals that both external auditors and management respondents were relatively reluctant to accept the AC oversight responsibilities for auditor independence and the quality of external audits. Such an attitude is detrimental to AC function. Hence, the Chinese market regulators should make much more clear mandates of AC responsibilities or obligations in order to enable ACs to play the specified roles.

With respect to AC characteristics, the general perceptions of AC's composition and disclosures or reporting are consistent with the existing recommendations of the market regulators in China. However, our study found that not all respondents were in favor of a full AC membership of independent directors. In fact the respondents of company officers were against such an AC membership requirement. It may be inferred that company management would prefer to include some insiders or non-independent directors in an AC in order to avoid a tough-minded AC. As experienced in western countries, an AC could not perform oversight roles effectively if insiders or affiliated directors would serve on the AC (Beasley and Salterio, 2001; Hemraj, 2003; Lee *et al.*, 2004). Therefore, it may be necessary for the Chinese market regulator to make a mandatory requirement for full AC membership of independent directors in order to promote effective AC operations.

Along with the reluctance to shoulder concrete responsibilities for overseeing or monitoring internal control, internal and external auditing and truthful financial reporting, the respondents of company officers and independent directors in our survey were particularly against the requirements of public disclosure of AC charters (or terms of reference) and AC reports. Although investors/creditors and external auditors demanded a greater accountability of ACs, company officers and independent directors were, at present, against a public screening of AC operations by opposing public disclosure of AC charters (terms of reference) and AC reports in order to be less responsible for the AC operations in their companies. Nonetheless, the accountability of the AC should be incorporated into the corporate governance mechanism. ACs should discharge their duties or responsibilities under the scrutiny of shareholders and the general public and ACs should demonstrate how and what they have fulfilled of the specified oversight responsibilities (ICAEW, 2001; NACD, 2002). Again, since it is silent in the existing regulations with respect to AC-related disclosure and reporting in China, the market regulators need to draw out more specific requirements in this regard.

As indicated by the survey results summarized in Tables III and IV, current AC practices in Chinese listed companies are much more problematic. Even though AC's positive roles and responsibilities are generally recognized by various stakeholders, actual AC operations are disappointing so far. In reality, most ACs in Chinese listed companies held few or no meetings in a year. The average of 1.1 AC meetings per year and 1.56 hours of meeting duration is substantially less than the practices in western countries. Furthermore, with almost no contact with the internal and external auditors and very limited involvement in the decisions of auditor selection and audit fees determination, it is hard to imagine how ACs can, in Chinese listed companies, exercise positive oversight over the management's financial performance and corporate reporting and auditing processes. It is no wonder that a majority of the respondents in our survey replied that ACs in their companies were not functioning effectively.

The poor AC practices in China may be attributed to several factors. First, it should be pointed out that AC formation is a very new phenomenon resulting from the Chinese government's recent efforts to adopt the Anglo-Saxon experience to improve corporate governance of Chinese listed companies. In general, the standards and practices of corporate governance in China are far behind those in the USA, the UK and other western countries as the stock companies and capital market reappeared in China with a relatively short history. Under formal state ownership and planned economy, the government had actually exercised direct controls over every aspect of business operations. Even though SOEs have now been converted into publicly-listed companies, the state maintains a dominant share of equity in the companies[14]. Company officers remain being appointed by parent SOEs or the government agencies in charge and they are mainly responsible to the latter. Within such an ownership structure, and subject to the persisting influences of the old business administration system stemming from the centrally planned economy, many important corporate governance mechanisms centered on the principal-agent relationship, in order to reduce the agency costs, are either ignored or becoming dysfunctional in Chinese listed companies at present. Although ACs would function as useful tools for BoD to oversee management performance and corporate financial reporting and auditing processes in western countries, it may be difficult for ACs to operate effectively in Chinese listed companies at the moment, unless more clear and stringent mandatory oversight powers and obligations are imposed on ACs in China.

Hence, an interesting issue may be brought into consideration, i.e. whether corporate governance practices (such as an AC function) can be applicable under different business environments? In other words, whether the AC function, originated in western countries, can work in Chinese listed companies that have different equity structures and business management systems (such as dominant state-ownership and heavy governmental influences)? It should be pointed out that the Chinese economy is in a course of transition from a centrally-planned economy to a market-oriented one after more than 20 years of economic reforms. The state's direct control over business enterprises (listed companies in particular) is decreasing while professional managers are emerging as a result of the separation of business ownership and management in China. Thus, corporate governance practices (including AC function), derived from principal-agent relations to reconcile the varied interests of different stakeholders, should be applicable to Chinese listed companies as well, although there may still be a gap in the perceptions of AC function, and actual AC operations are less then satisfactory at the present stage of enterprise reform in China. It is argued that the introduction of the AC function in China could strengthen the monitoring of management financial performance and corporate reporting and auditing processes, but it may take time for the new AC system to function effectively at the present stage of economic transition in China. Nonetheless, we should understand the differences in the present state of corporate governance in China and western countries and should not blindly copy corporate governance practices from western countries. A simple transplant of the AC system, without adaptation, to corporate governance practices under varied business environments may not necessarily produce the desirable outcome, especially at the early stage of capital market development in China.

On the other hand, the two-tier board system adopted by Chinese listed companies may have some effects on AC operations. According to *The Company Law*, every Chinese company should set up a SB consisting of representatives of shareholders and employees. The SB, under the existing regulations, is accountable to shareholders and has the obligation to oversee corporate financial affaires, and should exercise supervision over the legitimacy and effectiveness of the performance of corporate directors and senior management (Article 126, *The Company Law*, 1999). The CSRC has, however, introduced the independent director system and encouraged listed companies to form ACs to enhance BoD's oversight roles in recent years by adopting the experience of an Anglo-Saxon styled unitary board system. Nonetheless, AC mandates or responsibilities are overlapping with that of the SB, or AC's roles may be handicapped by the SB in some companies, since their management may treat the AC as a duplicated burden with respect to administrative costs. As a result, company management may resist or provide less support to AC operations. Furthermore, SB size is larger than that of AC and there are some inside members (representatives of large shareholders and employees) sitting on the SB, who have a closer relationship with management. It can be expected that senior company officers are less co-operative with ACs than SBs in respect of their responses to enquiries and investigations. Company management would usually not expect ACs to operate more effectively than SBs. Such a constraint may undermine the AC's effectiveness. Certainly AC operation under the two-tier board system in China may not only differ from that in the USA and the UK where the unitary-board system prevails, but also be a practical issue that is worthy of serious studies.

The ineffective AC operations in China may also be associated with poor qualifications of AC members. Although most Chinese listed companies have appointed independent (non-executive) directors as AC members or fulfilled the requirement of AC chairmanship of an independent director as specified by the CSRC, the majority of independent directors in China is currently coming from distinguished personages or social celebrities (including a large number of academics) and some ex-officers of government agencies, whose knowledge of business operations and management, corporate financial reporting and auditing in particular, is very limited (Li, 2001; Peng, 2002). In fact, most AC members in Chinese listed companies generally lack management expertise and practical experience of the corporate financial reporting and auditing process. Even the independent director as an accounting expert serving in an AC is usually an accounting academic who may not know the financial operations well in reality (Zhang, 2002). Without a good understanding of corporate financial operations and internal controls, AC members could hardly play an effective oversight role (DeZoort and Salterio, 2001; Bedard *et al.*, 2004). This problem is particularly severe in China where the independent director system and AC function are newly introduced. In addition, the appointment and remuneration of independent directors and AC members, as indicated by our survey results, are strongly influenced by company management. Many independent directors who serve as AC members would not have a tough mind towards the management's financial performance and reporting obligations, owing to their self-interests that are determined by the management.

It should also be pointed out that the remuneration for independent directors or AC members is currently at a very low level in China, which may not motivate AC members to make sufficient commitment and efforts to fulfill their oversight responsibilities effectively. In fact most independent directors or AC members have spent little time to understand business operations and corporate governance systems in the companies they are serving. With almost no AC meeting or no communication with internal and external auditors, AC members have just given up their oversight responsibilities. Thus, it is argued that ACs in Chinese listed companies may be more than a ceremonial decoration only when ACs are staffed with qualified members and with sufficient compensation that can attract independent directors to spend more time to fulfill their duties.

Conclusions

Through a questionnaire survey, we investigated the perceptions of various stakeholders over AC roles, responsibilities and desirable characteristics in China. Our study results reveal that, following increasing visibility of ACs in Chinese listed companies as required by the market regulators in recent years, the respondents have shared a general recognition of the AC's roles, particularly in the aspect of improving corporate governance image. However, the respondents have not fully recognized the AC's important roles in respect of overseeing management financial performance and corporate financial reporting and auditing processes, and substantial differences exist in the perceptions of various groups of stakeholders. This may indicate that the actual AC roles remain unclear in China. Similarly, the respondents were more in favor of the AC's ceremonial responsibilities, while they were less supportive of AC responsibilities in substance. In particular, the independent directors (serving as AC members) and the company officers would, in fact, like to dodge some important AC responsibilities, such as monitoring management financial performance and accountability, overseeing rule compliance, monitoring auditor independence and audit process, even though they have generally agreed with the AC's oversight roles.

On the desirable AC characteristics, the respondents were relatively consistent in their perceptions of AC's composition, size and member qualifications, which are also in line with the relevant requirements in the USA, the UK, and other western countries, except that the company officer respondents were against full AC membership of, and AC chairmanship by, independent directors. However, various groups of respondents shared different views on AC-related disclosure or reporting. For instance, company officers and independent directors were against public disclosure of AC charters (or terms of reference) and inclusion of an AC report in annual corporate reports. These two groups of respondents may prefer to avoid more concrete AC responsibilities for overseeing corporate financial reporting and auditing processes, and for improving internal control and rule compliance. It is argued that, at present, the acceptance of ACs in China by various stakeholders is in appearance rather than in substance.

Our study results further indicate that the AC operations in practice are far less than satisfactory. Although a considerable portion of Chinese listed companies have established ACs in recent years, many ACs did not operate at all, or held very few meetings with short meeting duration in a year. In addition, most ACs were not involved in auditor selection and audit fee determination and there is almost no contact or communication between AC members and their companies' internal and external auditors.

These facts confirm that ACs are at best a ceremonial decoration or "symbolic show-case" of corporate governance and have not functioned effectively in China at present.

Our study will enrich the literature on AC operations. The findings should not only benefit readers in understanding the recent development of corporate governance and stock market reform in China, but also generate some policy implications that may be applicable to other countries as well, emerging economies in particular. However, it should be pointed out that our study findings are based on a questionnaire survey. Some limitations exist in survey sampling and data collection. We tried to apply random sampling for data collection, but the representativeness of survey subjects might be further considered in the study design. In particular, the sample size is relatively small and the response rates are not very high. Readers should be cautious in making inferences from the study results. Perhaps, further studies based on a larger sample size, particularly, with empirical tests of market reactions towards AC establishment and operation could be carried out in order to obtain more robust and insightful study results. In addition, more powerful statistical tests might be designed to analyze the between-group variances in the views of varied subgroups of respondents. Furthermore, different cultural, historical, or social systems may have significant impacts on corporate governance and business management systems. The related issues could be explored in future studies. Finally, the interdependence or interaction of ACs and SBs under the two-tier board system is another area worthy of future research.

Notes

1. By the end of 2005, a total of 1,395 stock companies are listed in the two stock exchanges, with the total values of market capitalization of RMB¥4,953 billions (US$616 billions). Today, the Chinese stock market has become one of the fast-growing capital markets in the world.
2. The Chinese Government has introduced a reform measure of floating the shares owned by the state and other social legal entities under certain conditions since late 2005. But those shares would not be tradable until 2008.
3. In fact, continuing retreats took place in the Chinese stock market with the trading volume declining and market indexes sliding sharply since 2001. In 2004, as reported by a Hong Kong newspaper, SHSE and SZSE were the second and third worst-performers of the 60 global benchmarks tracked by the Bloomberg (*The Standard*, 2004).
4. The independent director system was initially adopted by a small number of Chinese companies that were listed in Hong Kong stock market (the H-share companies) after 1993. Later, *Guidelines for the Incorporation of Listed Companies* (1997) and *The Company Law* (1999) allow Chinese companies to appoint independent directors on a voluntary basis. However, there is no regulatory provision on the roles and responsibilities of independent directors in the regulations except for disqualifying management officers from related companies from serving as independent directors. Owing to no mandatory requirement, only a very small number of Chinese listed companies had appointed independent directors before 2001 (Li, 2001; He, 2004).
5. According to the CSRC's (2001), the terms of "accounting expert" is defined as "a person who has possessed senior accounting qualification rank (including senior accounting academics) or who is a certified public accountant."
6. For instance, the earliest audit committee report was issued by the Great Railway Company in the UK in 1892 (CICA, 1981). In the USA, the NYSE has recommended the listed

companies set up audit committee as early as in 1940 (Mautz and Neumann, 1970; Birkett, 1986).

7. In general, inside directors are excluded from AC membership by regulations. Although NYSE has not completely disallowed inside directors or someone who is associated with a company or its officers to serve the AC if the company management has good reasons that can justify that the inclusion of such persons will be in the best interests of the company, the recent development is to have independent or non-executive directors as AC members.
8. Nonetheless, there is no clear definition about the "financially literate" or "financial expert" in the regulatory requirements. In fact it is a gray area regarding such requirements on AC members' qualification.
9. As commonly applied in the design of the survey instrument, the rating scale, like Likert scale or summated scale, is used for the "agree-indifferent-disagree" classification of respondents' views or attitudes. A majority of the Likert scales are based on five-point design (Cooper and Schindler, 2001), and the scores of 1 and 2 can be combined to represent the "disagree" while 4 and 5 represent "agree." The mid-point of 3 is normally denoted as "indifferent" or "neutral" attitude towards survey questions concerned. In this study, we adopted a similar scaling technique. In addition, when the Likert scale is applied, the scores can be interpreted as "the respondents are more or less favorable to a topic, but they cannot tell how much more or less favorable they are" (Cooper and Schindler, 2001, Chapter 9). Thus, we will interpret the respondents' answering scores below 3 as "disagree" while that above 3 as "agree" and the wider gap above or below 3 should indicate stronger agreement or disagreement. The score near to 3 represents an indifferent or neutral position.
10. This section is incorporated only in the questionnaire being sent to the incumbent senior company officers and the independent directors, as they have actual knowledge of the existing AC practices at the listed companies they are affiliated with.
11. To ensure the quality of financial audits for listed companies, the Chinese Government has imposed more stringent standards for those CPA firms that will provide audit services associated with securities transactions. A separate set of qualification requirement and licensing system is in place. Although there are more than 1000 CPA firms in China at present, only 73 CPA firms nationwide have obtained the permission from the CSRC to offer audit services to listed companies.
12. The training class has about 200 participants, including independent directors and some professional persons who are interested in serving as independent directors. The survey questionnaires were only distributed to those who were serving as independent directors since they had first-hand experience of AC operations in the listed companies.
13. For the 129 responding companies, 83 were listed at SHSE and 46 were listed at SZSE, respectively. No significant difference was found for the mean scores of the two groups of listed companies based on *t*-test results.
14. As the larger shareholders, the parent SOEs or the state agencies in charge will exercise a significant administrative power and influence on the operations of listed companies. Public investors, relatively as the minority shareholders, have little control over company management.

References

Abbott, L.J., Park, Y. and Parker, S. (2000), "The effects of audit committee activity and independence on corporate fraud", *Managerial Finance*, Vol. 26 No. 11, pp. 55-67.

Abbott, L.J., Park, Y. and Peters, G. (2004), "Audit committee characteristics and restatements", *Auditing: A Journal of Practice & Theory*, Vol. 23 No. 1, pp. 69-87.

Abdolmohammadi, M.J. and Tomasko, P.A. (1992), "Audit committee member's perceptions of their responsibilities", *Internal Auditing*, Summer, pp. 53-63.

ASE (2003), *Principles of Good Corporate Governance and Best Practice Recommendations*, Australian Stock Exchange, Sydney.

Beasley, M.S. and Salterio, S.E. (2001), "The relationship between board characteristics and voluntary improvements in audit committee composition and experience", *Contemporary Accounting Research*, Vol. 18 No. 4, pp. 539-71.

Beattie, V., Fearnley, S. and Brandt, R. (2000), "Behind the audit report: a descriptive study of discussions and negotiations between auditors and directors", *International Journal of Auditing*, Vol. 4, pp. 177-202.

Bedard, J., Chtourou, S.M. and Courteau, L. (2004), "The effect of audit committee expertise, independence, and activity on aggressive earnings management", *Auditing: A Journal of Practice & Theory*, Vol. 23 No. 2, pp. 13-36.

Beecher-Monas, E. (2003), "Corporate governance in the wake of Enron: an examination of the audit committee solution to corporate fraud", *Administrative Law Review*, Vol. 55 No. 2, pp. 357-94.

Birkett, B.S. (1986), "The recent history of corporate audit committee", *The Accounting Historians Journal*, Vol. 13 No. 2, pp. 109-24.

Bradbury, M.E. (1990), "The incentives for voluntary audit committee formation", *Journal of Accounting & Public Policy*, Vol. 9 No. 1, pp. 19-36.

Braiotta, L. Jr (2003), "An exploratory study of adopting requirements for audit committees for non-US commercial bank registrants: an empirical analysis of foreign equity investment", *Managerial Auditing Journal*, Vol. 18 Nos 6/7, pp. 456-65.

BRC (1999), *Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees*, New York Stock Exchange, New York, NY.

Carcello, J.V. and Neal, T.L. (2000), "Audit committee composition and auditor reporting", *The Accounting Review*, Vol. 75 No. 4, pp. 453-68.

Carcello, J.V. and Neal, T.L. (2003), "Audit committee characteristics and auditor dismissals following 'new' going-concern reports", *The Accounting Review*, Vol. 78 No. 1, pp. 95-117.

CC (1992), *Report of the Committee on the Financial Aspects of Corporate Governance*, Gee, London.

CICA (1981), *Audit Committee: A Research Study*, Canadian Institute of Charted Accountants, Toronto.

CICA (1987), *Report of the Commission to Study the Public Expectation of Audits (McDonald Commission)*, Canadian Institute of Charted Accountants, Toronto.

Cohen, J., Krishnamoorthy, S. and Wright, A. (2002), "Corporate governance and the audit process", *Contemporary Accounting Research*, Vol. 19 No. 4, pp. 573-94.

Collier, P. (1993), "Audit committees in major UK companies", *Managerial Auditing Journal*, Vol. 8 No. 3, pp. 25-31.

Collier, P. (1996), "The rise of the audit committee in UK quoted companies: a curious phenomenon?", *Accounting, Business and Financial History*, Vol. 6 No. 2, pp. 121-40.

Collier, P. and Gregory, A. (1996), "Audit committee effectiveness and the audit fees", *European Accounting Journal*, Vol. 5 No. 2, pp. 177-99.

Collier, P. and Gregory, A. (1998), "Audit committee activity and agency", *Journal of Accounting and Public Policy*, Winter, pp. 311-32.

Cooper, D.R. and Schindler, P.S. (2001), *Business Research Methods*, 7th ed., Irwin/McGraw-Hill, Boston, MA.

Cotter, J. and Sylvester, M. (2003), "Board and monitoring committee independence", *Abacus*, Vol. 39 No. 2, pp. 211-33.

CSRC (2001), *Guidelines on the Establishment of Independent Directors in the Listed Companies*, China Securities Regulatory Commission, Beijing.

CSRC (2002), *Standards on Corporate Governance of the Listed Companies*, China Securities Regulatory Commission, Beijing.

Davidson, W.N. III, Xie, B. and Xu, W. (2004), "Market reaction to voluntary announcements of audit committee appointments: the effect of financial expertise", *Journal of Accounting and Public Policy*, Vol. 23 No. 4, pp. 279-91.

DeZoort, F.T. (1997), "An investigation of audit committees' oversight responsibilities", *Abacus*, Vol. 33 No. 2, pp. 208-27.

DeZoort, F.T. (1998), "An analysis of experience effects on audit committee members' oversight judgment", *Accounting, Organizations and Society*, Vol. 23 No. 1, pp. 1-21.

DeZoort, F.T. and Salterio, S.E. (2001), "The effects of corporate governance experience and financial reporting and audit knowledge on audit committee members' judgment", *Auditing: A Journal of Practice & Theory*, Vol. 20 No. 2, pp. 31-47.

DeZoort, F.T., Kernanson, D.R., Archambeault, D.S. and Reed, S.A. (2002), "Audit committee effectiveness: a synthesis of the empirical audit committee literature", *Journal of Accounting Literature*, Vol. 21, pp. 38-73.

FRC (2003), *The Combined Code on Corporate Governance*, Financial Reporting Council, London, available at: www.iia.or.uk

Guthrie, J. and Turnbull, S. (1995), "Audit committee: is there a role for corporate senates and/or stakeholders' councils?", *Corporate Governance: An International Review*, Vol. 3 No. 2, pp. 78-89.

Hansell, C. (2005), "Canada sets new policy on corporate governance", *International Financial Law Review*, January, p. 1.

He, J.C. (2004), "International comparison of corporate governance structure, mechanisms, and effectiveness", *China Securities Journal*, November 25 (in Chinese).

Hemraj, M.B. (2003), "Corporate governance: directors, shareholders and the audit committee", *Journal of Financial Crime*, Vol. 11 No. 2, pp. 150-60.

Huang, S.Z. (2001), "Accounting shams by the listed companies are attributed to deficiencies in corporate governance system", *China Securities Journal*, September 27 (in Chinese).

ICAEW (1997), *Audit Committees: A Framework for Assessment*, Institute of Charted Accountants in England and Wales, London.

ICAEW (2001), *The Effective Audit Committee: A Challenging Role*, Institute of Charted Accountants in England and Wales, London.

Institute of Internal Auditors (IIA) (1993), *Improving Audit Committee Performance: What Works Best*, IIA Research Foundation, Altamonte Springs, FL.

JCCG (2001), *Beyond Compliance: Building a Governance Culture*, Interim Report of the JCCG, CICA, Toronto.

Kalbers, L. and Fogarty, T. (1996), *A Comparative Assessment of Organizational and Economic Explanations of Corporate Control: An Investigation of Audit Committee Oversight*, American Accounting Association (AAA), Cleveland.

Kalbers, L. and Fogarty, T. (1998), “Organizational and economic explanations of audit committee oversight”, *Journal of Managerial Issues*, Vol. X No. 2, pp. 129-50.

Klein, A. (2002a), “Economic determinants of audit committee independence”, *The Accounting Review*, Vol. 77 No. 2, pp. 435-52.

Klein, A. (2002b), “Audit committee, board of director characteristics, and earnings management”, *Journal of Accounting and Economics*, Vol. 33, pp. 57-81.

KPMG Peat Marwick Thorne (1991), *Audit Committees: The Evolution Continues*, CCH Canadian Ltd, Don Mills.

Lansing, P. and Grgurich, C. (2004), “The Sarbanes-Oxley Act: new securities disclosure requirements in the United States”, *International Journal of Management*, Vol. 21 No. 3, pp. 292-300.

Lee, H.Y., Mande, V. and Ortman, R. (2004), “The effect of audit committee and board of director independence on auditor resignation”, *Auditing: A Journal of Practice & Theory*, Vol. 23 No. 1, pp. 131-46.

Lee, T. and Stone, M. (1997), “Economic agency and audit committee: responsibilities and membership composition”, *International Journal of Auditing*, Vol. 1 No. 2, pp. 97-116.

Li, K. (2001), “The independent director system must be improved”, *Securities Market Weekly*, October 15.

McDaniels, L., Martin, R.D. and Maines, L.A. (2002), “Evaluating financial reporting quality: the effects of financial expertise vs. financial literacy”, *The Accounting Review*, Vol. 77, pp. 139-67.

McMullen, D.A. (1996), “Audit committee performance: an investigation of the consequences associated with audit committee”, *Auditing: A Journal of Practice & Theory*, pp. 87-103, Spring.

Macintosh, N.B., Shearer, T., Thornton, D.B. and Welker, M. (2000), “Accounting as simulacrum and hyperreality: a post-structuralist perspective”, *Accounting, Organizations and Society*, Vol. 25 No. 1, pp. 13-50.

Mautz, R.K. and Neumann, F.L. (1970), *Corporate Audit Committees*, University of Illinois, Urbana, IL.

Menon, K. and Williams, J.D. (1994), “The use of audit committee for monitoring”, *Journal of Accounting and Public Policy*, Summer, pp. 121-39.

Morrison, J. (2004), “Legislating for good corporate governance: do we expect too much?”, *The Journal of Corporate Citizenship*, Vol. 15, pp. 121-34.

NACD (2000), *Report of the Blue Ribbon Commission on Audit Committee: A Practical Guide*, National Association of Corporate Directors, Washington, DC.

NACD (2002), *The NACD Board’s Recommendations for Governance Reform*, National Association of Corporate Directors, Washington, DC.

Ng, T.B-R. and Tan, H-T. (2003), “Effects of authoritative guidance availability and audit committee effectiveness on auditors’ judgment in an auditor-client negotiation context”, *The Accounting Review*, Vol. 78, pp. 801-18.

NYSE (2002), *Corporate Governance Rule Proposal*, available at: www.nyse.com

OSC (2003), *Proposed Multilateral Instrument 52-110 Audit Committees*, Ontario Securities Commission, Toronto.

Peng, Z.W. (2002), “The supervisory board should not be a rubber stamp”, *China Securities Journal*, October 23 (in Chinese).

Pergola, T.M. (2005), "Management entrenchment: can it negate the effectiveness of recently legislated governance reform?", *Journal of American Academy of Business*, Vol. 6 No. 2, pp. 177-84.

Porter, B. and Gendall, P. (1998), "Audit committee in private and public sector corporates in New Zealand: an empirical investigation", *Internal Journal of Auditing*, Vol. 2 No. 1, pp. 39-69.

Raghunandan, K., Read, W.J. and Rama, D.V. (2001), "Audit committee composition 'grey directors' and interaction with internal auditing", *Accounting Horizons*, Vol. 15 No. 2, pp. 104-18.

Rezaee, Z. and Lander, G.H. (1993), "The internal auditor's relationship with the audit committee", *Managerial Auditing Journal*, Vol. 8 No. 3, pp. 35-40.

Rezaee, Z., Olibe, K.O. and Mimmier, G. (2003), "Improving corporate governance: the role of audit committee disclosures", *Managerial Auditing Journal*, Vol. 18 Nos 6/7, pp. 530-7.

Scarbrough, P., Rama, D. and Raghunandan, K. (1998), "Audit committee composition and interaction with internal auditing: Canadian evidence", *Accounting Horizons*, March, pp. 51-62.

SEC (1999), *Final Rule: Audit Committee Disclosure*, Release No. 34-41987, File No. S7-22-99, Government Printing Office, Washington, DC.

SEC (2003), *Standards Relating to Listed Company Audit Committees*, Final Rules (April) Release No. 338220, Government Printing Office, Washington, DC.

Sharma, V.D. (2004), "Board of director characteristics, institutional ownership, and fraud: evidence from Australia", *Auditing: A Journal of Practice & Theory*, Vol. 23 No. 2, pp. 105-18.

SHSE (2003), "Eight major problems in the corporate governance of the listed companies", *China Securities Daily*, October 28 (in Chinese).

Song, J. and Windram, B. (2004), "Benchmarking audit committee effectiveness in financial reporting", *International Journal of Auditing*, Vol. 8 No. 3, pp. 195-207.

Spira, L.F. (1998), "An evolutionary perspective on audit committee effectiveness", *Corporate Governance: An International Review*, Vol. 6 No. 1, pp. 29-38.

Spira, L.F. (1999a), "Ceremonies of governance: perspectives on the role of the audit committee", *Journal of Management and Government*, Vol. 3 No. 3, pp. 231-60.

Spira, L.F. (1999b), "Independence in corporate governance: the audit committee role", *Business Ethics: A European Review*, Vol. 8 No. 4, pp. 262-73.

Spira, L.F. (2002), *Audit Committee – Performing Corporate Governance*, Kluwer Academic Publishers, Boston, MA.

(The) Standard (2004), *The Standard*, December 9, p. B1.

Teoh, H.Y. and Lim, C.C. (1996), "An empirical study of the effects of audit committees, disclosure of nonaudit fees and other issues on audit independence: Malaysian evidence", *Journal of International Accounting, Auditing and Taxation*, Vol. 5 No. 2, pp. 231-48.

Urbancic, F. (1996), "A content analysis of audit committee reports", *Internal Auditing*, Summer, pp. 36-42.

Vanasco, R.R. (1994), "The audit committee: an international perspectives", *Managerial Auditing Journal*, Vol. 9 No. 8, pp. 18-42.

Vicknair, D., Hickman, K. and Carnes, K. (1993), "A note on audit committee independence: evidence from NYSE on grey area directors", *Accounting Horizons*, March, pp. 53-7.

Vinten, G. (1995), "Audit committees, internal control, and corporate governance", *Managerial Auditing Journal*, Vol. 10 No. 6, pp. 3-4.

Wild, J.J. (1996), "The audit committee and earnings quality", *Journal of Accounting, Auditing and Finance*, Vol. 11 No. 2, pp. 247-76.

Wu, J.L. (2001), "Controlling shareholder behavior and corporate governance", *Shanghai Securities Daily*, June 8 (in Chinese).

Xiao, J.Z., Dahya, J. and Lin, Z.J. (2004), "A grounded theory exposition of the role of the supervisory board in China", *British Journal of Management*, Vol. 15 No. 1, pp. 39-56.

Yermack, D. (1996), "Higher market valuation of companies with a small board of directors", *Journal of Financial Economics*, Vol. 40, pp. 185-212.

Zaman, M. (2001), "Turnbull-generating undue expectations of the corporate governance role of audit committees", *Managerial Auditing Journal*, Vol. 16 Nos 1/2, pp. 5-10.

Zhang, F. (2002), "Independence directors should be 'independent'", *China Securities Journal*, May 19 (in Chinese).

Further reading

Dewing, I.P. and Russell, P.O. (2003), "Post-Enron developments in UK audit and corporate governance regulation", *Journal of Financial Regulation and Compliance*, Vol. 11 No. 4, pp. 309-21.

Felo, A.J., Krishnamoorthy, S. and Soleri, S. (2001), "Audit committee characteristics and the quality of financial reporting: an empirical analysis", working paper, Penn State University, University Park, PA.

Hines, R. (1991), "The FASB's conceptual framework, financial accounting and the maintenance of social work", *Accounting, Organizations and Society*, Vol. 16 No. 4, pp. 313-31.

Rogers, V.C., Marsh, T.A. and Ethridge, J.R. (2004), "Internal controls: winning the battle against risks", *Internal Auditing*, Vol. 19 No. 4, pp. 28-35.

Sommer, A.A. Jr (1991), "Auditing audit committee: an educational opportunity for auditors", *Accounting Horizons*, Vol. 5 No. 2, pp. 91-3.

Xie, B., Davidson, W.N. III and DaDalt, P.J. (2003), "Earnings management and corporate governance: the role of the board and audit committee", *Journal of Corporate Finance*, Vol. 9, pp. 295-316.

Yin, S.P. (2001), "Which corporate governance model is more superior?", *China Securities Journal*, April 27 (in Chinese).

Corresponding author
Z. Jun Lin can be contacted at: linzj@hkbu.edu.hk