

A GOVERNANCE FRANKENSTEIN INTEGRATING THE
AGENCY AND INSTITUTIONAL PERSPECTIVES:
FOCUSING ON AUDIT COMMITTEES

A thesis submitted in fulfilment of the requirements for the degree of
Doctor of Philosophy

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DECLARATION

I, Akeel Mansour Lary certify that except where due acknowledgement has been made, this thesis is my original work and not that of another author; this thesis has not been previously or is currently being submitted, in whole or in part, to qualify for any other academic award; the content of the thesis is the result of work which has been carried out since the official commencement date of the approved research program; any editorial work, paid or unpaid, carried out by a third party is acknowledged; and ethics procedures and guidelines have been followed.

Akeel M. Lary

28th January 2014

ACKNOWLEDGEMENTS

I would like to express my gratitude to my senior supervisor, Prof Dennis Taylor, for his patience, guidance and support, who throughout the past three years has dedicated his efforts and guided me through the preparation and completion of this thesis. It is his belief in my research abilities which motivated me to overcome my research obstacles– from research planning to the submission of this completed thesis.

My appreciation goes to my associate supervisor, Dr Grace Wong, for her support and consultation. This thesis would not be in its current shape had it not been for her efforts and feedback.

I would also like to express my appreciation to Prof Christopher Napier, Prof Lee Parker, Prof Rob Gray, Dr Prem Yapa, Associate Prof Robert Inglis, Prof Paul De Lange, Prof Geoffrey Stokes, Dr Tehmina Khan and Dr Pavithra Siriwardhane for their feedback and consultation.

I thank the staff from RMIT University's School of Accounting for their support. Further, I am thankful to the School of Accounting for the facilities and resources made available. I acknowledge RMIT University but particularly the School of Accounting, for the opportunity to complete my research goals.

Beyond academia, I am grateful to the Institute of Internal Auditors Australia, particularly, Joe Garbutt and Stephanie Koehn, for their efforts and support. Further, I express my appreciation to each of the interview participants in my case study research. They took time from their busy schedules as a director, top executive or consultant to provide me with their insights. While I cannot disclose your names for ethical and confidentially reasons, I would like to say thank you.

Finally, I would like to express my deepest gratitude to my family, especially my parents whose support and belief in me motivated and inspired me to believe in myself.

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LIST OF ABBREVIATIONS

ACGPR	ASX Corporate Governance Council's Corporate Governance Principles and Recommendations
ARC	Audit, Business Risk and Compliance Committee
ASIC	Australian Securities and Investments Commission
ASX	Australian Securities Exchange
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFOO	Chief Financial and Operating Officer
CSO	Chief Strategy Officer
FCA	Fellow Chartered Accountant
FAICD	Fellow of the Australian Institute of Company Directors
IIA	Institute of Internal Auditors – Australia
NC	Nomination Committee
RC	Remuneration Committee
riskGM	General Manager of Risk
VAGO	Victorian Auditor-General's Office

A GOVERNANCE FRANKENSTEIN INTEGRATING THE
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ABSTRACT

This thesis focuses on the relationships between corporate governance structures and the interactions between corporate governance actors. It places the audit committee at its central focus point, but within a holistic corporate eco-system.

To develop a more rounded understanding of corporate governance phenomena, the relationships between governance structures and the interactions between governance actors are framed through the lenses of both agency theory and institutional theory. In particular, the different sets of assumptions underlying these two grand theories are assessed against the evidence of audit committees' structures, policies and actor behaviours within their wider corporate eco-systems. Case-based methods are used to gather the evidence for this thesis and qualitative analysis is applied. Corporate governance phenomena associated with a large corporation and four local government entities in Australia is investigated. In particular the thesis adopts a three stage coding scheme and a two-step analysis approach.

To reiterate, this thesis addresses the way in which governance actors and their structures interact as part of an organisation's holistic corporate eco-system. A pluralistic approach to perceiving and interpreting this phenomenon is taken by invoking both agency and institutional theoretical perspectives. It is the assumptions about organisational structures and key players' behaviours on which these two grand theories are founded that are especially assessed in this thesis. Therefore, while agency theory and institutional theory have spawned their own sub-branches and sub-theories, these two theories are only addressed in this thesis at their broad level where their original assumptions have been formulated.

The findings of this thesis suggest that the classical agency perspective of western-derived corporate governance can be better explained adopting a mixed theoretical framework which draws on both agency theory and institutional theory. In particular, agency theory better explains the purpose and

function of corporate governance and its mechanisms, while institutional theory better explains its homogeneity and isomorphic change. Further, the thesis proposes an expanded governance model which incorporates both agency theory and institutional theory. This expanded governance model can be viewed as a theoretical Frankenstein which fits together an amalgam of assumed behaviours to better illustrate and more holistically capture the governance phenomena. Nonetheless, the model may also be disaggregated to explain the governance phenomenon applying either agency or institutional theory. Apart from this theory testing, the thesis provides insights into the descriptive governance workings of a large Australian listed company and also of Victorian local governments (i.e., city councils).

The expanded governance model proposed in this study has implications for corporate and public sector regulators, as well as an organisation's independent directors. They should re-think any myopic agency theory perspective that uses solely agency-based policies for developing governance mechanisms. The evidence in this study infers that relevant regulators and directors need to design mechanisms that are structured to accommodate multilayers of homogeneous institutional groups. They also should orient policies towards achieving the desired effect on the legitimacy standards of the superordinate social system within which institutional groups interact under the expanded governance model.

FOREWORD

This study parallels Mary Shelley's fictional character Victor Frankenstein's pursuit of knowledge. In his pursuit Victor attempts to bestow life upon an inanimate body by collecting and infusing limbs of proportion and beauty. In this thesis, my pursuit is to better theoretically define the corporate governance phenomena by "bestow[ing] animation upon lifeless matter" (Shelley 1818, p. 42). This pursuit is achieved by collecting and then infusing the combined assumptions of agency theory and institutional theory. Each chapter embraces a quote from Mary Shelley's Frankenstein as a form of mirrored reflection.

"I shall satiate my ardent curiosity with the sight of a part of the world never before visited, and may tread a land never before imprinted by the foot of a man. These are my enticements, and they are sufficient to conquer ... and to induce me to commence this laborious voyage" (Shelley 1818, p. 4).

CHAPTER ONE INTRODUCTION

1.1 INTRODUCTION TO THE THESIS

This is a study on the relationships between corporate governance structures and the interactions between corporate governance actors. It places the audit committee at its central focus point, but within a holistic corporate eco-system (i.e., a corporate ecological system consisting of economic, legal, political and social elements). Moore (1993, p.76) suggested that a firm should be "viewed not as a member of a single industry but as part of a business ecosystem that crosses a variety of industries". As such a firm is considered to exist within an open interacting corporate eco-system with various influences and power relations among internal and external actors (Moore 1993; Pettigrew 1992; Roberts et al. 2005). Moore (1996, p.26) defined this corporate eco-system concept as

"An economic community supported by a foundation of interacting organizations and individuals—the organisms of the business world ... organisms also include suppliers, lead producers, competitors, and other stakeholders. Over time, they coevolve their capabilities and roles, and tend to align themselves with the directions set by one or more central companies".

To develop a more rounded understanding of corporate governance phenomena, the relationships between governance structures and the interactions between governance actors are framed through the lenses of both agency theory and institutional theory. In particular, the different sets of assumptions underlying these two grand theories are assessed against the evidence of audit committees' structures, policies and actor behaviours within the wider corporate eco-system. Case based methods are used to gather the evidence for this thesis and qualitative analysis methods are applied.

This thesis diverges from most prior empirical corporate governance research within the accounting, financial economics and management disciplines. Such prior research has predominantly relied on secondary data reported under regulatory guidelines by listed companies and, to a lesser extent, by government and non-for-profit entities. This body of research typically takes a deductive approach generated from agency theory assumptions and perspectives, using readily available secondary data and quantitative analysis. Actual board and management behaviour is not explored in these studies, even though many use proxies for actual behaviour (Huse 2005). This 'mainstream' corporate governance research has been criticised in two areas in particular: (a) not using a pluralistic approach to board and board committee role theories (Johnson et al. 1996; Roberts et al. 2005); and (b) not understanding governance structures within an open interacting system with various influence and power relations among internal and external actors (Pettigrew, 1992; Roberts et al. 2005). Further, Young and Thyl (2008) believe that the study of corporate governance would greatly benefit from the addition of a more holistic governance model as previous models provide an incomplete picture.

To reiterate, this thesis addresses the corporate governance phenomena associated with large corporations and government entities in Australia. It focuses on the way in which governance actors and their structures interact as part of a holistic corporate governance eco-system. A pluralistic approach to perceiving and interpreting this phenomenon is taken by invoking both an agency and

institutional theoretical lens. It is the assumptions about organisational structures and key players' behaviours on which these two grand theories are founded that are especially assessed in this thesis. Therefore, while agency theory and institutional theory have spawned their own sub-branches and sub-theories, these two theories are only addressed in this thesis at their broad level where their original assumptions have been formulated.

This chapter is structured to first provide a brief introduction to corporate governance concepts and practices. It then proceeds to state the research aim and objectives of this thesis. Third, an outline is given of the case study based research method adopted. Fourth, arguments are given on the motivation and significance of this thesis. Fifth, the scope of the thesis is clarified. Finally, the chapter concludes with an outline of the organisation of this thesis.

1.2 BACKGROUND ON CORPORATE GOVERNANCE

Firms predominately need economic resources to expand and grow; as, firms eventually grow beyond the means of single ownership, i.e., beyond an owner who is capable of meeting a firm's increased economic needs and obligations (Davis et al. 1997). Accordingly, firms need to be able to attract external funding, which would be funding otherwise allocated by investors (Mallin 2010; Dowling and Pfeffer 1975). Consequently, investors need assurance that firms will be well managed and continue to be profitable (Mallin 2010). Published annual reports and other informational releases form part of the assurance process; investors expect firm disclosers to represent a true and fair view of firm activities (Mallin 2010).

Good corporate governance serves as the process set which forms part of the assurance process. It serves to: (1) improve the credibility of financial reports, (2) safeguard against earnings manipulation, and (3) ensure a fair return on investor investment (Bhagat et al. 2010, Dechow et al. 1996). Collier and Zaman (2005) and Mallin (2010a) note that governance models and mechanisms have been driven by corporate collapses and financial scandals, while being motivated by investor desire for increased transparency, accountability and market confidence. Moreover, Todd (2010)

identifies the proposition of corporate governance is to direct and control firm activities by establishing structures, processes and procedures for decision making. Sir Adrian Cadbury (cited in Mallin 2010, p. 7) stated that

“Corporate governance is concerned with holding the balance between economic and social goals ... between individual and common goals ... the aim is [to] align as nearly as possible the interests of individuals, corporations and society”.

Modern firms identify the board (i.e., board of directors) as a governance mechanism with diverse duties and responsibilities; further, it is regarded as the most important decision-making vehicle in modern firms (DeZoort et al. 2002; Ferreira 2010). Boards typically delegate some of their oversight and compensation functions to various board sub-committees, including an audit committee, nomination committee, risk and compliance committee, and remuneration committee (DeZoort et al. 2002; Rezaee 2010; Vera-Munoz 2005). However the board retains the ultimate responsibility and accountability over any delegated functions (Rezaee 2010; Vera-Munoz 2005). These board sub-committees are viewed as monitoring mechanisms formed to aid the board in fulfilling its fiduciary duties by making efficient use of individual director’s time and expertise (Rezaee 2010).

Of the board sub-committees, the one that is mandated in several countries is the audit committee. It is a governance mechanism which is distinctly responsible for monitoring the external auditor and internal controls, and vetting of published annual reports. The Australian Securities Exchange (ASX) (2010a, p.29) identifies the role of an audit committee as reviewing “the integrity of the company’s financial reporting and oversee[ing] the independence of the external auditors”.

Previous literature on audit committees has examined the notion of audit committee effectiveness by benchmarking effectiveness outcomes against the widely recognised monitoring roles of audit committees. Audit committees are typically considered to have three principal monitoring roles: monitoring of external financial statements, monitoring of external auditors, and monitoring of

internal controls (Kalbers and Fogarty 1993). The notion of audit committee effectiveness is considered critical to corporate governance as it reinforces the underlining propose of corporate governance; i.e., to improve the credibility of financial reports; safeguard against earnings manipulation; and ensure a fair return to investors on their investments (Bhagat et al. 2010, Dechow et al. 1996).

As was noted above corporate governance has been driven by financial scandal and corporate collapses as a result of self-interested decisions and behaviour of decision makers (Mallin 2010). Consequently, agency theory has been the primary underlying paradigm for corporate governance practice and its literature (Anderson et al. 2007; Cohen et al. 2008). Accordingly, while this literature has been predominantly driven by agency theory, some researchers have addressed corporate governance through other theoretical paradigms. Other widely recognised corporate governance theoretical frameworks include institutional theory, stewardship theory, stakeholder theory, resource dependence, and managerial hegemony (Cohen et al. 2008; Mallin 2010; Todd 2010).

(Kalbers and Fogarty 1998) believe that by combining both the agency and institutional perspectives the governance phenomena can be better explained. Extending on this preliminary research by Kalbers and Fogarty (1998), this thesis takes a similar pluralistic theoretical perspective (agency and institutional) in understanding the way in which corporate governance mechanisms and actors interact as part of a holistic corporate eco-system.

1.3 RESEARCH AIM

The aim of this thesis is to contribute a deeper understanding of the way in which corporate governance mechanisms and actors interact as part of a holistic corporate eco-system in order to more pluralistically define corporate governance phenomena. This is a broad aim, so the contribution of this study will be limited in scope to an identification and assessment of sets of assumptions related to agency theory and institutional theory, each of which are 'grand theories' that have been separately invoked in corporate governance research.

1.3.1 Research Objectives and Questions

In addressing the aim of this thesis, this thesis has developed three primary objectives and two research questions.

Objective 1: Identify a firm's internal and external actors who exist within the formal governance structures and the corporate eco-system

Objective 2: Examine the impact of these actors on the shaping of outcomes within the corporate eco-system

Objective 3: Develop an integrated model of internal and external mechanisms which co-exist within a corporate eco-system

RQ1: To what extent do governance mechanisms and actors interact as part of a holistic corporate eco-system?

RQ2: Does agency or institutional theory more pluralistically (pluralistic is used in the sense of a system that recognises more than one ultimate worldview or paradigm) define the governance phenomena?

1.4 RESEARCH METHODS

This thesis adopts more of an interpretivist than a positivist epistemological position. The method of gathering and analysing data resides towards the qualitative end of the continuum (Creswell 2009). The qualitative approach is more suited as a means of meeting the thesis's aim of exploring and understanding the interactions of corporate governance actors and mechanisms within a corporate eco-system.

Consequently, the case study research strategy is adopted. The case study strategy for gathering and interpreting evidence can enable an in-depth holistic focus on corporate governance relationships and interactions to be pursued. The sampling frame adopted for the thesis is determined by the 'key case unit' method (Thomas 2011). This allows the deliberate selection of a case organisation that is reputed to demonstrate sound governance practices and a strong commitment to the protection of

shareholder interests. As a supplement to the 'key case' method, this thesis also separately embraces a 'nested case unit' method (Thomas 2011).

These two types of case units will be used to provide illustrations, through qualitative analysis and interpretations, as the basis for addressing the research objectives of the thesis. The key case unit (a single listed corporation) will be central to the wider case while the nested case unit (a set of local governments) will be complementary. The evidence collected from the key case unit involved semi-structured taped interviews conducted with the company secretary, audit committee chair and external audit partner. Additionally, it collected evidence from multiple documents available online. Similarly, the nested case unit involved evidence collected from the transcripts of semi-structured taped interviews conducted with two local government audit committee chairs, as well as written documents obtained from the interviewees.

1.5 RESEARCH MOTIVATION AND SIGNIFICANCE

Existing corporate governance literature has provided insights into the need and purpose of various corporate governance mechanisms. Additionally, the literature on audit committees has provided insights into the factors or characteristics which improve the effectiveness of audit committees. However, this literature has relied on publicly available disclosures of corporate governance mechanisms, often set in the context of publicly known failure of these mechanisms.

This thesis will extend the literature by proposing a more rounded governance framework which can be interpreted by employing either an agency or institutional theoretical lens or both. This thesis chooses to address the issue of whether an integration of *both* agency and institutional theoretical perspectives can provide improved insights about governance phenomena, Integration of key behavioural assumptions underlying these respective theories may provide a richer governance framework. For example, an agent's opportunistic behaviour (i.e., agency assumption) is likely to be moderated by a need to use information asymmetry in a way that is perceived to be legitimate by conforming to the institutional environment's expectations (i.e., institutional theory). This

framework may lay the foundations for new directions for governance research. The strength of the framework is that it can allow for a more flexible examination of corporate governance mechanisms and their various actors. In addition, this thesis will fill the gap in current corporate governance literature by providing insights into the corporate governance mosaic of local governments. The literature gap is due to the general paucity of qualitative research into corporate governance, including the absence of any qualitative research on corporate governance phenomena in the context of local government.

Results can provide insights into the inter-compositional dynamics of corporate governance mechanisms; this can facilitate a better understanding of how corporate governance mechanisms work collectively in fulfilling their governance role(s). This information may be used to improve communication channels and reduce role conflicts. The exploratory testing of this framework through the joint evaluation of the presence of agency and institutional assumptions has pointed to the potential for developing a practical way forward for evaluating whether, and in what circumstances, current corporate governance mechanisms and regulations are effective in fulfilling their monitoring and assurance roles.

1.6 RESEARCH SCOPE

This thesis seeks to identify potential governance actors both internal and external to a firm's corporate eco-system. Moreover, this thesis explores the impact these actors have in shaping the corporate eco-system. Consequently, it develops an integrated model of a corporate eco-system which encompasses both the firm's internal and external actors. The thesis focuses on the audit committee of a large listed Australian firm and the audit committees of a small set of Australian local governments to assist in developing a theoretical framework for governance, which is the focus of this thesis. These audit committees are viewed within the context of their relationships and interactions with the corporate eco-system. Therefore, the thesis seeks to identify the extent to which an audit committee's collective operating mode is characterised by either an institutional

(rituals, myths, taken-for-granted behaviours) or agency (independence, rational economic decision making, diligence) phenomena. Finally, the thesis attempts to provide insights into the structures and behaviours of audit committees to better align theoretical frameworks and organisational practice.

1.6.1 Beyond the Research Scope

This thesis will not seek to directly measure the overall effectiveness of corporate governance mechanisms in fulfilling their purpose, roles and responsibilities. In addition, the thesis will not address the agency costs incurred in relation to the carrying out of the roles of audit committees; e.g., the costs allocated to the external auditor and to the company's financial reporting systems. These are costs that could be benchmarked against the effectiveness of the external audit and financial reporting functions. Unlike numerous quantitative studies, this thesis does not address cause and effect relationships between various models of governance mechanisms and organisational financial or market performance, together with the associated endogeneity issue. Further, this thesis does not address how firms balance stakeholder interests. Additionally the thesis does not address the effects of firm ownership in affecting the firm's responses to the pressures of the corporate eco-system. Nor does this thesis address the firm responses to the pressures of the corporate eco-system.

1.7 ORGANISATION OF THIS THESIS

This thesis is organised into seven chapters. The remaining six chapters are as follows:

1. A review of corporate governance literature and its underlying theoretical perspectives

The purpose of this chapter is to provide a detailed review of the literature on corporate governance and the main theories which underpin the corporate governance phenomenon. The chapter is primarily focused on boards and their audit committees as governance mechanisms. The chapter presents an introduction to corporate governance, synthesis of previous audit committee literature, the theoretical paradigms

which underpin the corporate governance phenomena, and present an integrated model which adopts elements from the primary theoretical paradigms.

2. Research methodology

The purpose of this chapter is to provide insights into the adopted research design and strategy of this thesis, including its evidence collection methods.

3. A case study of corporate governance policies and practices focusing on the audit committee

The purpose of this chapter is to present the findings of the selected corporate case. It presents a qualitative analysis of the text obtained from company documents and interview transcripts. The chapter is primarily focused on the board and its audit committee. As it was a formal condition and request, the name of the Company and identities of participants are kept confidential.

4. A case study of local government corporate governance focusing on the audit committee

The purpose of this chapter is to provide a detailed understanding of the policies, practices and interfaces of the bodies and key players within the corporate governance mechanisms of four Victorian local governments. The focus of this case based analysis is centred primarily on the audit committee. This chapter presents the findings from a qualitative analysis of the text obtained from Victorian local governments' documents and interview transcripts. As it was a formal condition and request, the identities of participants and consequently the names of the Victorian local governments are kept confidential.

5. Discussion of findings and the generation of an expanded governance model

The purpose of this chapter is to interpret the policies, practices and interfaces, as were presented in Chapters 4 and 5 into the expanded governance model presented in Chapter 2. This chapter begins by examining the agency assumptions of the expanded

governance model in light of the findings of Chapters 4 and 5. It continues by examining the institutional assumptions. It concludes by re-examining and modifying the expanded governance framework.

6. Conclusions

This chapter begins by providing an overview for the thesis and presents the main findings and conclusions. It then addresses the research objectives and questions. It continues by disclosing the limitations of this thesis. It later, discusses the implications of this thesis. It finally, provides suggestions for future research.

1.8 CHAPTER SUMMARY

This chapter has provided an introduction to the main issues, concepts and methods of this thesis. The chapter has defined corporate governance as a process set forming part of the assurance process, which serves to improve the credibility of financial reports; safeguard against earnings manipulation; and ensure a fair return on investor investment (Bhagat et al. 2010, Dechow et al. 1996). The assurance process is important for firms as firms are dependent on external economic resources to expand and grow (Davis et al. 1997). Moreover, current governance models and mechanisms have largely been driven by corporate collapses and financial scandals, while being motivated by investor desire for increased transparency, accountability and market confidence (Collier and Zaman 2005; Mallin 2010). Consequently, agency theory has been the primary underlying paradigm for corporate governance practice and its literature (Anderson et al. 2007; Cohen et al. 2008).

This thesis aims to examine the way in which corporate governance mechanisms and actors interact as part of a holistic corporate eco-system; to better theoretically define the corporate governance phenomena by adopting either or both agency and institutional assumptions.

The thesis adopts a qualitative research design, as it provides an enhanced means of exploring and understanding the interactions of corporate governance actors and mechanisms within a corporate

eco-system. Moreover, the thesis adopts a case study research strategy, as it will enable an in depth holistic focus of a firm's corporate eco-system. The thesis adopts the key case method and the nested case unit process.

The thesis will extend current literature by proposing a more comprehensive governance framework which can be interpreted by employing both an agency and institutional theoretical lens. This framework can allow for a more flexible examination of corporate governance mechanisms and their various actors.

“The labours of men of genius, however erroneously directed, scarcely ever fail in ultimately turning to the solid advantage of mankind” (Shelley 1818, p. 37).

CHAPTER TWO

A REVIEW OF CORPORATE GOVERNANCE LITERATURE AND ITS UNDERLYING THEORETICAL PERSPECTIVES

2.1 INTRODUCTION

The purpose of this chapter is to provide a review of the literature on corporate governance, emphasising board-related governance, and the main theories which underpin the corporate governance phenomenon. A large body of literature exists on corporate governance. This chapter focuses on corporate boards and their audit committee as governance mechanisms. It then broadens to a review of major theories that have been invoked to model and explain corporate governance structures and behaviours and their effects. The chapter first provides a background into the rationale for corporate governance. Second it focuses on a synthesis of previous literature on audit committees. Third it presents the current theoretical perspectives which underpin the corporate governance phenomena, with emphasis on the detailed examination of elements of agency and institutional theories. Fourth it re-examines how corporate governance phenomena is viewed through the lens of agency theory and the lens of institutional theory. It concludes by constructing a new corporate governance model which integrates elements from these two primary theoretical lenses.

2.2 CORPORATE GOVERNANCE

Firms can eventually grow beyond the means of a single owner, i.e., beyond the financial capability of an owner who is able meet the firm’s increased economic needs and obligations (Davis et al. 1997). As such, firms need to be able to attract funding from investors (i.e., additional owners) to expand and grow; however this funding may be otherwise allocated. Therefore, these investors need assurance that the firm will be well managed and continue to be profitable (Dowling and Pfeffer 1975; Mallin 2010). Published annual reports and other informational releases provide part of this

assurance. But investors expect these firm disclosers to represent a true and fair view of the firm's activities (Mallin 2010). Corporate governance is the process set which forms the final part of this assurance process, it serves to: (1) improve the credibility of financial reports, (2) safeguard against earnings manipulation, and (3) ensure a fair return on investors' investment (Bhagat et al. 2010, Dechow et al. 1996). Collier and Zaman (2005) and Mallin (2010a) note that governance models and mechanisms have been driven by corporate collapses and financial scandals, while being motivated by investor desire for increased transparency, accountability and market confidence. Table 2.1 (below) lists some key corporate cases of financial scandals and collapses which have motivated the rise of corporate governance. According to Todd (2010), the proposition of corporate governance is to direct and control the activities of firms by establishing structures, processes and procedures for decision making. Sir Adrian Cadbury (cited in Mallin 2010, p. 7) stated

“Corporate governance is concerned with holding the balance between economic and social goals ... between individual and common goals ... the aim is [to] align as nearly as possible the interests of individuals, corporations and society”.

Table 2.1: Key Corporate Cases which have Motivated Corporate Governance	
Case	Apparent Lessons
Barings Bank	Lack of effective internal controls – complete trust in one person without adequate supervision and understanding of that individual's activities.
Enron	Lack of director independence, integrity and honesty; and the independence of external auditors and concern over non-audit consultancy fees.
Royal Ahold	Suppressed investor involvement – chief executive officer (CEO) dominance enabled directors to have overgenerous remuneration packages.
Parmalat	Lack of independent directors and timely discloser.
HIH	Risk framework complexity – boards need to be informed of and understand their risk framework and management system.
Centro	Lack of director knowledge – directors need to be financially competent, to critically understand the reports they are meant approve; and directors cannot solely rely on executive management and auditors on producing financial reports.
Source: BDO Australia 2012; Mallin 2010	

Ferreira (2010) identifies the board (i.e., board of directors) as the most important decision making body in modern corporate firms. The board is a governance mechanism with diverse duties and responsibilities (DeZoort et al. 2002). These include overseeing a firm's strategic decisions, financial reporting processes and procedures, internal controls, risk framework, audit practices, executive oversight and compensation, promotion and protection of shareholder interests, and stakeholder protection (Andres et al. 2010; DeZoort et al. 2002; Fama and Jensen 1983; Rezaee 2010). Boards typically delegate some of their oversight and compensation functions to various board sub-committees (typically these are an audit committee, nomination committee, risk and compliance committee, and remuneration committee) (DeZoort et al. 2002; Rezaee 2010; Vera-Munoz 2005). However the full board retains the ultimate responsibility and accountability over any delegated functions (DeZoort et al. 2002; Rezaee 2010; Vera-Munoz 2005).

2.2.1 Audit Committees: their nature and role

Board sub-committees are monitoring mechanisms formed to aid boards fulfil their fiduciary duties by making efficient use of individual director's time and expertise (Rezaee 2010). Of the board sub-committees, the one that is mandated in several countries (e.g., US, UK, Australia, New Zealand, and Canada) is the audit committee. Audit committees were first proposed by the American Institute of CPAs in 1937 (Sommer 1991). The New York Stock Exchange provided its mandate in 1977, the mandate stated that "each domestic company, with common stock listed on the Exchange ... [will] establish no later than June 30, 1978 and maintain ... [an audit committee] comprised solely of directors independent of management" (Spangler & Braiotta 1990, p.135). The Australian mandate regarding the formation of audit committees was introduced by the ASX in March 2003 (ASX 2010b).

The Blue Ribbon Committee (cited in Abbott et al. 2003b, p. 29) asserted that the characteristics of "independence, expertise and diligence could lead to better overall audit committee oversight ... [as the role of the audit committee] is clearly one of oversight and monitoring" and in carrying out this role it acts in reliance on executive management and external auditors. In addition, according to Abbott et al. (2003b), these characteristics of the audit committee rather than its presence, critically

impacts its ability to effectively execute its duties. Further McMullen (1996) argues that audit committees are a mechanism for maintaining balance in the relationship between executive managers and external auditors. According to Bedard and Gendron (2010, p. 184), “investor confidence in the quality of financial reporting and financial markets is an important objective for regulators”. Consequently, audit committees also act as a mechanism that should increase investor confidence.

Both the academic and professional literature concur that an audit committee is to have three principal monitoring roles: monitoring of external financial statements, monitoring of external auditors (i.e., handle all matters that relate to the external audit and act as liaison between the external auditors and the board of directors), and monitoring of internal controls (ASX 2010a; Collier & Gregory 1996; Kalbers and Fogarty 1993; DeZoort 2002; Spira 1998). The role of the audit committee is to:

“Review the integrity of the company’s financial reporting and oversee the independence of the external auditors” (ASX 2010a, p.29);

Provide, on behalf of the Board an oversight responsibility over the firm’s financial reporting process (Klien 2002b);

“Provide assistance in the form of assurance regarding its financial reporting, internal controls, reporting structure and internal and external audit responsibilities. The Committee’s role is to assist the Board to independently verify and safeguard the integrity of the Group’s financial reporting” (Ausenco Ltd 2008, p.12).

As such, the audit committee is regarded as a governance mechanism, distinctly responsible for monitoring the external auditor, internal controls, and vetting of published annual reports. However, according to Sarens et al. (2009) audit committees are facing an ever-expanding monitoring role. Accordingly, this monitoring role of the audit committee is one of change and adaptability; at times

it must act as a threat, arbiter or ally to executive management (Turley and Zaman 2007). Nevertheless, Collier and Zaman (2005) suggest that there has been an increased conformity internationally in governance models and mechanisms. International conformity is identified in the appointment of non-executive directors, the actual formation of board sub-committees, and the separation between the board chair and CEO roles (Collier and Zaman 2005). Further, Collier and Zaman (2005) suggest that the adoption of governance models and mechanisms maybe a symbolic concept used to signal the addressing of monitoring and control concerns regardless of their efficacy.

The incidence of high profile corporate failures (as discussed above) involving fraud and corruption, failure of internal controls and poor accounting processes have raised concerns with regulators, government bodies and researchers in many countries in relation to the adequacy and effectiveness of audit committee monitoring (Turley and Zaman 2004). It has been noted that effective audit committees' may assist the board which is charged with safeguarding and advancing the interests of shareholders by enhancing the credibility of audited financial reports and disclosures (Fama and Jensen 1983; McMullen 1996). Further, an audit committee can potentially shield auditors from executive management pressure, therefore shifting the balance of power in the auditors' favour (Abbott 2003b).

Consequently, the notion of audit committee effectiveness has received significant attention across regulative, professional and academic fronts. As such, monitoring mechanisms are positioned on the forefront against fraudulent financial reporting (Bedard and Gendron 2010). Given the audit committee's role as a vehicle for monitoring the external auditors, financial reports and internal controls, its effectiveness is an important concept in the context of good corporate governance. Audit committee effectiveness is commonly benchmarked against its widely recognised original roles. According to DeZoort (1998) an audit committee is only as effective as its members. Following

DeZoort (1998) this thesis defines audit committee effectiveness as a *collective ability* to fulfil its original oversight duties.

Both Sommer (1991) and Spira (1998) suggest that an audit committee is and should be established to protect its stakeholder's interests and not a mere symbolic signal (i.e., cosmetic purposes). Further, according to Bradbury (1990) an audit committee should be established to enhance the credibility and objectivity of annual audited financial statements, enhance the external auditor independence, and assist company directors in meeting their fiduciary duties and responsibilities. Moreover, Abbott et al. (2003b) and Kalbers and Fogarty (1993) note the mere formation of an audit committee will not translate into an effective monitoring body. Alternatively, Spira's (1998) findings suggest that this mere symbolic formation will overtime translate into effective monitoring.

Effective boards and audit committees are expected to: (1) lead to higher transparency and reliability in financial statements; (2) reduce the risk that the auditor will provide an incorrect audit opinion; (3) protect auditor independence by assuming responsibility for their appointment, termination and remuneration; and (4) provide an independent platform for auditors to express their opinions and concerns in relation to management policies (Zaman et al. 2011). As such an effective audit committee is to be competent, inquisitive, and decisive (Palmer 1977). In addressing the notion of audit committee effectiveness this thesis follows previous literature and adopts the below definition:

"An effective Audit Committee is to have qualified and well informed members, with a majority of independent members ... [the audit committee is to have] the authority and resources to protect stakeholder interests by ensuring reliable financial reporting, internal accounting controls, and risk management through ... diligent oversight efforts" (Lary and Taylor 2012, p. 337).

The audit committee can directly improve the quality of information (which leads to improved investor confidence), by overseeing the financial reporting process; it can indirectly do this by overseeing internal controls and external auditing (Bedard and Gendron 2010). The Institute of Internal Auditors (cited in Sarens et al. 2009, p. 92) defined internal auditing as an activity that “helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”. The audit committee holds the responsibility for the monitoring of internal controls and effective monitoring leads to improved internal control quality (Bedard and Gendron 2010). Consequently, Zain et al. (2006) identify the internal control function as a key control mechanism for assessing and improving the quality of internal control systems. In monitoring the external audit function, it includes auditor selection, compensation, work and independence; as such effective auditor oversight leads to improved audit quality (Bedard and Gendron 2010).

2.2.2 Audit Committee Effectiveness: an annotated literature review

In addressing the effectiveness of audit committees in fulfilling their original roles, previous studies have provided findings about the following matters: its member characteristics (Abbott and Parker 2000; Abbott et al. 2004; Aier et al. 2005; Beasley 1996; Klien 2002a; McDaniel et al. 2002), external audit quality (Abbott and Parker 2000; Abbott et al. 2003b), incidences of restatements in published financial reports (Abbott et al. 2004; Aier et al. 2005; Kinney et al. 2004; Stanley and DeZoort 2007), incidences of fraud (Beasley 1996; Klien 2002a), the audit to non-audit fee (Ashbaugh et al. 2003; DeFond et al. 2002; Kinney et al. 2004; Raghunandan et al. 2003; Stanley and DeZoort 2007), and the level of earning management (Klien 2002a; DeFond and Jiambalvo 1991; Xie et al. 2003). In essence, effective audit committees are considered to improve the integrity and quality of published financial statements, by monitoring internal controls and maintaining auditor independence (McMullen 1996).

Table 2.2 (below) provides an annotated summary of the literature on the notion of audit committee effectiveness. The table summary is categorised into three sections: (1) literature which has focused

on *governance characteristics*, i.e., director independence, director competence, committee size and committee meeting frequency; (2) literature which has focused on *governance mechanisms*, i.e., on general governance structures and issues; and (3) literature which has focused on *non-audit services, auditor independence, audit quality and the integrity of financial reports*.

Table 2.2: Annotated Literature Summary on Audit Committee Effectiveness			
Authors (year)	Research Questions/ Objectives	Theory (actual or implied)/ Method	Central Findings/ Conclusions
(1) Governance Characteristics			
Abbott and Parker (2000)	Investigate the relationship between the governance characteristic of independence and audit committee meeting frequency on auditor selection, i.e., an industry specialist.	Agency/ Quantitative	Independent and active (i.e., meet at least twice a year) audit committees are more likely to select an industry specialist (an indicator of external auditor quality).
Abbott et al. (2003a)	Investigate the association between the governance characteristic of independence and audit committee meeting frequency on the ratio of non-audit service fees to total audit service fees.	Agency/ Quantitative	Solely independent and active (i.e., meets at least four times a year) audit committees are more likely to purchase less non-audit services. Non-audit service fees are considered as a threat to external auditor independence.
Abbott et al. (2003b)	Investigate the association between the governance characteristics of independence, financial expertise and diligence (i.e., audit committee meeting frequency) on audit service fees.	Agency/ Quantitative	Independent and financially expert audit committees are associated with higher audit service fees, which proxy for audit quality. Audit committee meeting frequency was not associated with higher audit service fees.
Abbott et al. (2004)	Investigates whether audit committee structures that are consistent with the Blue Ribbon Committee recommendations are less likely to experience a	Agency/ Quantitative	Finding support the hypotheses, i.e., Blue Ribbon Committee's governance recommendations. Audit committees solely composed of independent

	restatement in published financial reports.		<p>directors are less likely to experience a restatement.</p> <p>Audit committees composed of at least three directors are less likely to experience a restatement.</p> <p>Audit committees composed with at least one financially literate director are less likely to experience a restatement.</p> <p>Audit committees that meet frequently are less likely to experience a restatement.</p>
Beasley (1996)	Examines the relation between board compositions (i.e., independent non-executive members) on the likelihood of financial statement fraud.	Agency/ Quantitative	<p>Non-fraud firms have boards with significantly higher percentages of independent non-executive members than fraud firms.</p> <p>Board composition rather than audit committee presence, is more critical for reducing the likelihood of financial statement fraud.</p>
Beasley et al. (2000)	Investigates the association between audit committee and board characteristics of fraud and non-fraud firms across the technology, health care and financial services industries.	Agency/ Quantitative	<p>Results suggest that different and unique fraud opportunity exist for each industry.</p> <p>Non-fraud firms are more likely to have more independent boards and audit committees.</p> <p>Non-fraud audit committees are associated with an increased meeting frequency.</p> <p>Fraud firms are less likely to have an internal control framework.</p>
Bedard and Gendron 2010	Reviews the literature on audit committees to evaluate their effectiveness in strengthening financial reporting.	N/A	The financial reporting process is strengthened with the presence of an audit committee and its composition in relation to its independence, competence,

			meeting frequency and size.
Carcello and Neal 2000	Examines the association between audit committee independence on the likelihood of the auditor issuing a going-concern report for financially distressed firms.	Agency/ Quantitative	The less independent the audit committee the less likely the auditor will issue a going-concern report.
Carcello et al. (2002)	Examines the relation between the board characteristics of independence, diligence (meeting frequency) and expertise (other directorships held) on the audit service fee.	Agency/ Quantitative	Results indicate that more independent, diligent, and expert boards seek to protect their reputational capital, to avoid legal liability, and promote shareholder interests by purchasing higher quality audit services (cost of such services is reflected in the audit service fee).
DeZoort (1998)	Examines whether audit committee members with auditing experience (in internal control evaluation) will affect their oversight judgments. Focuses on the individual member level rather than the group level.	Agency/ Quantitative	Results indicate that members with experience made internal control judgments more like auditors than did members without experience. Provides support for suggestions that prior auditing experience may improve individual audit committee member oversight ability.
DeZoort and Salterio (2001)	Investigates whether audit committee members with audit, corporate governance and financial reporting knowledge and experience will affect their judgments in conflict situations between auditors and executive management.	Agency/ Quantitative	Results indicate that more experienced independent directors with greater audit knowledge were more likely to support the external auditor in conflict situations. Results provide justification for calls that audit committees should be completely composed of independent directors with mix of knowledge and experience.

DeZoort et al. (2002)	To synthesise empirical literature on audit committee effectiveness to guide future thinking and research.	N/A	An effective audit committee is to have qualified members with the authority and resources to protect stakeholder interests by ensuring reliable financial reporting, internal controls, and risk management through diligent oversight efforts.
Dhaliwal et al. (2010)	Examines how the monitoring effectiveness of audit committees is affected by the personal characteristics of accounting experts and the presence of non-accounting financial experts on audit committees.	Agency/ Quantitative	Accounting experts who are independent, held fewer directorships, and have a lower tenure with the firms had a positive impact on accrual quality (proxy for financial reporting quality). Insignificant corresponding results for non-accounting financial experts.
Farber (2005)	Examines the association between the credibility of the financial reporting system and the quality of governance mechanisms.	Agency/ Quantitative	Results indicate that fraud firms have poor governance mechanisms relative to the control sample. Fraud firms had fewer independent members, meet less frequently and had less financial expertise on their audit committee.
Klien (2002a)	Examines the association between audit committee and board characteristics on the occurrence of biased financial reporting.	Agency/ Quantitative	More independent audit committees and boards are more effective in monitoring the financial accounting processes and ensuring the firm is less likely to be involved in biased financial reporting.
Lary and Taylor (2012)	Examines the association between the governance characteristics of audit	Agency/ Quantitative	Audit committee's require all three measured governance characteristics (i.e.,

	committees and their role effectiveness in maintaining the integrity financial reports.		independence, competence and diligence) to effectively fulfil their various roles of maintaining financial statement integrity (occurrence and severity of financial restatements) and external auditor independence (lower non-audit service fees to audit service fees).
Turley and Zaman (2004)	To synthesise and evaluate current research on the governance effects associated with audit committee.	N/A	No association between the formal adoption of audit committee structures or characteristics on the achievement of governance outcomes.
Vera-Munoz (2005)	Examines audit committee effectiveness literature to discuss the new expectations in relation to audit committee responsibilities in the wake of corporate governance reforms.	N/A	As the ultimate monitor of the financial reporting process; the audit committee members must be informed, vigilant, and financially literate or have a general understanding of the firms risk framework.
Xie et al. (2003)	Examines the role of the board, audit committee and executive committee in preventing biased financial reporting (i.e., earnings management)	Agency/ Quantitative	More independent, financially expert and frequently meeting boards and audit committees are less likely to be involved in biased financial reporting.
Zaman et al. (2011)	Examines the possible influence of corporate governance quality, i.e., audit committee effectiveness (independence, expertise, meeting frequency and size) on auditor remuneration.	Agency/ Quantitative	More effective audit committees are associated with higher audit service fees. More independent and expert audit committees are associated with lower non-audit service fees.
(2) Governance Mechanisms			
Anderson et al. (2007)	Examines the perspectives and behaviour of directors and	Stewardship/ Quantitative	The role of the Board is evolving as a strategic partner to

	institutional investors.		management. Directors are seeking a balance between their monitoring and strategic partnering roles. Institutional investors have increased their monitoring role.
Bradbury (1990)	Examines the association between agency characteristics on the voluntary formation of audit committees.	Agency/ Quantitative	Audit committees are not voluntary employed to reduce the incentive problems arising from the separation of ownership and control.
Cohen et al. (2010)	Examines external auditor experiences in their interactions with the audit committee, board and internal auditors to determine whether external auditors experiences with these governance mechanisms are in line with an effective monitoring (agency) or symbolic (institutional) approach in the post Sarbanes-Oxley era.	Agency and Institutional/ Qualitative	In the post Sarbanes-Oxley era auditors experiences pointed to an effective monitoring approach (agency) as opposed to a symbolic approach (institutional) as indicated by Cohen et al. in 2002 (pre Sarbanes-Oxley era).
Dey (2008)	Investigates whether corporate governance mechanisms are a result of firm agency conflicts.	Agency/ Quantitative	Results support the notion that the existence and roles of various governance mechanisms are a function of the degree of the firms' agency conflicts.
Gendro and Bedard (2006)	Examines whether audit committee effectiveness is internally developed and sustained by the people who attend audit committee meetings.	Agency/ Qualitative	Analysis suggests that every attendees sense of effectiveness is dependent on symbolic and reflective acts of the audit committee processes and outcomes.
Kalbers and Fogarty (1993)	Investigates the audit committee effectiveness in terms of the type and extent of	Agency/ Quantitative	Audit committee effectiveness is perceived as a function of the types and extent of its power.

	its power.		<p><u>Power Typology</u></p> <ul style="list-style-type: none"> - Legitimate, significantly related to all effectiveness measures. - Sanctionary, highly related to external auditing effectiveness. - Institutional support, highly related to external auditing effectiveness. - Expert, significantly related to financial reporting effectiveness. - Referent, no significant relationship with any effectiveness measures. - Diligence, strongly related to internal auditing effectiveness.
Kalbers and Fogarty (1998)	Contrast two competing theoretical governance orientations of agency and institutional theory in an attempt to better understand the effectiveness of audit committees.	Agency and Institutional/ Quantitative	<p>Effectiveness is a function of audit committee processes.</p> <p>Results suggest that firms will not naturally invest in a degree of board oversight to protect shareholder interests.</p> <p>Finds significant correlations between agency and institutional theory variables.</p>
McDaniel et al. (2002)	Investigate the difference between judgements made by financial experts and literates in relation to financial reporting quality.	Agency/ Quantitative	<p>Financial literates assess the quality elements for reporting treatments of prominent and non-recurring items comparatively lower than experts.</p> <p>Financial experts assess the quality elements for reporting treatments of less prominent and recurring items comparatively lower than literates.</p>
McMullen (1996)	Examines the association between the formal audit committee presence and the	Agency/ Quantitative	The presence of an audit committee is linked to improved financial reporting quality.

quality of financial reports.			
Menon and Williams (1994)	Looks for evidence that firms actually rely on audit committees, i.e., board reliance on the audit committee as a mechanism to control executive management.	Agency/ Quantitative	Majority of firms voluntarily formed audit committees, however many did not rely on them. Audit committee reliance is related to board composition (the more independent the greater the reliance on the audit committee). Audit committee activity appeared to increase, as the proportion of non-executive directors increased on the board. Audit committee meeting frequency is associated with firm size.
Sarens et al. (2009)	Examine the relationship between the audit committee and the internal audit function.	Agency and Comfort/ Qualitative	Audit committees rely on internal auditors to reduce the information asymmetry (between itself and executive management) in relation to the control environment and internal controls.
Spangler and Braiotta (1990)	Investigate the audit committee effectiveness, in terms of the leadership style of its chair.	Agency/ Quantitative	The leadership style of the audit committee chair was found to influence the effectiveness of the audit committee.
Spira (1998)	Examines the link between audit committee establishment and its effectiveness.	Institutional/ Qualitative	Audit committee effectiveness is linked to its purpose and role, which are influenced by the initial reason for its establishment. However, an audit committee will evolve into an effective monitoring body over its life; its reason for establishment will affect the speed in which the audit committee becomes an

			effective monitoring body.
Turley and Zaman (2007)	Examine the conditions and processes which affect the orientational effectiveness of audit committees.	Institutional/ Qualitative	Audit committee effectiveness is not solely the result of formal structures, characteristics and process but is additionally dependent on informal voluntary interactions and communications. The existence and operation of an audit committee has behavioural effects which influences the importance of the functional activities of the internal audit. The role of the audit committee within the governance mosaic may be regarded as an ally, arbiter and threat.
(3) Non-audit Services, Auditor Independence, Audit Quality and the Integrity of Financial Reports			
Aier et al. (2005)	Investigates the link between accounting restatements and the financial expertise of the chief financial officer (CFO).	Agency/ Quantitative	The greater the expertise and experience of the CFO, the lower the probability of restatements.
Ashbaugh et al. (2003)	Investigates Frankel et al. (2002)'s results which indicated that higher non-audit service fees are associated with biased financial reporting.	Agency/ Quantitative	Finds no evidence to support Frankel et al. (2002)'s finding that external auditors may violate their independence due to the performance of more non-audit services to audit services.
DeAngelo (1981)	Examines the relation between audit firm size and overall audit quality.	Agency/ Quantitative	Ceteris paribus, the larger the size of the audit firm (measured by number of current clients) and the smaller the size of the client as a fraction of the auditors total returns in excess of the short-term opportunity cost, the less incentive the auditor has to behave opportunistically, and the higher the perceived audit quality.

Dechow et al. (1996)	Investigates the potential causes (relation between earnings manipulation and governance structure weakness) and consequences (capital market reactions to alleged earnings manipulation) of earnings manipulation.	Agency/ Quantitative	<p>No evidence to support notion that managers manipulate earnings for self-interest.</p> <p>Poor oversight management (governance structure weakness) are catalyst for earnings manipulation.</p> <p>Motivation for earnings manipulation is linked to the desire for low cost external financing.</p> <p>Manipulating firms are:</p> <ul style="list-style-type: none"> - More likely to have boards dominated by executive management; - Role duality as the CEO and board chair; - Less likely to have outside blockholders.
DeFond and Jiambalvo (1991)	Examines the incidence of accounting errors (i.e., prior-period adjustments).	Agency/ Quantitative	<p>Results consistent with the view that overstatements errors are result of managers responding to economic incentives.</p> <p>Overstating firms are less likely to have audit committees.</p>
DeFond et al. (2002)	Examines the association between non-audit service fees and external auditor independence.	Agency/ Quantitative	<p>No association between non-audit service fees and impaired auditor independence (i.e choice to issue going concern opinion).</p> <p>Suggest that market based institutional incentives, such as reputational loss and litigation costs, promote auditor independence and outweigh the potential economic dependency created by higher non-audit service fees.</p>

Frankel et al. (2002)	Examine whether non-audit service fees are associated with biased financial reporting.	Agency/ Quantitative	Results indicate that external auditors may potentially violate their independence due to the performance of more non-audit services to audit services.
Kinney et al. (2004)	Examine whether non-audit service fees are associated with financial restatements.	Agency/ Quantitative	No association between non-audit service fees for financial information system design and implementation or internal audit services and the occurrence of financial restatements. Find some evidence of an association between unspecified non-audit service fees to total audit fees and financial restatements. Tax service fees were associated with reduced probability of a restatement, which suggests improved audit quality.
Raghunandan et al. (2003)	Examines the association between financial restatements and the magnitude of non-audit service fees to total fees paid to the auditor.	Agency/ Quantitative	Findings are not consistent with concerns that non-audit service fees influence the audit such that financial reports are restated.
Simunic (1984)	Examines the cost efficiency from the joint production between managerial advisory services and the audit service fee.	Agency/ Quantitative	The audit service fee of clients who purchase managerial advisory services is significantly higher than those who did not.
Srinivasan (2005)	Examines the career and litigation consequences of financial restatements (income-decreasing, income-increasing, and technical) for non-executive directors.	Agency/ Quantitative	Income-decreasing and income-increasing restatements, non-executive directors face a high risk for turnover, likelihood for departure is increased for audit committee members (responsibility for overseeing the

			<p>financial reporting process), and are likely to lose positions on other boards.</p> <p>No evidence of plenty for technical restatements.</p> <p>Overall results suggest that non-executive directors, particularly audit committee members bare a reputational plenty for poor board or audit committee oversight.</p>
Stanley and DeZoort (2007)	Examine the relation between the length of the audit firm engagements and financial restatements.	Agency/ Quantitative	<p>Long-term audit firm engagements increased the likelihood of financial restatements.</p> <p>No relation between long-term audit engagements and non-audit services on the likelihood of financial restatements.</p> <p>Short-term audit engagements lower industry specialisation and audit fees increased the likelihood of financial restatements, suggests that lowballing may impair audit quality during initial years of audit engagement.</p> <p>Lack of client specific knowledge (industry specialisation) in short-term audit engagements may impair audit quality.</p>

2.2.3 Audit Committee Characteristics

Based on the literature summary in Sections (1) and (2) of Table 2.2, the effectiveness of audit committees can be regarded as a function of the characteristics of the audit committee and its members and related governance mechanisms. The characteristics of the committee include, for example, the financial literacy of committee members, the proportion of independent directors on

the committee and the frequency of committee meetings. These characteristics and related governance mechanisms can be conceived as producing four types of attributes, namely, coerciveness, independence, competence and diligence (Lary and Taylor 2012). It is these four attributes that can indicate the effectiveness of an audit committee. Each attribute is discussed in turn in the next sub-sections.

2.2.3.1 Coerciveness

The notion of coerciveness is defined as a function of an audit committees' responsibilities (formal and informal), authority and influence (Abbott et al. 2003b; Carcello et al. 2002; and Lary and Taylor 2012). Conger et al. (1998) suggest effective boards and audit committees require the power and authority to act as a governing body in making key recommendations and decisions; and probing executive management in implementing board decisions. Kalbers and Fogarty's (1993) findings suggest the type and extent of audit committee authority is fundamental to its effectiveness. Further, Turley and Zaman's (2007) findings suggest that an audit committee's ability and authority to influence the decisions over its formal responsibilities is critical to its effectiveness, more so than its members independence, competence and diligence. Therefore, the formal adoption and appointment of an audit committee is without significance if it lacks the authority and influence in making key recommendations. A watchdog without teeth is merely a symbolic illusion.

2.2.3.2 Independence

From the governance literature, the notion of director independence can be regarded as a precedent concept in sound corporate governance practice (Lary and Taylor 2012). Non-executive director presence and leadership in monitoring governance mechanisms is considered desirable as it ensures the occurrence of proper management oversight (Davis et al. 1997). Further, Fama (1980) regards non-executive directors as professional referees tasked with the oversight and stimulation of executive management.

Beasley (1996) identifies that as an internal control mechanism, the viability of a board is enhanced with the inclusion of independent non-executive directors. As such directors have incentives to

develop their reputations as experts, and such expert reputation is dependent on their performance as decision managers (Beasley 1996). Moreover, Dhaliwal et al. (2010) suggest that independent directors have less economic incentives to collude with executive management and are more likely to objectively monitor executive management performance. Further, Zaman et al. (2011) conclude that the potential director litigation risk and reputation impairment acts as an incentive for the effective discharge of responsibilities. Therefore, independent board members are considered to benefit from prestige, reputational enhancement, learning opportunities and networking (Fama and Jensen 1983; Sirinivasan 2005). Accordingly, members who perform their duties effectively are likely to be rewarded with additional board appointments, while poor performing members are likely to be penalised with termination (Fama and Jensen 1983; Sirinivasan 2005).

However in relation to the composition of boards, Klien (2002b) identifies that the degree of board independence is a reflection of the trade-off between director independence and expertise, which reflects the balancing of the firm's monitoring needs and its requirement for specialised information. Klien (2002b) views non-executive directors as independent monitors, while executive directors possess specialised expertise in relation to the firm's activities. Such directors have direct information and knowledge about firm operations and investment opportunities, further provide insights in relation to suppliers, customers, financial opportunities and legal issues (Klien 2002b). As such boards composed of both executive and non-executive directors are better positioned to evaluate and ratify a firm's future strategic plans (Klien 2002b).

As the audit committee holds an oversight role its independence is critical for ensuring monitoring quality (Bedard and Gendron 2010). Bradbury (1990) hypothesises that the establishment of audit committees is to: (1) increase the creditability of audited financial statements; (2) enhance auditor independence; and (3) assist directors in meeting their fiduciary duties and responsibilities. This indicates that a corporate board will have the incentive to form an audit committee in order to fulfil these three essential functions articulated by Bradbury (1990). Further, McMullen (1996) suggests

that audit committees composed of non-executive directors are more likely to enhance the effectiveness and independence of auditors. The ASX considers audit committees as efficient monitoring mechanisms *when* primarily composed of non-executive and independent directors (ASX 2010a).

The concept of independence is regarded to improve the monitoring ability of audit committees' because independent directors lack the economic ties to executive management which may interfere with their ability to question and probe executive management (Abbott et al. 2004). Further, directors that are independent of executive management are more likely to demand higher quality audits, display better financial reporting quality, be more interested in reducing the likelihood of fraud and earnings management, and be concerned with threats which are likely to impair auditor independence (Zain et al. 2006; Zaman et al. 2011). Independent audit committee members are considered to demand greater levels of audit assurance, as independent directors are concerned with the enhancement and preservation of their professional reputation and liability minimisation (Abbott et al. 2003a; 2003b). Consequently, independent members are regarded to provide stronger support for auditors during scope negotiations with management (Abbott et al. 2003b).

2.2.3.3 Competence

Conger et al. (1998) contend business environments are so complex and intricate that they can be regarded as labyrinths. Consequently, it is nearly impossible for any one person or small group of individuals to completely comprehend issues that come before a board (Conger et al. 1998). Therefore, to be effective boards require a broad range of information in relation to their firm's operations and its environment (Conger et al. 1998). Presented information should be clear and concise as board time is scarce (Conger et al. 1998). However, board members should be competent to ensure an understanding and comprehension of presented information. Accordingly, competent members are regarded as more able monitors (Abbott et al. 2003b; DeZoort and Salterio 2001; Lary and Taylor 2012; Zaman et al. 2011). Therefore, it is critical to ensure regular assessments of board

expertise and experience, to ensure maintenance in the right mix of expertise and experience, which matches a firm's strategic demands (Conger et al. 1998).

Given the nature of board and audit committee operations and functions, i.e., operating as a group, their effectiveness is often defined as a *collective ability* to fulfil original roles and oversight responsibilities (Conger et al. 1998; DeZoort 1998). In this respect, Lindell (cited in DeZoort 1998) suggested that the competence of audit committees is largely dependent on the competence of its members. In addition, DeZoort and Salterio (2001) find that directors holding prior directorships or industry experience are better equipped to address board and audit committee issues and concerns. Accordingly, a competent audit committee is considered to have a mix of both financial and industry sophistication (DeZoort and Salterio 2001; Lary and Taylor 2012). Such audit committees are considered better equipped and prepared to monitor the integrity of audited financial statements (Lary and Taylor 2012; Vera-Munoz 2005).

Moreover, Kalbers and Fogarty (1993) identify that the effectiveness of audit committees may be improved with the inclusion of members skilled in the function areas of accounting, finance and corporate relations. For effective audit committees, their members need to be able to comprehend the various financial and operational issues confronting the firm's executive management (Abbott et al. 2004). DeZoort et al. (2002) suggest that audit committee members should be financially competent to the extent that the group does not heavily rely on one financial expert, to avoid situations where other members add little value and fail to address issues.

The literature identifies financially competent and knowledgeable audit committees as being better equipped for overseeing and understanding the complexities of the financial reporting process and detect material misstatements (Abbott et al. 2003b; Zaman et al. 2011). Accordingly such members are better able to understand auditing issues, risks, and the audit pressures proposed to address these issues and risks (Abbott et al. 2003b; Zaman et al. 2011). Zain et al. (2006) believe that more financially competent audit committees are able to enhance internal audit structures and processes,

which increases the probability that external auditors will rely on internal auditors and their work. As the external auditor is to assess the risk of a material misstatement in clients' financial statements, this includes a review of the internal control system (Zain et al. 2006). The internal audit function is part of this internal control system; as such external auditors will seek to understand tests of internal controls and substantive testing procedures as part of the audit planning process (Zain et al. 2006).

2.2.3.4 Diligence

Diligence is regarded as an audit committee process factor required for effective operations; it refers to individual member desire to carry out their monitoring roles (Lary and Taylor 2012). Factors include number of meetings and member behaviour; this includes member preparation before meetings, attentiveness and participation during meetings, and post-meeting follow-ups (Carcello et al. 2002; Lary and Taylor 2012). Conger et al. (1998) suggest that directors require sufficient and well organised periods of time together as a group to make effective decisions.

Prior studies have often used audit committee meeting frequency and size as indirect proxy measures for board and audit committee diligence. Such studies find audit committees which are composed of at least three members and which meet frequently are more likely to be effective monitors. Such audit committees are believed to have adequate resources and are continually up to date with current firm issues. Accordingly, the literature identifies frequently meeting audit committees as diligent; that is, frequently meeting audit committees are more likely to be informed and knowledgeable on current auditing issues (Abbott et al. 2003b; Abbott et al. 2004). Therefore, they are better positioned to address such issues in a timely manner, which leads to a reduced incidence of financial statement restatement and a more diligent discharge of their duties (Abbott et al. 2003b; Abbott et al. 2004).

2.2.4 External Auditor Issues, Financial Statement Integrity and Audit Committee Effectiveness

Based on the literature summary in Section (3) of Table 2.2, the effectiveness of an audit committee can also be manifest in the external auditor's extent of non-audit services and independence, as well as the level of integrity of financial statements.

2.2.4.1 Concern over non-audit service fees

Levitt (2000) identifies the complexity of the relationship between the external auditor and auditee, and regards non-audit service fees as intensifying this relationship. This is particularly relevant because approximately 50% of revenue earned by large audit firms is generated by non-audit services (Levitt 2000). Concern regarding the significance of the non-audit service fee was exacerbated by the Enron case, where their auditors reported having received \$25m in audit service fees and \$27m in non-audit service fees (Beattie et al. 2011). Abbott et al. (2003a) found that while non-audit services are likely to have little impact on the auditor's ability to detect material misstatements, such services may create a *perceived* reduction in the auditor's willingness to report a material misstatement. In addition, Raghunandan et al. (2003) found that audit firms have become far too dependent on revenue generated from non-audit service fees and are unwilling to risk such revenues by opposing executive management.

The major concern of the debate on non-audit service fee is over auditor independence. Abbott et al. (2004) believe that the most critical auditor characteristic in reducing financial statement restatement occurrence and severity is independence. DeFond et al. (2002, p.1251) defined auditor independence "as the probability that the auditor will report a discovered breach in the financial reports ... auditor independence is synonymous with auditor objectivity and the ability to withstand client pressure to acquiesce to substandard reporting". The debate over the non-audit service fee recognises that income from non-audit services may strengthen the economic bond between the audit firm and audit client (Ashbaugh et al. 2003; Frankel et al. 2002; Kinney et al. 2004). This economic bond is regarded as threatening to an auditor's independence as it creates fear of revenue

loss (Frankel et al. 2002). This fear in turn increases the audit firms' financial dependence on the audit client, thereby deteriorating the auditors' willingness to oppose executive management pressure and increasing the auditor's incentive to acquiesce to executive management pressure, e.g., pressure to allow earnings manipulation and object to executive management's accounting choices (Ashbaugh et al. 2003; DeFond et al. 2002; Frankel et al. 2002; Kinney et al. 2004). Frankel et al. (2002) and Defond and Jiambalvo (1991) find that the performance of non-audit services potentially impairs auditor's independence; however, Ashbaugh et al.'s (2003) and Raghunandan et al.'s (2003) finding is contra.

Alternatively, Simunic (1984) finds that the audit service fee of firms that purchased non-audit services (i.e., managerial advisory services) is significantly higher than those that did not. This suggests that firms which purchase non-audit services are experiencing unusual problems, which motivates their purchase of non-audit services and the consequential increase in the audit service fee (Simunic 1984). Moreover, non-audit service fees are correspondingly regarded as improving audit quality and reducing the audit service fee through knowledge spillovers; i.e., when an auditor provides both services, the auditor aims to gain insider knowledge (DeFond et al. 2002; Frankel et al. 2002; Kinney et al. 2004).

Therefore, this view identifies market-based incentives as motivating auditors (Raghunandan et al. 2003). Consequently, an auditor has an overarching concern over their professional reputation which acts as an incentive in the maintenance of independence and audit quality (Raghunandan et al. 2003). According to Simunic (1984), the degree of competition among auditing firms is a critical factor in ensuring the efficiency of these market-based incentives. Meanwhile, DeFond et al. (2002) recognise the presence of market-based incentives for auditors to remain independent. However they note that non-audit service fees are a force which may potentially threaten the auditors' independence by increasing the economic bond, i.e., the auditors' financial dependence on the audit client (DeFond et al. 2002).

Turning to the association between external auditors' services on audit committees, Carcello et al.'s (2002) findings suggest that effective boards and audit committees are associated with increased or higher external audit service fees. Alternatively, Abbott et al. (2003b) explain that an auditor may view an effective audit committee as improving the overall control environment, in turn reducing the auditor's control risk and the amount of audit work deemed necessary, i.e., effective audit committees are likely to reduce the external auditor's service fee. Ashbaugh et al. (2003, p. 612) address the overall significance and relevance of the fee ratio by offering the following consideration "two firms in our sample have a fee ratio of 73 percent; one firm reports total fees of \$71,000 and the other firm reports total fees of \$5.7 million. Based on their fee ratios, both firms are considered threats to independence, whereas only the latter is economically significant to the auditor". This view is in line with DeAngelo's (1981) findings which identifies that the lower the economic benefit from non-audit services proportional to the audit firms total economic benefit, the lower the incentive of the auditor to behave opportunistically.

2.2.4.2 Integrity of financial statements

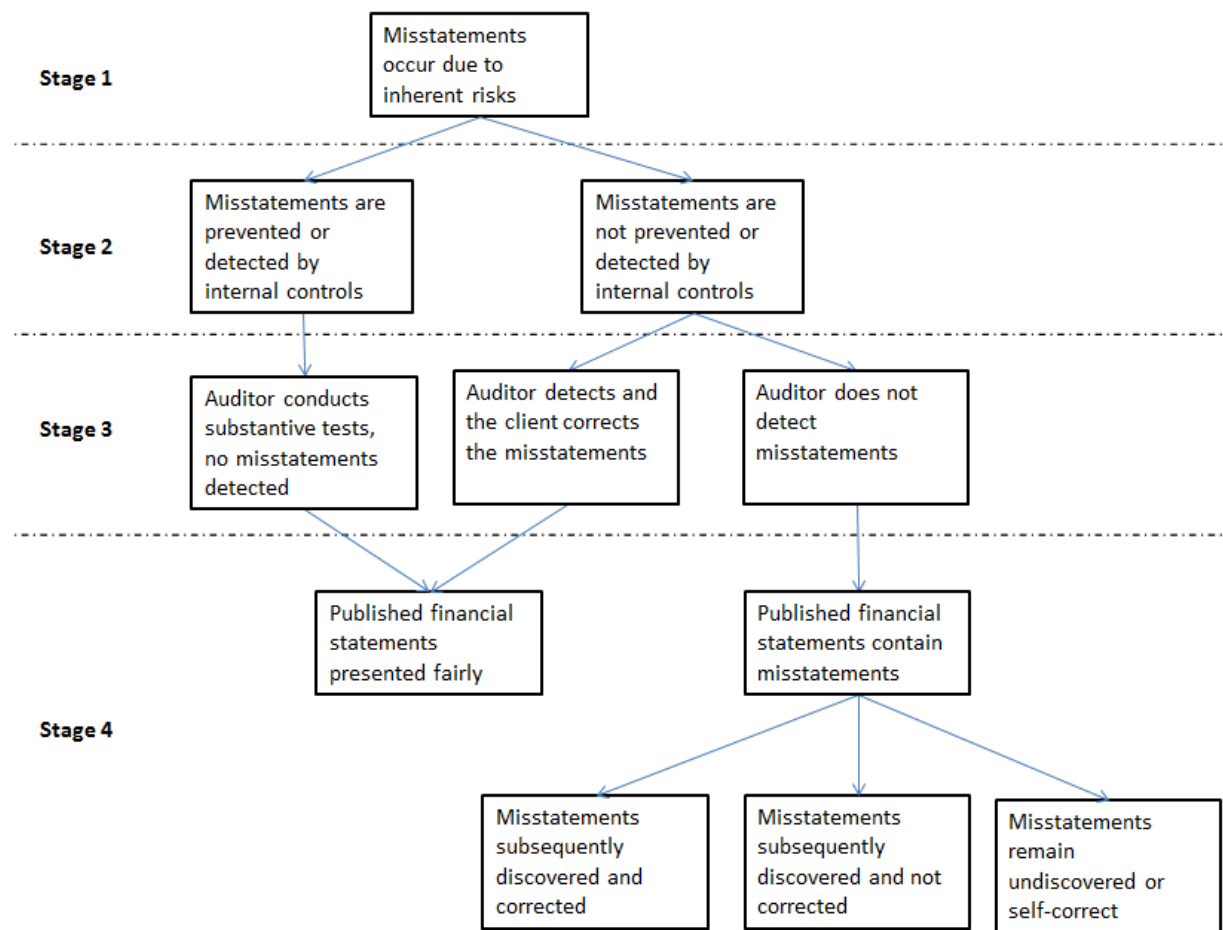
Dechow et al. (1996, p.4) note that initial motivations for fraud, misrepresentation and manipulation of financial reports are "[1] To encourage investors to buy an interest in a company's stock as owners, or in bonds as creditors ... [2] To increase the value of the stock of present shareholders of the company". Accordingly, Stanley and DeZoort (2007) identify financial statement or announcement *restatements* resulting from either error or fraud as *de facto* reporting failures. This is because the originally released financial information is not free from material errors (Stanley and DeZoort 2007). This financial reporting integrity literature does not regard occurrences of restatements as direct manifestations of financial report fraud, misrepresentation or manipulation, but rather as an irregularity occurrence (e.g., Abbott et al. 2004; Aier et al. 2005). Only Farber (2005) and Beasley (1996) have considered malfeasance based on a proxy of fraud disclosures to assess the effectiveness of audit committees to maintain the integrity of financial statements. Moreover, Sirinivasan (2005) believes that the occurrence of a restatement merely implies that an

irregularity occurred and that this irregularity has been detected and corrected. However the integrity of financial statement preparation and assurance processes would have been weakened in the process.

This financial reporting integrity literature typically regards financial restatements as explicit acknowledgments of material omissions or misstatements in previously released financial reports (Abbott et al. 2004). Figure 2.1 (below) identifies and illustrates the typical process of financial report restatement incidence, occurrence and detection (see Eilifsen and Messier 2000 for a review). Accordingly, Abbott et al. (2004) and Eilifsen and Messier (2000) identify four conditions for the occurrence of financial report restatement:

- (1) The occurrence of a material misstatement as a result of some type of inherent risk (e.g., executive management's aggressive accounting practices or accounting standard misapplication);
- (2) The firm's internal controls fail to prevent and detect the material misstatement, due to ineffective or poorly designed internal controls;
- (3) The external auditor fails to detect the misstatement and financial statements are issued;
- (4) The misstatement is subsequently discovered and if deemed material corrected.

Figure 2.1: Process of Financial Report Restatement Incidence, Occurrence and Detection



Source: Eilifsen and Messier 2000, p.4

2.3 CURRENT GOVERNANCE THEORIES

As previously mentioned, corporate governance has been driven by financial scandal and corporate collapses due largely to executive management's self-interested decisions and behaviour (Mallin 2010). Hence, agency theory is considered the fundamental underlying paradigm for corporate governance research and policy-making (Anderson et al. 2007; Cohen et al. 2008). While corporate governance literature has been predominantly driven by agency theory, some researchers have addressed corporate governance through other theoretical lenses. These other recognized corporate governance theoretical paradigms include institutional theory, stewardship theory, stakeholder theory, resource dependence, and managerial hegemony (Cohen et al. 2008; Mallin 2010; Todd 2010). In this thesis, the application of underpinning theory to a case study based investigation of audit committees will be limited in scope to aspects of two theoretical paradigms, known as grand

theories – namely, agency theory and institutional theory. Consequently, the theoretical perspectives of stewardship, stakeholders, resource dependence, and managerial hegemony are briefly reviewed as to their possible use in corporate governance research. They also provide a point of departure from agency and institutional theories. The following sections then go on to review in detail the use of agency theory and institutional theory in corporate governance research.

2.3.1 Stewardship Theory

Stewardship theory is viewed as an alternative paradigm to agency theory. It asserts that the model of man is self-actualising and collective, as opposed to self-serving and individualistic (Anderson et al. 2007; Davis et al. 1997). The behaviour of stewards is regarded as collective, because stewards seek to adhere to and attain the objectives of their principals (Davis et al. 1997).

Stewardship theory identifies executive managers as stewards and not as agents as they are not motivated by individual goals (Davis et al. 1997). Following stewardship theory's behavioural assumption, executive managers would act in the best interests of principals, regardless of whether monitoring and incentive mechanisms are put in place. Executive managers' behaviour is assumed to be self-actualising and collective. Therefore stewards place greater emphasis on the firm rather than self-serving behaviour (Anderson et al. 2007; Davis et al. 1997). In summary the steward's utility functions are maximised by protecting and maximising the principal's wealth (Davis et al. 1997).

The stewardship paradigm "presumes that managers are inherently good stewards of corporations and can be trusted to work diligently at attaining high levels of corporate profit and shareholders' returns ... this presumption leads ... [to the] conclusion that boards ... [and their sub-committees] are redundant" (Todd 2010, p. 59). Alternatively, Anderson et al. (2007) note that following the stewardship paradigm the role of the board and its sub-committees would have to be revised to act in ways which empower executive managers, rather than a means of control through monitoring. The stewardship paradigm while relevant may be more directly suited to contractual relationships in non-commercial contexts, e.g., volunteer workers in charitable organisations. However, stewardship

theory would not be directly suited to addressing the governance phenomenon which has been driven by corporate collapses and financial scandals (i.e., greed and self-serving behaviour), while being motivated by investor desire for increased transparency, accountability and market confidence (Collier and Zaman 2005; Mallin 2010).

2.3.2 Stakeholder Theory

Stakeholder theory maintains that firms are not only accountable to shareholders but rather to the larger community within which the firm operates and interacts (Donaldson and Preston 1995; Riahi-Belkaoui 2003). Traditionally the stakeholder view identifies a firm as accountable to all actors whom have a stake in the firm (Donaldson and Preston 1995). This includes investors, employees, customers, suppliers, lenders, local communities, governments and political groups (Donaldson and Preston 1995; Riahi-Belkaoui 2003). However, the traditional stakeholder view has been criticised as too narrow, since it only includes actors which the firm is dependent upon for its continued survival (Riahi-Belkaoui 2003). Consequently, the modern stakeholder view defines a stakeholder to include any actor or group which can affect the achievement of firm objectives, or is affected by the achievement of firm objectives. Hence, this view accounts for mute (e.g., environment) and absent (e.g., future generations) stakeholders (Mitchell et al. 1997; Riahi-Belkaoui 2003). Stakeholder theory is useful for identifying and determining stakeholder salience, which can aid firms in prioritising and addressing stakeholder demands, needs and concerns (Mitchell et al. 1997).

Adopting the stakeholder paradigm means that the establishment and strengthening of specific governance mechanisms is rationalised as responses to stakeholder concerns. Additionally, it suggests that boards will promote stakeholder interests as opposed to firm objectives. The stakeholder paradigm is useful for identifying firm stakeholders and how firms will address stakeholder concerns. While holding great prospective significance to governance research and policy-making, it creates high complexity and uncertainty in designing corporate governance mechanisms and decision-rules that can align diverse and competing stakeholder interests, some of whom will have no direct voice.

Nevertheless, it is acknowledged that stakeholder theory has been invoked to give deeper insights into governance (e.g., Greenwood 2007; Van Buren and Greenwood 2009). This thesis, however, is primarily focused on the audit committee, where direct demands or pressures from stakeholders such as shareholders or ratepayers and regulators are filtered through the relevant corporate board or local government.

2.3.3 Resource Dependence

Developed in the strategic management literature, the resource dependence paradigm can be viewed as a contrast to the institutional paradigm (Cohen et al. 2008). Where the institutional paradigm assumes that actors are motivated to comply with external pressures, the resource dependence perspective assumes actors are motivated to optimise available economic choices (Oliver 1997). Consequently, resource dependency actors make economically rational choices, as opposed to the normative rational choices of actors under institutional theory (Oliver 1997). Resource dependency theory postulates that resource selection and accumulation is a function of internal firm decision making and external strategic factors (Oliver 1997). Internal firm decision making suggests that actors are guided by economic rationality and are driven by motives of efficiency, effectiveness and profitability (Oliver 1997). In comparison, external strategic factors include buyer and supplier power, competition intensity, and market structure, i.e., industry factors which impact the firm (Oliver 1997).

In terms of corporate governance issues, resource dependence theory focuses on the contribution of governance mechanisms as vehicles which help firms achieve and further their strategic objectives (Cohen et al. 2008). Additionally, it suggests that both shareholders and executive managers may rely on the board as a means to manage and access scarce resources (Cohen et al. 2008). Further, it suggests that the board is also to help set the strategy of the firm (Cohen et al. 2008). Consequently the role of the board is more of a partner to executive management rather than its monitor (Cohen et al. 2008). Cohen et al. (2008) identify that the resource dependence paradigm enhances long-term firm success as board members are focused on firm strategy. The resource dependence

paradigm holds some significance in addressing the governance phenomena, but it potentially fails to address the importance of the board in acting as a monitor of executive managers.

2.3.4 Managerial Hegemony

Managerial hegemony was originally proposed in the management strategy literature (Cohen et al. 2008). Similarly to agency theory it views actors as self-serving, yet simultaneously concerned with firm legitimacy as with institutional theory. However, unlike institutional theory, actors are more likely to conceal legitimising type pressure. It suggests that executive managers will select associates and colleagues who are willing to be passive participants and who will not curtail their actions (Cohen et al. 2008).

Consequently, the board is composed of members who are selected to be ‘yes-men’ to executive managers’ decisions and actions. Therefore the board and its sub-committees are viewed as passive participants in the governance process, and are additionally dependent on executive managers for information and insights about the firm and its industry (Cohen et al. 2008). This paradigm views governance mechanisms as symbolic, i.e., meeting regulatory requirements, rather than of substance, i.e., a tool for executive manager control and oversight (Cohen et al. 2008). Therefore, the managerial hegemony perspective views the board and its sub-committees as being under management control and existing merely to fulfil regulatory requirements (Cohen et al. 2008). While this paradigm reveals alarming concerns regarding the governance phenomenon, it holds more relevance in a US setting due to the duality in the roles of the CEO and board chair.

2.4 THE AGENCY PARADIGM

Jensen and Meckling (1976) propose that the theory of agency is a theory of firm ownership structure, associated with property rights and finance. Additionally, Eisenhardt (1989a) suggests that agency theory is of practical use in understanding contractual relationships and why certain contractual relationships arise. Agency theory’s application to the understanding of contractual relationships has much to do with testing the veracity of the theory’s assumptions. These

assumptions are that (1) actors are self-interested, rationally bounded and risk adverse; (2) firms have conflicting objectives among its actors; and (3) information is a purchased commodity (Eisenhardt 1989a). However, Kalbers and Fogarty (1998) noted that at the broadest level the heart of agency theory is economic self-interest. Accordingly, the agency paradigm views a firm as a nexus of “a set of contracts among factors of production, with each factor motivated by its self-interest” (Fama 1980, p. 289). Moreover, according to Alchian-Demsetz (cited in Fama 1980, p. 291) adopting the agency paradigm suggests that

“The essence of the classical firm is identified ... as a contractual structure with: 1) joint input production; 2) several input owners; 3) the classical firm one party who is common to all the contracts of the joint inputs; 4) who has the right to renegotiate any input's contract independently of contracts with other input owners; 5) who holds the residual claim; and 6) who has the right to sell his central contractual residual status. The central agent is called the firm's owner and the employer”.

Further, Jensen and Meckling (1976) believed that a firm is not an individual but a legal fiction; which serves as a nexus for a set of contracting relationships and a focus for the complex process for the equilibriumisation of conflicting objectives. As such, the agency paradigm defines a firm as a legal entity which serves as a nexus for a complex set of contracts (both written and unwritten), and these contracts determine the rules of the game and its critical dimensions; that is the performance evaluation system, reward system, and assignment of decision rights (Jensen 2001b). Accordingly, Fama (1980) contended that the view of a firm as a nexus for a set of contracts has an ulterior motive. It is to dispel “the tenacious notion that a firm is owned by its security holders [this] is important because it is a first step toward understanding that control over a firm's decisions is not necessarily the province of security holders” (Fama 1980, p. 290). That is, firm owners are principals as they contract individuals (agents), who are to manage their firm on their behalf (Davis et al. 1997).

As such, agency theory is underpinned by the notion that ownership (or risk bearing) and control (or management) are separate factors within the *nexus of contracts* which makes up the firm (Fama 1980). As a result of this separation, an agency relationship is created. Jensen and Meckling (1976, p.308) define this agency relationship as a

“contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent”.

Moreover, parties within this contractual relationship are utility maximisers; accordingly, the interests of agent(s) may diverge from those of the principals, and therefore the agent will not always act in the best interests of the principal (Fama 1980; Jensen and Meckling 1976). Further, Davis et al. (1997, p. 22) state “given the opportunity, agents will rationally maximize their own utility at the expense of their principals”. As such, the contractual relationship between principals and agents is fraught with conflicting interests resulting from the separation of ownership and control (Dey 2008). This conflict produces divergent objectives and information asymmetries (Dey 2008). Information asymmetry refers to the principal’s resource scarcity and/or inability to observe and verify the actions of agents (Eisenhardt 1989a; Kalbers and Fogarty 1998). This creates a power imbalance that can bring about behaviours of adverse selection and moral hazard (Akerlof 1970; Eisenhardt 1989a; Kalbers and Fogarty 1998).

In explaining the separation of ownership and control, the notion of *control* is typically referred to as *management* which is a type of labour with a specialised role of “coordinating the activities of inputs and carrying out the contracts agreed among inputs” (Fama 1980, p. 290). Jensen and Meckling (1976, p. 308) refer to the process of creating *control* as the principals’ engagement of an agent(s) “to perform a service on their behalf which involves delegating some *decision making authority*”. Further, Fama and Jensen (1983, p. 303) identify the exercise of decision making authority as a process or system which involves four steps:

1. *“initiation – generation of proposals for resource utilization and structuring of contracts;*
2. *ratification – choice of the decision initiatives to be implemented;*
3. *implementation – execution of ratified decisions; and*
4. *monitoring – measurement of the performance of decision agents and implementation of rewards”.*

“Because the initiation and implementation of decisions typically are allocated to the same agents, it is convenient to combine these two functions under the term decision management. Likewise, the term decision control includes the ratification and monitoring of decisions. Decision management and decision control are the components of the organization's decision process or decision system” (Fama and Jensen 1983, pp.303-304).

As a result, Fama and Jensen (1983) identify three principle contract mechanisms within the *nexus of contracts*, decision management, decision control, and residual risk bearing. Additionally, Fama and Jensen (1983, p. 305-306) noted that without the “separation of decision management from decision control, residual claimants have little protection against [the potential] opportunistic actions of decision agents”.

Therefore, as a result of the separation of ownership and control, agency theory views control agents as self-interested actors who may engage in opportunistic behaviour, i.e., control agents have the incentive and ability to manipulate firm outcomes to maximise their own utility (Carcello et al. 2002; Cohen et al. 2008; Dey 2008; Jensen and Meckling 1976). Consequently, principals need to establish mechanisms to monitor, control, and limit the potential undesirable actions and behaviours of these self-serving agents, and align agent actions, behaviours, and objectives to the interests of their principals (Dey 2008; Todd 2010). Jensen (2001a, p. 49) noted that the “central

proposition of agency theory is that rational self-interested people *always* have incentives to reduce or control conflicts of interest, so as to reduce the losses these conflicts engender”.

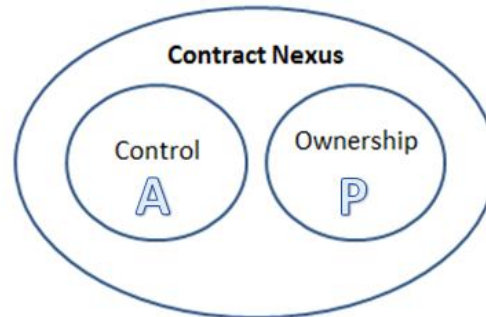
The essence of agency theory is summed up in the concept of the ‘agency problem’. The agency problem is defined by the separation of ownership and control, as control is in the hands of contracted individuals whom act as agents on behalf of the owners (Anderson et al. 2007). It arises due to conflicting interests and information asymmetries (Eisenhardt 1989a). Anderson et al. (2007, p.781) noted that the debate in relation to the agency problem “began in earnest with Berle and Means’ (1932) seminal work on the separation of ownership ... and control”. Furthermore, the essence of the agency problem is that agents will behave in opportunistic ways which serve their own interests at the expense of their principals (Anderson et al. 2007; Eisenhardt 1989a).

Fama and Jensen (1983) suggested that agency problems arise as firm contracts may not be costlessly written and enforced. As such, in controlling the agency problem, principals need to incur interest alignment costs because, given the opportunity, agents will rationally maximise their own utility at the expense of their principals; such costs are referred as agency costs (Cohen et al. 2008; Davis et al. 1997). Costs of agency include the costs of structuring, monitoring and bonding a set of contracts among agents with conflicting interests; it also includes lost output value when the full cost of contract enforcement exceeds its benefits (Fama and Jensen 1983).

The relationship between firm owners (shareholders) and executive managers is regarded as a pure agency relationship, as it is uniquely associated with conflicting interests, i.e., divergent objectives and information asymmetries which arise due to the separation of ownership and control (Davis et al. 1997; Dey 2008). Agency theory depicts shareholders as principals whose interests need protection from executive managers, as these executive managers are self-interested agents who could engage in opportunistic behaviour and whose interests may diverge from their principals; where both executive managers and firm owners are utility maximisers (Cohen et al. 2008; Davis et

al. 1997; Jensen and Meckling 1976). Figure 2.2 (below) depicts this traditional agency governance model.

Figure 2.2: The Traditional Agency Governance Model



Todd (2010) notes that the agency paradigm presumes that executive managers are self-interested agents of firm owners who need to be monitored and controlled in order to limit self-interested behaviour and to align their behaviour with the interests of firm owners. As executive managers are presumed to have conflicting interests, they are regarded as having the incentive and ability to maximise their own utility at the expense of corporate owners (Dey 2008). However, Dey (2008) noted that contracts alone may not always be enough to resolve such conflicting interests. “Consequently, the owners (and in some situations the managers themselves) have reason to establish mechanisms to monitor managerial activities and limit undesirable managerial behaviour” (Dey 2008, p. 1144).

The solution to constraining such opportunistic behaviours is to impose a combination of monitoring and incentives (Anderson et al. 2007). *Monitoring* serves to increase the quality and flow of information to firm owners in relation to the behaviours of management while *incentives* serve to align the interests of agents with those of the firm owners to promote and encourage desired behaviour (Anderson et al. 2007). Therefore, adopting an agency paradigm assumes that the agency separation constitutes the primary motivation for the existence of corporate governance mechanisms (Bedard and Gendron 2010; Bradbury 1990). As such, corporate governance is regarded

as a contractual mechanism, presumed to reduce agency costs resulting from the information asymmetries between principals and agents (Cohen et al. 2008).

“A common contractual means for reducing these agency costs is the provision for an independent party (the board) to monitor the agent (the management) while reporting back to the owner (the stockholders). Hence, the primary attributes for a board member in the agency perspective are independence from management and expertise in monitoring and control” (Cohen et al. 2008, p. 183).

Governance mechanisms and compensation schemes are established to protect the interests of firm owners and to ensure an alignment of agent-principal interests (Davis et al. 1997). Therefore, to enhance the viability of the board as an internal control mechanism, appropriate incentive schemes need to be established to align director interests with those they are meant to represent, i.e., shareholders and other stakeholders (Beasley 1996; Conger et al. 1998). Lary and Taylor (2012) explained that governance mechanisms need to function effectively to limit the potential agency problems arising from the separation of ownership and control.

Following the agency paradigm, the purpose of the board is to constrain opportunistic behaviour and control agents (executive management) by acting as monitors (Anderson et al. 2007). “The board is viewed as a market-induced institution, the ultimate internal monitor of the set of contracts called a firm, whose most important role is to scrutinize the highest decision makers within the firm” (Fama 1980, p. 294). The board (the decision controller) delegates the decision management and many decision control functions to internal agents; however it retains ultimate control over these internal agents (Fama and Jensen 1983). Moreover, Spangler and Braiotta (1990) note that with the increasing complexity and size of firms and the separation of ownership and control, firm owners require assurance with respect to the integrity of the financial reporting process, as well as the internal and external auditing processes. Accordingly, the agency paradigm presumes the role of the board is to monitor executive management, while the audit committee is to reduce agency costs by

monitoring and ensuring financial reporting quality (Dhaliwal et al. 2010). As such, boards and audit committees act as important signalling mechanisms to stakeholders (in particular current or potential stockholders) by conferring *control* transparency and competency (Cohen et al. 2008).

Further, adopting the agency paradigm the role of the auditor is one of assurance, which is to provide assurance that management reports and the financial statements conform to the contractual relationship between firm owners and control agents (Eilifsen and Messier 2000). Moreover, this role of the auditor extends to giving assurance that financial statements are free from material misstatements (Eilifsen and Messier 2000).

The agency paradigm views the audit committee as a mechanism which strengthens information quality by monitoring executive managers and auditors (Bedard and Gendron 2010; McMullen 1996). An audit committee attempts to protect the principal's interests by monitoring the actions of agents, in relation to financial reporting, risk management and internal control (McMullen 1996). That is the audit committee is expected to reduce information asymmetries between principals and agents, and executive and non-executive board members (McMullen 1996; Sarens et al. 2009). Sarens et al. (2009) note the inherent existence of an informational asymmetry between the audit committee and executive management in relation to the risk framework and internal controls; they identify the internal audit function as a key mechanism for reducing this informational asymmetry. Therefore, adopting an agency paradigm, principals' have clear reason to establish such mechanisms to monitor agent activities and limit their potential undesirable behaviours (Dey 2008). However, since principal-agent contracts do not always resolve conflicting interests and informational asymmetries, corporate governance mechanisms may *evolve* to help mitigate the informational asymmetry and conflicting interests (Dey 2008).

Nevertheless, agency theory has been criticised for its generalisation that human behaviour is at all times self-interested as historically humans have displayed signs of altruistic behaviour. However, Jensen (2001a) argues that there is no inconsistency between self-interested and altruistic

behaviour, i.e., the notion of altruistic behaviour does not imply a perfect agent. Jensen (2001a, p. 42) defines a perfect agent as a person “who makes decisions with no concern for his or her own preferences”. However, he also argues that the “willingness to sacrifice some of one’s own time, energy, and resources for the benefit of others by no means indicates that a person is a perfect agent” (Jensen 2001a, p. 42). Jensen (2001a, p. 43) stated that

“Mother Teresa was not a perfect agent because she would have been willing to devote her time and energy to arbitrarily chosen ends of an employer. Her preferences evidenced a strong desire to help the poor of Calcutta over all sorts of alternatives, and to that extent she was self-interested although altruistic”.

While Kalbers and Forgarty (1998) state that *economic self-interest* is placed in the centre of the theoretical explanation of agency theory, Jensen (2001a) alternatively argues that *self-interested behaviour* (i.e., personal preferences) is placed in the centre of the theoretical explanation of agency theory. He, therefore, contends that the nature of human behaviour is defined as dualistic (i.e., both rational and irrational) and coexisting in inherent contradiction (Jensen 2001a). This contradiction is not an aberration from normality but rather an integral part of normality (Jensen 2001a). The use of incentives addresses self-control problems, i.e., resist self-destructive impulses or irrational behaviour (Jensen 2001a). Consequently, the agency model inherently remains opportunistic, regardless of the fact that the interest divergence between principal and agent may differ to varying degrees (Davis et al. 1997). Therefore the viewpoint stands that governance mechanisms are to be regarded as tools of control.

2.5 THE INSTITUTIONAL PARADIGM

Institutional theory provides a basis for understanding the process of how certain structures develop and change (Dillard et al. 2004). According to Cohen et al. (2008) institutional theory considers a comprehensive set of firm dynamics, this includes the institutional environment and the ceremonial structures that actors within this dynamic display. Additionally Dillard et al. (2004) identify the

primary concern of institutional theory as a firm's interaction within its institutional environment, and the effects of social expectations on the firm, including the incorporation of these expectations as reflected in firm practices and structures.

Institutional theory identifies the existence of a firm in a superordinate social system, which utilises resources that may otherwise be allocated, where firm survival is dependent on the legitimate utilisation of these resources (Dowling and Pfeffer 1975). Oliver (1997, p.699) notes that from an institutional paradigm "firms operate within a social framework of norms, values, and taken-for-granted assumptions about what constitutes appropriate or acceptable economic behaviour". Moreover, Scott (1987) argues that such a paradigm suggests that a firm's structure is an adaptive vehicle which is shaped in reaction to internal and external factors – namely, the characteristics and commitments of participants, and the influences and constraints from the external environment.

The notion of institutionalisation underpins institutional theory; institutionalisation is viewed as a social process by which a shared definition of a social reality (i.e., legitimacy) comes to be accepted by the actors within an institutional environment (Scott 1987). Accordingly, legitimacy is considered an outcome of the institutionalisation process which is enacted by focal institutional actors and the relevant norms and values of other institutional actors (Dowling and Pfeffer 1975). This makes the notion of *legitimacy* at heart of institutional theory. Firms will actively engage in convergence so their practices and processes align to the prevailing definitions of institutional legitimacy, set by the superordinate social system, in an attempt to enhance or protect their legitimacy by conforming to the expectations of institutional actors (Berrone and Gomez-Mejia 2009; Dowling and Pfeffer 1975). Additionally, firm activities are motivated by an imperative of legitimacy-seeking behaviour, such behaviour is influenced by institutionally constructed norms (Dillard et al. 2004). Firm survival is dependent on firm interaction within its institutional environment as perceived as acceptable by the various constituents of that environment (Dillard et al. 2004). Consequently, the notion of legitimacy

may be viewed as a resource which can enhance firm survival, although survival is loosely dependent on legitimacy (Dowling and Pfeffer 1975; Zucker 1987).

Legitimate processes, practices, structures and actions are defined within the firm's institutional environment (Berrone and Gomez-Mejia 2009). This institutional environment transcends the industry in which firms directly compete (Berrone and Gomez-Mejia 2009). It is an environment that establishes the idiosyncratic rules, belief systems, and practices deemed to be legitimate (Berrone and Gomez-Mejia 2009). As such, firms are legitimate to the extent their activities and resource utilisations are congruent with the goals of the superordinate social system (Dowling and Pfeffer 1975). Specifically, firms can gain legitimacy: (1) by adapting or adopting structures, practices and processes which conform to the prevailing definitions of legitimacy, (2) though communication, alter the definition of legitimacy so it conforms with the organisations, and (3) though communication, adopt symbols, values, or institutions with a strong sense of legitimacy (Dowling and Pfeffer 1975). Additionally, Dowling and Pfeffer (1975, p. 133) state

“While legitimacy is a constraint on all organizations, it is likely that it affects some organizations more than others. This is because (1) some organizations are considerably more visible, and (2) some organizations depend relatively more heavily on social and political support”.

Importantly, DiMaggio and Powell (1983) identify change innovations (e.g., new firm structures, practices or processes) as being commonly driven by the desire to improve firm performance. But they argue that these same change innovations may, alternatively, be adopted due to legitimacy rather than performance improvement reasons (DiMaggio and Powell 1983). Oliver (1997) points out that the institutional paradigm assumes actors within an institutional environment are motivated by peer pressure compliance (institutional environment pressure). However, institutional players remain motivated to comply with institutional pressures, to ensure the legitimate utilisation of stakeholder resources (Dowling and Pfeffer 1975; Oliver 1997). Because firms which can

legitimately utilise stakeholder resources are rewarded with increased support, resources and survival prospects (Dowling and Pfeffer 1975; Oliver 1997). Moreover, Dowling and Pfeffer (1975) suggest that by focusing on the legitimacy problem, firm legitimisation activities (firm behaviour and responses) may be examined.

Therefore, adopting an institutional paradigm assumes that firms are influenced by institutional pressures which arise from a combination of internal sources, i.e., the firm is an institution, and external sources, i.e., the institutional environment (Zucker 1987). The passive acquiesce to institutional pressure as a sociological norm is generally formed by an external institutional actor (i.e., firm) that is hierarchically superior (Zucker 1987). Consequently, firm choice is “limited by a variety of external pressures ... environments are collective and interconnected ... [and firms] must be responsive to external demands and expectations in order to survive” (Oliver 1991). However, while the institutional paradigm assumes acquiesce and conformity to institutional pressure, Oliver (1991) identifies the typical response strategies firms may adopt in relation to such pressure. These are acquiesce (i.e., comply with pressures); negotiate (i.e., attempt to balance with external constituents); avoid (i.e., concealing non-conformity); defy (as firm values dramatically divergent from institutional values); or control and manipulate (i.e., attempt to co-opt, influence or control institutional pressures) (Oliver 1991).

The basic thesis of the institutional paradigm is that firms will adapt and conform to the institutional forces of predominant institutional norms and traditions (Dowling and Pfeffer 1975; Oliver 1997). Since this conformity causes change in firms and overtime, there will be an increasing convergence in firm structures, activities, practices, processes, and values, i.e., institutional homogeneity (Dowling and Pfeffer 1975; Oliver 1997; Zucker 1987). However this institutional homogeneity is considered costly, problematic and complex for firms (Dowling and Pfeffer 1975). Even as firms conform and adapt, social values and beliefs are constantly changing, i.e., definitions of legitimacy change (Dowling and Pfeffer 1975). Nonetheless firms must take steps to ensure their continued legitimacy

as the adoption of legitimated elements increases the possibility of firm survival (Dowling and Pfeffer 1975; Zucker 1987). Conformity to institutional homogeneity pressure increases firm support, in terms of the flow of societal resources and enhances long-term survival prospects (Oliver 1997; Zucker 1987). According to DiMaggio and Powell (1983), while homogeneous change by firms is likely to be driven by competition or a need for efficiency, it alternatively may be a result of some other factor or process which is forcing firms to be more homogeneous without necessarily improving structural or operational efficiency. Additionally, Scott (1987) suggests that firm tendency toward conformity and homogeneity is not because it constitutes institutional or social reality, but rather because firms are rewarded with increased legitimacy, resources, and survival capabilities.

Isomorphism and decoupling are considered the prevailing responses to these institutional pressures. Institutional isomorphism reflects the notion that institutions (or firms) adopt policies, practices, and structures similar to those around them (Cohen et al. 2008). However, decoupling is based on the notion that institutions are loosely coupled and are simultaneously open and closed to external pressure (Orton and weick 1990; Weick 1976).

Isomorphism is a response to the formal internal and external pressures, exerted on firms by stakeholders which the firm is dependent upon, and by the cultural expectations of the superordinate social system (DiMaggio and Powell 1983). Isomorphism is a concept that best captures the homogenization process (DiMaggio and Powell 1983). "Isomorphism is a constraining process that forces one unit in a population to resemble other units that face the same set of environmental conditions" (DiMaggio and Powell 1983, p. 149). Isomorphism is defined as pressure mechanisms which force firms towards institutional convergence (Cohen et al. 2010). Further, isomorphic pressures arise through three institutional mechanisms; coercive isomorphism, normative isomorphism, and mimetic isomorphism (Cohen et al. 2008; DiMaggio and Powell 1983).

Coercive isomorphism is the result of regulatory or political pressures (Cohen et al. 2008; DiMaggio and Powell 1983). Normative isomorphism suggests convergence through professionally accepted

policies, practices, and structures (Cohen et al. 2008; DiMaggio and Powell 1983). Mimetic isomorphism is the standard response to significant environmental uncertainty, a process where an organisation will mimic organisations pioneering the current expectations of social legitimacy (Cohen et al. 2008; DiMaggio and Powell 1983).

Loose coupling is a concept which considers a firm as operating in a system which is closed from external pressures yet simultaneously open to external pressures (Orton and weick 1990; Weick 1976). Such firms respond to institutional pressure to protect their technical activities by decoupling sociological norms into their structure and activities (Zucker 1987). Moreover, decoupling refers to a situation where the formal structure or practice of the firm is separate and distinct from actual firm practice; i.e., firm practice is not integrated into firm processes (Dillard et al. 2004; Meyer and Rowan 1977). The formal structure acts as a means of presentation rather than an actual operational reflection (Dillard et al. 2004; Meyer and Rowan 1977). Therefore, firms operate in a loosely coupled superordinate social system which is open yet simultaneously closed to external pressures. Therefore, loose coupling addresses the firms' response to institutional pressures of the superordinate social system.

Consequently, this concern over legitimacy forces firms to adopt managerial structures and practices which are expected to have social value (Berrone and Gomez-Mejia 2009). Dillard et al. (2004) importantly addresses the relevance of social culture on accounting practice, particularly the use of accounting practices which enhance or maintain legitimacy. By adopting formal structures which adhere to institutional prescriptions (i.e., environmental norms and behaviour expectations), firms demonstrate and reflect an alignment of corporate and societal values (Berrone and Gomez-Mejia 2009; Dillard et al. 2004; Meyer & Rowan 1977). Accordingly, they are able to protect themselves from having their conduct questioned (Dillard et al. 2004; Meyer & Rowan 1977).

Applying an institutional lens to the governance phenomena allows for the behavioural observation of boards and their sub-committees (Cohen et al. 2008). In periods of ambiguous and uncertain

environments, the board and its sub-committees may emphasise ceremonial and symbolic roles (Cohen et al. 2008). For example, a ceremonial role of an audit committee is the formal engagement and termination of the external auditor (Cohen et al. 2008). As such, institutional theory “suggests that it is necessary to understand the substance of the interactions between different governance parties and how these parties use at times symbolic gestures and activities to maintain their form to all relevant parties” and it “considers a comprehensive set of organizational dynamics including the institutional environments and the ceremonial structures that actors within this dynamic display” (Cohen et al. 2008, p. 181; p.186). In essence, the institutional lens emphasises the notion that governance mechanisms fulfil ceremonial and symbolic roles which help legitimise the interactions between the various actors within the governance mosaic (Cohen et al. 2008).

Kalbers and Fogarty (1998) believe that institutional theory suggests that firm structures within an institutional environment become symbolic displays for conformity and accountability. Consequently, Berrone and Gomez-Mejia (2009) argue that the forming of board sub-committees may be a mere response to institutional pressure following the high profile corporate case failures and collapses. Similarly, Turley and Zaman (2004) contend that the adoption of audit committees may be primarily symbolic, and their associated benefits may be more rhetorical than substantive. Further, Kalbers and Fogarty (1998) findings suggest that changes in firms’ corporate governance structures are symbolic displays. Nonetheless, from an institutional perspective boards and audit committees fulfil an important signalling mechanism to stakeholders (in particular current or potential stockholders) by conferring and conforming to the social perceptions of transparency and competency (Cohen et al. 2008).

2.6 THE GOVERNANCE DILEMMA: AGENCY THEORY, INSTITUTIONAL THEORY, AND CORPORATE GOVERNANCE

As stated earlier corporate governance is a process set which forms part of the investor assurance process, i.e., that firms will be well managed and continue to be profitable (Bhagat et al. 2010; Dechow et al. 1996; Dowling and Pfeffer 1975; Mallin 2010). This investor assurance process is

critical for firms as they eventually grow beyond the financial means of a single owner, and need to attract funding from investors to expand and grow (Davis et al. 1997; Dowling and Pfeffer 1975; Mallin 2010). Further, it serves to improve the credibility of financial reports, safeguard against earnings manipulation, and ensure a fair return on investor investment (Bhagat et al. 2010, Dechow et al. 1996).

Under accepted corporate governance policies and practices, the board is viewed as a governance mechanism with diverse duties and responsibilities, which include overseeing a firm's strategic decisions, financial reporting processes and procedures, internal controls, risk framework, audit practices, executive oversight and compensation, promotion and protection of shareholder interests, and stakeholder protection (Andres et al. 2010; DeZoort et al. 2002; Fama and Jensen 1983; Rezaee 2010). Consequently, the board is regarded as the most important decision making body in modern firms (Ferreira 2010). However, boards typically delegate some of these duties and responsibilities to internal agents by forming board sub-committees (DeZoort et al. 2002; Rezaee 2010; Vera-Munoz 2005). But the board retains the ultimate accountability over all delegated duties and responsibilities (Rezaee 2010). The authority delegated to the audit committee by the board, together with the requirement for the audit committee to comprise a majority of independent directors, will allow the audit committee to credibly take discretionary actions to fulfil its roles. Importantly, the audit committee is viewed as a board sub-committee distinctly responsible for monitoring external auditors, internal controls and vetting of published financial reports. Audit committees have faced an expanding monitoring role since the early-2000s, so a main issue for the audit committee is to adapt to change (Sarens et al. 2009; Turley and Zaman 2007).

The formal structure of a firm is the blueprint for its activities and links its goals and policies (Meyer and Rowan 1977). As part of the firm's formal structure, the structuring of the monitoring functions and responsibilities of the board and its sub-committees is central in ensuring proper accountability, probity and openness in the conduct of a firm's business (Lary and Taylor 2012). Bradbury (1990)

argues that the control of a firm is delegated to the board by residual claimants; however these claimants, though vote, retain approval rights on board membership, mergers and the issuing of new stock. The board (the decision controller) then delegates the decision management and many decision control functions to internal agents (Fama and Jensen 1983). However it retains ultimate control over these internal agents, including the right to ratify and monitor policies, and to appoint, terminate and set compensation of decision agents (Fama and Jensen 1983). However, only the relationship between firm owners and decision managers is regarded as a pure agency relationship, as it is uniquely regarded as being associated with the separation of ownership and control (Davis et al. 1997). Consequently, due to this separation of ownership and control, decision managers potentially have incentives to misreport financial reports for self-interested opportunistic purposes (Carcello et al. 2002).

A review of previous governance literature suggests that traditional agency assumptions provide an adequate basis for the explanation of the formation of governance mechanisms (Kalbers and Fogarty 1998). Agency theory identifies the role and purpose of the board as the ultimate monitor of management and assurer that managers will maximise shareholder value; and audit committees are established to reduce agency costs by monitoring financial report quality (Dhaliwal et al. 2010; Anderson et al. 2007; Eisenhardt 1989a).

However, Kalbers and Fogarty (1998) suggest that in situations where information is difficult to verify (e.g., by an audit committee), agents (e.g., management) may mimic quality messages. An example could be that when shareholders have difficulty verifying information about the quality of management performance, management may provide selected information that not only serves their own interests but also is perceived as conforming to the institutional environment's expectations. This latter point about an agent's opportunistic behaviour being moderated by a need to use information asymmetry in a way that is perceived to be legitimate by conforming to the institutional environment's expectations; this provides a bridge from the agency paradigm into the

institutional paradigm. Institutional theory potentially provides useful insights into a firm's political struggle of power and survival (Cohen et al. 2008; DiMaggio and Powell 1983). It potentially provides a means for evaluating prior agency theory-based research (Cohen et al. 2008). Institutional theory offers a sociological approach for understanding corporate governance (Kalbers and Fogarty 1998).

Parkinson (cited in Brennan and Solomon 2008) states that corporate governance is "the process of supervision and control ... intended to ensure that the company's management acts in accordance with the interests of shareholders". Therefore, agency theory is considered the mainstream paradigm for governance, as it provides a rational economic explanation for the existence and form of control mechanisms (Kalbers and Fogarty 1998). Consequently, traditional agency literature has focused on providing evidence on relationships between the strength of governance mechanisms' characteristics and financial reporting quality. However this literature yields inconclusive findings (Cohen et al. 2008). The traditional hierarchical governance model conceives sets of contractual relationships based on economic considerations. It depicts executive managers interacting with auditors, who interact with the audit committee, who interact with the board (Beattie et al. 2011). However, recent governance models show governance actors interacting in a more dynamic and interdependent way (Beattie et al. 2011).

The traditional agency paradigm views the existence of the board and its sub-committees to be a direct result of the separation of firm ownership and control on the grounds that firm owners need to be protected from the opportunistic self-interested behaviour of corporate agents (Jensen and Meckling 1976; Jensen 2001a). This basic agency view extends to defining a firm as a contract labyrinth of conflicting interests, while firm behaviour is defined by the resulting equilibriumisation of conflicting interests (Jensen 2001a). This suggests that the establishment of boards and audit committees is a response to the firms' need for equilibriumisation of conflicting interests. Accordingly, boards and audit committees that comply with best practice governance

recommendations will reduce informational asymmetries by monitoring control agents. Boards and audit committees are intended to act as signalling mechanisms to firm owners by conferring control transparency and competency (Cohen et al. 2008). Klien (2002b) contends that the monitoring role of audit committees is becoming more essential as stakeholders demand for scrutiny in the accounting processes of firms.

However, the achieving of equilibriumisation of conflicting interests through efficient contracts may not be enough. Davis et al. (1997, p. 27) identify that “humans need to grow beyond their current state and reach higher levels of achievement ... the assumptions of the economic view of man limit[s] people from attaining their full potential”. Further, Dey (2008) suggests that because principal-agent contracts (i.e., governance mechanisms) may not have an effect on conflicting interests and informational asymmetries alone, governance mechanisms may evolve beyond basic agency theory purposes. Anderson et al. (2007) find that the role of boards has been evolving towards more of a partner to management, and departing from the monitoring role under the agency concept.

These concerns about the limited scope of agency theory give rise to the need for some alternative supplementary theoretical perspective. Institutional theory views a firm as a closed system yet simultaneously open to external pressure as a legitimacy seeking institution. From this perspective, firm behaviour is defined by the superordinate social system within which the firm operates. The adoption of legitimated elements and conformity to prevailing rules increases the firm’s ability to justify and defend its actions and decisions (Ocasio 1999; Zucker 1987). This increases the possibility of firm survival (Ocasio 1999; Zucker 1987). Therefore the formation of boards and audit committees may be considered a response to internal and external institutional pressure. The institutional theory argument would be that boards and audit committees that comply with best practice governance recommendations are actively responding to isomorphic pressures and actively engaging in legitimacy seeking behaviour. The perspective is that the adoption of legitimated elements and

conformity to prevailing rules increases the firm's ability to justify and defend its actions and decisions, which increases the possibility of firm survival (Ocasio 1999; Zucker 1987).

Under an institutional worldview, boards and audit committees will act to conform, therefore over time these mechanisms will adopt similar structures, roles and responsibilities to conform to other institutions and their mechanisms within their institutional environment (Cohen et al. 2008). Scott (1987) importantly contends that a firm's tendency toward conformity may not be because it constitutes cultural social reality, but rather because firms may be rewarded with increased legitimacy, resources, and survival capabilities. Additionally, Ocasio (1999) holds that prevailing best practices and processes help directors justify and defend their actions and decisions.

Institutional theory goes a step further into ceremonial and symbolic roles played out by members within an institutional group. Cohen et al. (2008, p. 187) states that the institutional paradigm "emphasizes how governance mechanisms fulfill ritualistic roles that help legitimize the interactions among the various actors within the corporate governance mosaic". Cohen et al. (2008) goes on to argue that in periods of ambiguous and uncertain environments boards and their committees may emphasize ceremonial and symbolic agency roles. Institutional theory provides a means of exploring such phenomena which, in this thesis, will be undertaken in relation to audit committees.

Returning to the agency roles of audit committees, Abbott and Parker (2000) emphasise the importance of an audit committee to the monitoring of financial reporting quality. Likewise, Bradbury (1990) points out that audit committees are established to increase quality and credibility of financial statements, assist directors in meeting their duties and responsibilities, and enhance audit independence. These primary functions, according to Bradbury (1990), provide the underlying basis and incentive for their formation. Again, McMullen (1996) views the role of audit committees as improving financial reporting integrity and credibility, through their monitoring of: (1) the whole financial reporting process, which includes internal controls and use of accounting principles and (2) the full audit process, i.e., both the internal and external audit functions. Hence, researchers like

Bradbury (1990), McMullen (1996) and Abbott and Parker (2000) invoke an agency theory perspective in identifying the fundamental role of an audit committee as overseeing the financial reporting process, i.e., monitoring financial reporting quality, and serving as a vehicle for the maintenance of auditor independence. The empirical evidence on whether audit committees are driven by agency considerations in shaping and fulfilling their roles, however, is mixed. For example, Dey (2008) provides findings in support of this notion. Dey (2008, p. 1143) concludes that “the existence and role of various governance mechanisms in a firm are a function of the level of agency conflicts in the firm”. However, Bradbury’s (1990) findings are contrary. And reaches the conclusion that audit committees are not employed to improve the quality of external financial reports nor reduce the agency cost arising from the separation of ownership and control (Bradbury 1990).

Further, Cohen et al. (2010, p. 777) “Prior literature suggests that audit committees play a more passive, ceremonial role that is consistent with institutional theory, rather than the monitoring-focused role implicit in agency theory”. Additionally, Cohen et al. (2008) identified that auditors take a broader governance view which includes executive managers as part of the governance mosaic; i.e., acknowledging the role of executive managers in influencing the effectiveness of governance structures. Such a notion is inconsistent with the agency perspective as governance actors are to monitor it suggests that the decision management function is an important actor within the governance mosaic (Cohen et al. 2008). Moreover, Turley and Zaman (2007) find governance outcomes are significantly influenced by informal processes and power relationships.

This leads into literature that seeks to address the interface between the agency and institutional paradigms in corporate governance research. Studies which take an agency perspective assume that boards and audit committees that comply with best practice governance recommendations are more likely to be effective monitors of executive managers (Cohen et al. 2008). For example, DeZoort (1998) defines an effective audit committee as one which can collectively fulfil its fundamental agency roles. On the other hand, an institutional paradigm assumes that boards and

audit committees that comply with best practice governance recommendations are more actively responding to isomorphic pressures and are engaging in legitimacy seeking behaviour. This institutional perspective focuses attention on the influence of external pressures. However, Kalbers and Fogarty (1998) argue that effective governance is embedded within firm culture, not enforced by external mandate or fiat. They contend that effective governance is more attributable to firm internal logic rather than external structure (Kalbers and Fogarty 1998).

Nevertheless, there is a clear fundamental difference in the way governance structures and behaviours are perceived to be affected under the agency versus the institutional paradigm. The agency perspective suggests that governance innovations are driven by agency conflicts within firms, whereas the institutional perspective suggests that social legitimacy would drive such innovations (DiMaggio and Powell 1983; Dey 2008). For example, agency conflicts due to management acting in self-interest has led to high profile corporate collapses (e.g., Enron) which have resulted in major corporate governance innovative reforms. Empirical studies on corporate governance phenomena which separately adopt either an agency paradigm or institutional paradigm have presented inconsistent and at times contrary findings. Interestingly, Kalbers and Fogarty (1998) find correlations between the agency and institutional variables when used in models to explain the governance phenomena. The implication, they suggest, is that combining both the agency and institutional perspectives to better explain the governance phenomena (Kalbers and Fogarty 1998). Further, Young and Thyil (2008, p. 94) note the need for “new theoretical perspectives and new models of governance”. Extending on this preliminary research by Kalbers and Fogarty (1998), this thesis takes a similar pluralistic theoretical perspective (agency and institutional) in understanding and interpreting the policies, processes and practices of audit committees. As discussed in the next section, the agency paradigm arising from the separation of ownership and control will be interfaced with prevailing pressures for institutional legitimacy in explaining the structures, policies, activities and interconnections of audit committees.

2.7 THE GOVERNANCE MODEL

The premise of this thesis is that an audit committee functions within the context of a firm which is viewed as a nexus of contracts within a superordinate social system. Smith and Watts's (cited in Deegan 2007, p. 227) define the contract nexus

“as a set of contracts among various parties who have a claim to a common output ... parties include stockholders, bondholders, managers, employees, suppliers and customers ... [the firm is considered to have] an indefinite life ... [and this] set of contracts ... evolves over time”.

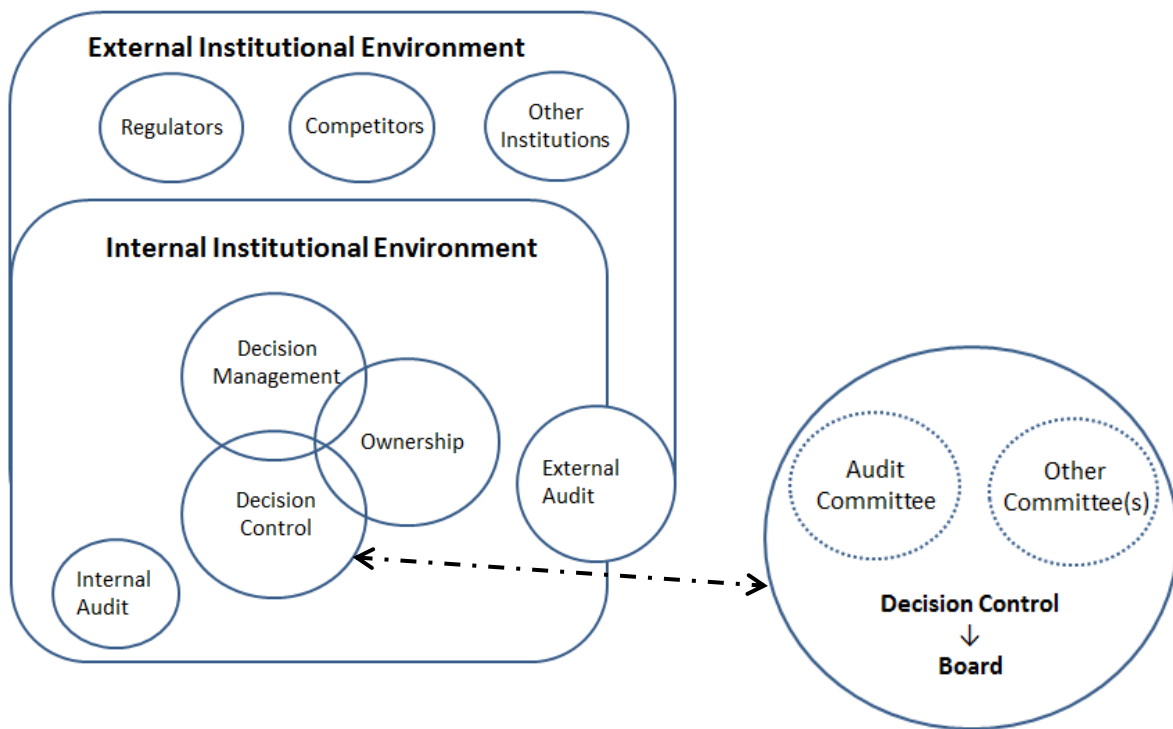
As mentioned above, traditional governance models show governance actors interacting in a bureaucratic way, where executive managers interact with auditors, who interact with the audit committee, who interact with the board; however more recent governance models show governance actors interacting in a more dynamic and inter-dependent way (Beattie et al. 2011). This thesis seeks to embrace the model of governance actors interacting within and beyond the audit committee in an inter-dependent way. In doing so, this thesis will view the ‘corporate governance process set’ from an institutional perspective in which audit committee members and other governance actors interact in a dynamic rather than a linear bureaucratic way. But the audit committee’s ‘governance process set’ is set up within a framework that expects adherence to structures and processes put in place on the rationale of agency theory. These agency-based governance structures and processes emphasise the need for the independence of actors undertaking the assurance and monitoring processes, not the inter-dependency among governance players.

By taking an institutional theory perspective, this thesis aims to investigate the social structures and behaviours of governance mechanisms and actors as part of a holistic corporate eco-system. Specifically, it investigates the internal and external institutional impacts on the audit committee’s operating mode and role fulfilment (Berrone and Gomez-Mejia 2009). As explained by Dowling and

Pfeffer (1975, p.123), an institution exists within a *superordinate social system* and its activities are “legitimate to the extent that ... [they] are congruent with the goals of the superordinate system”. As such, the audit committee is viewed as ‘an institution’ which exists within an open interacting corporate eco-system with various influences and power relations among internal (e.g., the board and executive management) and external (e.g., the external auditor and Australian Securities and Investments Commission (ASIC)) actors or ‘institutions’ (Moore 1993; Pettigrew 1992; Roberts et al. 2005). This thesis will view a firm as a contractual institution (nexus of contracts) with self-interested factors, within a superordinate social system, i.e., corporate eco-system (Fama 1980; Fama and Jensen 1983; Dowling and Pfeffer 1975; Moore 1993).

Figure 2.3 (below) presents the conceptual model developed as a framework to address the objectives of this thesis and provide a guide for their investigation. While the model in Figure 2.3 depicts two broad institutional environments – internal and external to a firm, it also depicts the principal-agent (ownership-control) actors or relationship that exists within a firm. Accordingly, the thesis identifies the principal-agency separation as the driving force behind the governance phenomena. However its form, integration and evolution into a firm as a contractual institution within the corporate eco-system are more likely to be driven by the notion of legitimacy. By incorporating elements from both the agency and institutional paradigms, Figure 2.3 allows the audit committee’s structure, policies, processes, activities and behaviours of its members to be examined and explained by zooming in or zooming out using either an agency or institutional paradigm or both.

Figure 2.3: The Expanded Governance Model



In Figure 2.3, the firm's formal governance model for this thesis adopts an agency rationale, and it therefore remains inherently opportunistic. The expanded governance model, however, identifies that human behaviour is dualistic, with both economic and social rationality coexisting in inherent contradiction (Jensen 2001a). Therefore the model argues that internal governance actors remain self-interested, but this self-interested behaviour is not purely economic. Accordingly such self-interested behaviour is driven by personal preferences which can be economic, social or political.

McMullen (1996) identifies audit committees as monitoring mechanisms which reduce information asymmetries between executive and non-executive board members. Audit committees are considered to be key governance mechanism for enhancing the creditability of audited financial reports, therefore assisting the board in fulfilling its fiduciary duties and responsibilities, i.e., the ratification and monitoring of decisions to safeguard and advance shareholder interests (Fama and Jensen 1983; McMullen 1996). Therefore, the notion of audit committee effectiveness has been an interesting concept for researchers. In addressing audit committee effectiveness from an agency

perspective, audit committee effectiveness is defined in terms of its collective ability to fulfil its original agency roles and oversight duties (DeZoort 1998). However, an institutional perspective defines audit committee effectiveness in terms of ensuring its own survival. This suggests that the audit committee is effective to the extent that it is perceived by the other actors of the institutional environment (e.g., the board or external auditor) as acting legitimately in balancing and satisfying the different interests and demands of these institutional actors. Alternatively, following Figure 2.3 and adopting the hybrid perspective. Audit committee effectiveness is defined in terms of its collective ability to fulfil its original agency roles and oversight duties while balancing and satisfying the different interests and demands of its institutional actors.

From an agency perspective, the quality of the audit is dependent on the joint probability that an auditor will *both* (a) discover a breach, and (b) report the breach (DeAngelo 1981). The probability of breach discovery is dependent on the auditor's capabilities, and the audit processes and procedures employed on a given audit (DeAngelo 1981; DeFond et al. 2002). Moreover, the probability that an external auditor will report the breach is dependent on the auditor's independence (DeAngelo 1981). From an institutional perspective, the probability that an external auditor will report the breach is dependent on balancing the different pressures in the institutional environment that could affect that auditor's survival (Dillard et al. 2004; Dowling and Pfeffer 1975). However, the hybrid perspective suggests that the reporting of the breach is dependent on the auditor's independence and on the balancing of the different institutional environment pressures. Again, under agency theory, the role of the auditor in the principal-agent relationship is to provide assurance that financial reports are free of material misstatements and conform to the contractual relationship between both parties (Eilifsen and Messier 2000). But from an institutional perspective, the auditor will conform to the expectations and norms of the institutional environment that govern auditor engagements. On the other hand, the hybrid perspective suggests that the auditor will conform to the contractual relationship to the extent it conforms to the expectations and norms of the

institutional environment. Young and Thyl (2008) believed that to explain governance systems in truly holistic sense an integrated view is necessary.

2.7.1 Agency Assumptions

Focusing on the internal institutional environment, Figure 2.3 separates the traditional roles of the contracted agents into decision management and decision control. This would mean that a firm's shareholders would typically entrust decision management to the CEO and executive managers, and would typically entrust decision control to the board and its committees. As was stated earlier, the central premise of agency theory is the *separation* of ownership and control, where *control* refers to a principal's (owner's) contracting of an agent to perform some service on the principal's behalf. This contract involves delegating some decision making authority (Jensen and Meckling 1976). Fama and Jensen (1983) identify this notion of decision making authority as a process of four steps. These four steps were explained earlier as initiation, ratification, implementation and monitoring. As stated by Fama and Jensen (1983p. 303-304)

“Because the initiation and implementation of decisions typically are allocated to the same agents, it is convenient to combine these two functions under the term decision management. Likewise, the term decision control includes the ratification and monitoring of decisions. Decision management and decision control are the components of the organization's decision process or decision system”.

In fact, Fama and Jensen (1983) identify three principle contract mechanisms within the *nexus of contracts*: decision management, decision control, and residual risk bearing. Without the “separation of decision management from decision control, residual claimants have little protection against [the] opportunistic actions of decision agents” (Fama and Jensen 1983, pp. 305-306). Both the internal and external audit functions are considered as critical mechanisms in the firm's investor assurance process. However the external auditor, while providing a service internal to the firm,

simultaneously remains external to the firm. So the external audit is depicted in Figure 2.3 are straddling both the internal and external institutional environments of the firm.

In this thesis, the framework in Figure 2.3 will be used to guide the examination of governance phenomena concerning the audit committee. In doing so, it is to be noted that this framework is underpinned by the following agency assumptions, as drawn from the agency literature reviewed in this chapter:

- Governance actors are self-interested;
- Governance actors are solely economic utility maximisers;
- The firm is a contract nexus, i.e., a series of contractual relationships;
- There exists a separation between decision control and decision management;
- The board is the decision controller, and it then delegates the decision management and some decision control functions to internal agents;
- Governance mechanisms act as monitors;
- Governance mechanisms evolve to better address agency problems;
- The external audit function is external (independent) yet simultaneously internal to the client; and
- Actor interactions and processes are bureaucratic.

Some of these agency behavioural assumptions will be in dispute with assumptions from the institutional paradigm. This creates a key point for analysis in this thesis, given that it is expected that both the agency and institutional paradigms will underpin the framework in Figure 2.3.

2.7.2 Institutional Assumptions

In this thesis, the firm will be depicted as a contract nexus of self-interested actors, which operates and interacts within a superordinate social system. For any actors in the firm's governance system, the effects of the firm's superordinate social system are likely to come into play. This thesis will centre mainly on the *decision control* agent (i.e., the audit committee) in the firm's governance system. When the firm's superordinate social system is factored into an understanding of the actions or behaviours of the decision control agent such as the audit committee, then actors in the external institutional environment such as the audit committees of the firm's *competitor* firms need to be considered. Such an external institutional environment can place mimetic or normative isomorphic pressures on the *decision control* agent. The *decision control* agent (e.g., audit committee) may acquiesce to such pressure imposed by the competitor; consequently the *decision control* agent may adopt practices, processes or structures for its own legitimation reasons. Similarly, the external auditor which, as a distinct institution, that lies within both a firm's external and internal institutional environments, may put mimetic or normative isomorphic pressure or demands on the client firm's *decision control* agents (e.g., the audit committee).

As discussed above the term decision control includes the *ratification* and *monitoring* components of the decision making authority. The board is regarded as the decision control agent. The board and its committees can also be perceived as simultaneously operating as an institution within an environment of institutions. In that sense, they make up a decision control institution. Moreover, the board alone and the audit committee alone could be perceived as separate institutions. In this sense, multiple institutions can be perceived to exist within the firm's *decision control* structures. Further adding to the complexity, each institution within the *decision control* structures is able to impose and acquiesce to institutional pressure in both the internal and external institutional environments. Following the institutional literature discussed earlier in the chapter, the framework in Figure 2.3 is deemed to be underpinned by the following institutional assumptions which need to be taken into account when examining a firm's governance phenomena:

- Legitimacy is a resource;
- Actors interact in a dynamic and interdependent way;
- Firms operate and interact within a superordinate social system;
- Firms are closed yet simultaneously open to the pressures of the superordinate social system and consequently, there exists some form of peer pressure or institutional compliance pressures;
- There exists some institutional homogeneity;
- Governance mechanisms are adaptive;
- Change innovations are driven by performance enhancement and legitimacy;
- Governance mechanisms are merely symbolic displays for conformity and legitimacy; and
- Governance mechanisms use symbolic gestures to legitimise interactions.

If the framework in Figure 2.3 was viewed solely from the institutional paradigm, then it would reflect the superordinate system within which an organisation operates, it would focus on the interactions between various governance mechanisms, and it would indicate that a mechanism may at times use symbolic gestures to maintain its legitimacy to other mechanisms (Cohen et al. 2008). The main premise of institutional theory is that organisations will acquiesce to institutional pressure, e.g., adopting managerial practices that have social value, to enhance or protect their legitimacy (Berrone and Gomez-Mejia 2009; DiMaggio and Powell 1983).

2.8 CHAPTER SUMMARY

This chapter provides a background into the literature and the main theoretical paradigms behind the governance phenomena. The chapter defines corporate governance as a process set which forms part of the investor assurance process (Bhagat et al. 2010; Dechow et al. 1996; Dowling and

Pfeffer 1975; Mallin 2010). This assurance process becomes critical for firms, as firms eventually grow beyond the financial means of a single owner, therefore firms need to attract investor funding to expand and grow (Davis et al. 1997; Dowling and Pfeffer 1975; Mallin 2010). The assurance process serves to improve the credibility of financial reports, safeguard against earnings manipulation, and ensure a fair return on investor investment (Bhagat et al. 2010, Dechow et al. 1996).

Bradbury (1990) noted that the control of a firm is delegated to the board by residual claimants. However these claimants though vote retain approval rights on board membership, mergers and the issuing of new stock (Bradbury 1990). Accordingly, the board is viewed as a governance mechanism with diverse duties and responsibilities (DeZoort et al. 2002). Consequently, it is regarded as the most important decision making body in modern firms (Ferreira 2010). However, boards typically delegate some of these duties and responsibilities to internal agents, but it retains the ultimate accountability vehicle (DeZoort et al. 2002; Rezaee 2010; Vera-Munoz 2005). Importantly, the audit committee is viewed as a board sub-committee distinctly responsible for monitoring external auditors, internal controls and vetting of published financial reports.

Under the agency paradigm, the agency separation problem is identified as the driving force behind the formation and maintenance of governance mechanisms. A firm is defined as a contract nexus with conflicting interests. All contract agents are assumed to be self-interested utility maximisers. Therefore due to this inherent self-interested behaviour, control agents will serve their personal preferential interests at the expense of residual claimants. Accordingly, these self-serving agents need to be monitored and controlled, consequently the agency paradigm views governance as a tool of control.

Alternatively, under an institutional paradigm, governance is viewed as a form of legitimacy through homogeneity. The notion of legitimacy is regarded as a resource which firms are dependent upon, because legitimate firms have better survival prospects. The institutional paradigm defines a firm as

an institution which operates and interacts within a larger social institutional environment. In this environment each institution is closed yet simultaneously open to isomorphic pressures, and each institution is capable of imposing isomorphic pressures. However, while the institutional paradigm assumes acquiesce to such pressures, firms may negotiate, conceal, defy or control and manipulate isomorphic pressures. Consequently, the institutional paradigm views governance mechanisms as symbolic displays of conformity.

Of special interest to this thesis is the limited evidence that there are links between the governance phenomena and both the agency and institutional paradigms. It is speculated that the potential combination of elements of both the agency and institutional paradigms could better explain the governance phenomena. Accordingly, this thesis identifies the agency separation problem as the driving force behind the governance phenomena, however its form, integration and evolution into a firm as set of institutions determined by their agency contracts and their larger social system is more likely to be driven by the notion of legitimacy.

The next chapter will identify a research method which will investigate the governance phenomena to identify whether a sole theoretical paradigm (i.e., agency or institutional) or a combination of these paradigms better explains the phenomena.

“... the theory which he relates soon changed this feeling into enthusiasm. A new light seemed to dawn upon my mind, and, bounding with joy” (Shelley 1818, p. 28).

“In order studies you go as far as others have gone before you, and there is nothing more to know; but in a scientific pursuit there is continual food for discovery and wonder” (Shelley 1818, p. 40).

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 CHAPTER OVERVIEW

The purpose of this chapter is to provide insights into the adopted research design and strategy of this thesis. The chapter is structured to flow as a broader reflection on research design and methods which leads into the specific research design and methods to be used in this study. It begins by defining *research*, which leads to the concept of a research design and its various assumptions. It continues by providing a summary of multiple research strategies, and then provides justification for the case study research strategy to be adopted in this thesis. A detailed explanation of the case study research strategy is then provided, including details of the evidence collection methods and analysis approaches used for the thesis.

3.2 THE RESEARCH DESIGN

Research is defined by Merriam-Webster (2013, para. 2) as an “investigation or experimentation aimed at the discovery and interpretation of facts”. Its purpose is to gain knowledge through the examination and interpretation of raw data or pre-existing facts to answer a question which solves a problem (Booth et al. 2008). As previously stated this thesis aims to address the following questions:

RQ1: To what extent do governance mechanisms and actors interact as part of a holistic corporate eco-system?

RQ2: Does agency or institutional theory more pluralistically define the governance phenomena?

Denscombe (2007, p. 3) notes that the virtuous social research process cannot be attained by the “slavishly following [of] a set of rules about what is right and wrong”. The social researcher is faced

with a variety of options and alternatives and must be strategic in making decisions, with each choice bringing a set of advantages and disadvantages (Denscombe 2007). While there is no one right direction, some strategies are better suited than others (Denscombe 2007). In choosing among strategies the social researcher must ensure that the chosen strategy will lead to accurate and objective conclusions (Denscombe 2007).

The first decision the social researcher must make is the research design. The research design is defined as the underlying foundation or blueprint for a study, it spans across broad philosophical assumptions to detailed methods of data collection and analysis (Creswell 2007; 2009). The selection of a particular research design is dependent on the nature of the research problem (Creswell 2009). The research design may be defined as qualitative, quantitative or mixed methods (Creswell 2009; Denzin and Lincoln 2005). Creswell (2009) noted that the qualitative and quantitative approaches are not to be regarded as polar opposites or dichotomies but rather as different ends on a continuum. A study will either tend to be more qualitative than quantitative or vice versa (Creswell 2009). A mixed methods approach will reside in the middle of this continuum, as it incorporates both elements of the qualitative and quantitative approaches (Creswell 2009).

Table 3.1 presents the basic distinctions between the qualitative and quantitative approaches. In summary the qualitative approach adopts open-ended questions and analyses words while the quantitative approach adopts closed-ended questions (hypotheses) and analyses numbers (Creswell 2009; Denscombe 2007).

Table 3.1: Basic distinctions between the qualitative and quantitative approaches	
Qualitative approach	Quantitative approach
Open-ended questions (themes)	Closed-ended questions (hypotheses)
holistic perspective	Specific focus
Description or word analysis	Analysis
A means for exploring and understanding the meanings of individuals or groups	A means of testing objective theories by examining the relationship among variables
Emerging questions and procedures	Measurable variables

Interpretive analysis	Statistical analysis
Non-generalisable findings	Generalisable findings
Non-replicable findings (findings are generally specific to the study and researcher)	Potentially replicable findings
Source: Creswell 2009; Denscombe 2007	

This thesis examines the way in which corporate governance structures (with a particular focus on the audit committee) interact within a corporate eco-system. As stated earlier, the corporate eco-system consists of internal and external economic, legal, political and social elements, including the firm's internal organisational and behavioural systems. To pursue such an examination, this thesis adopts the qualitative research approach. This choice of research strategy is dictated by the nature of the research problem. As this study seeks to address the complexities of the audit committee's interactions within its wider environment, therefore it is deemed to reside more towards the qualitative end of the continuum.

The qualitative research approach provides an enhanced means of exploring and understanding the behaviours and interactions of governance actors and structures within a firm's wider system. Therefore, the study resides more towards the qualitative approach on the research design continuum. As stated by Creswell (2009, p.19)

"The logic that the qualitative researcher follows is inductive, from the ground up, rather than handed down entirely from a theory or from the perspectives of the inquirer ... research questions change in the middle of the study to reflect better the types of questions needed to understand the research problem. In response, the data collection strategy ... needs to be modified to accompany the new questions".

This thesis will draw heavily on theoretical perspectives and behavioural assumptions of agency theory and institutional theory, the approach in this study is to follow a more inductive line of

reasoning in order to critically assess and identify linkages at the ‘ground level’ between the perspectives and assumptions underlying these two ‘grand’ theories.

3.2.1 Philosophical Assumption Underlying the Qualitative Research Design Strategy

By choosing a qualitative research design strategy in this study, certain philosophical assumptions will be invoked by the researcher. “The philosophical assumptions consist of a stance toward the nature of reality (ontology), how the researcher knows what she or he knows (epistemology), the role of values in the research (axiology), the language of research (rhetoric), and the methods used in the process (methodology)” (Creswell 2007 p.16). The orientation of these philosophical assumptions towards a qualitative research design is summarised in Table 3.2.

Assumption	Question	Characteristics	Implications for Practice
Ontological	What is the nature of reality?	Reality is subjective and multiple, as seen by participants in the study	Researcher uses quotes and themes in words of participants and provides evidence of different perspectives
Epistemological	What is the relationship between the researcher and that being researched	Researcher attempts to lessen distance between himself or herself and that being researched	Researcher collaborates, spends time in the field with participants, and becomes an “insider”
Axiological	What is the role of values?	Researcher acknowledges that research is value-laden and that biases are present	Researcher openly discusses values that shape the narrative and includes his or her own interpretation in conjunction with the interpretations of participants
Rhetorical	What is the language of research?	Researcher writes in a literary, informal style using the personal voice and uses qualitative terms and limited definitions	Researcher uses an engaging style of narrative, may use first-person pronoun, and employs the language of qualitative research

Methodological	What is the process of research?	Researcher uses inductive logic, studies the topic within its context, and uses an emerging design	Researcher works with particulars (details) before generalizations, describes in detail the context of the study, and continually revises questions from experiences in the field
Source: Creswell 2007, p. 17			

As previously stated, the purpose of this thesis is to address the way in which the audit committee functions and interacts within corporate governance structures and, in turn, the wider internal and external corporate systems. Moreover, this study aims to better theoretically understand the governance phenomenon by adopting and reflecting on elements from both the agency and institutional theoretical lens. Hence, the ontological assumption embraced in this study is that reality is subjective and multiple. With this view of the ontological assumption, the governance phenomenon can be addressed through the adoption of either the agency or institutional orientations or both.

Other aspects of the philosophical assumptions underlying this study are, first, epistemologically, the researcher attempts to lessen the distance between him and that being researched by engaging with participants and documents in the field. Second, in terms of the axiological assumption, the researcher acknowledges that this thesis is reliant on a limited number of participants and documents, so the subjectivity involved in gathering, synthesising and interpreting the evidence will be subjected to the values and biases of the researcher. Third, in terms of the rhetorical assumption, the use of first-person voice and limited definitions is not, however, strongly followed by the researcher. The text of interviews with participants is not directly quoted but rather is paraphrased in order to convey a more succinct and integrated understanding of the participants' views and comparative positions. Also definitions of concepts drawn from agency and institutional theories

need to be carefully defined when undertaking a critical discussion of how they apply to case-based practices and other phenomena observed in this thesis.

To guide and direct the thesis an inquiry paradigm or world view is also considered. Creswell (2007, p.248) identifies an inquiry paradigm as the basic set of beliefs which guide actions, it defines the “nature of the world, the individual’s place in it, and the range of possible relationships to that world”. It is the net which contains the social researcher’s philosophical assumption. According to Creswell (2007) multiple inquiry paradigms may be adopted. He identifies four common paradigms: post-positivism, constructivism, advocacy, and pragmatism.

This thesis adopts multiple inquiry paradigms, namely, post-positivism, constructivism and pragmatism. In post-positivism, researchers adopt a scientific approach to qualitative research which has the elements of being “reductionistic, logical, an emphasis on empirical data collection, a cause-and-effect oriented, and deterministic” (Creswell 2007, p.20). This study examines empirical data on the corporate governance phenomena in a somewhat reductionist and deterministic way drawing on concepts and theoretical assumptions from prior theories. Additionally, this study embraces social constructivism which involves the researcher relying on the various participants’ views of the situation, from which the researcher develops subjective meanings. From a constructivist viewpoint, this study is underpinned by the notion of multiple realities as per the varied perspectives of participants. Finally, this study also simultaneously adopts a pragmatist’s inquiry paradigm which focuses on “the actions, situations, and consequences of inquiry ... rather than antecedent conditions” (Creswell 2007, p.22). This study pays attention to the practical interaction of governance actors. In summary, the study adopts multiple inquiry paradigms because it seeks to understand corporate governance (with particular emphasis on the interactions of the audit committee within the firm’s internal and external systems) as a phenomenon that is bounded by causality and shaped by prior events and theories, yet it remains simultaneously evolutionary.

In addition to these inquiry paradigms or worldviews, this study associates with a particular so-called 'interpretive community', in order to further shape, narrow and direct the thesis. Interpretive communities operate at a less philosophical level, each community with a distinct body of literature and unique issues of discussion. These interpretive communities provide a pervasive lens or perspective on all aspects of a qualitative research project (Creswell 2007). The most common interpretive communities include: (1) post-modernism (or postmodern perspective), the concept is that knowledge must be within the conditions of the world today and in the multiple perspectives of class, race, gender, and/or other group afflictions; (2) feminist theories, issues of gender equality; and (3) critical theory (or critical race theory), issues of human empowerment to transcend constraints placed on them by race, class, and gender (Creswell 2007). This thesis identifies with the post-modernism interpretive community, as the concept of governance must be within the boundaries of the modern business world which incorporates the multiple perspectives of group afflictions.

3.3 THE RESEARCH STRATEGY

The purpose of this section is to provide insight into the initial research strategy adopted for the study. Once the social researcher has decided upon the research design, the decision must then be made about the research strategy or approach (Creswell 2007; Denscombe 2007; Denzin and Lincoln 2005). The research strategy is influenced by the research design and may be regarded as a micro examination of the methods of data collection and analysis. Typical qualitative research strategies include ethnography, case study, action research, clinical research, phenomenology, historical research and narrative research (Creswell 2007; Denscombe 2007).

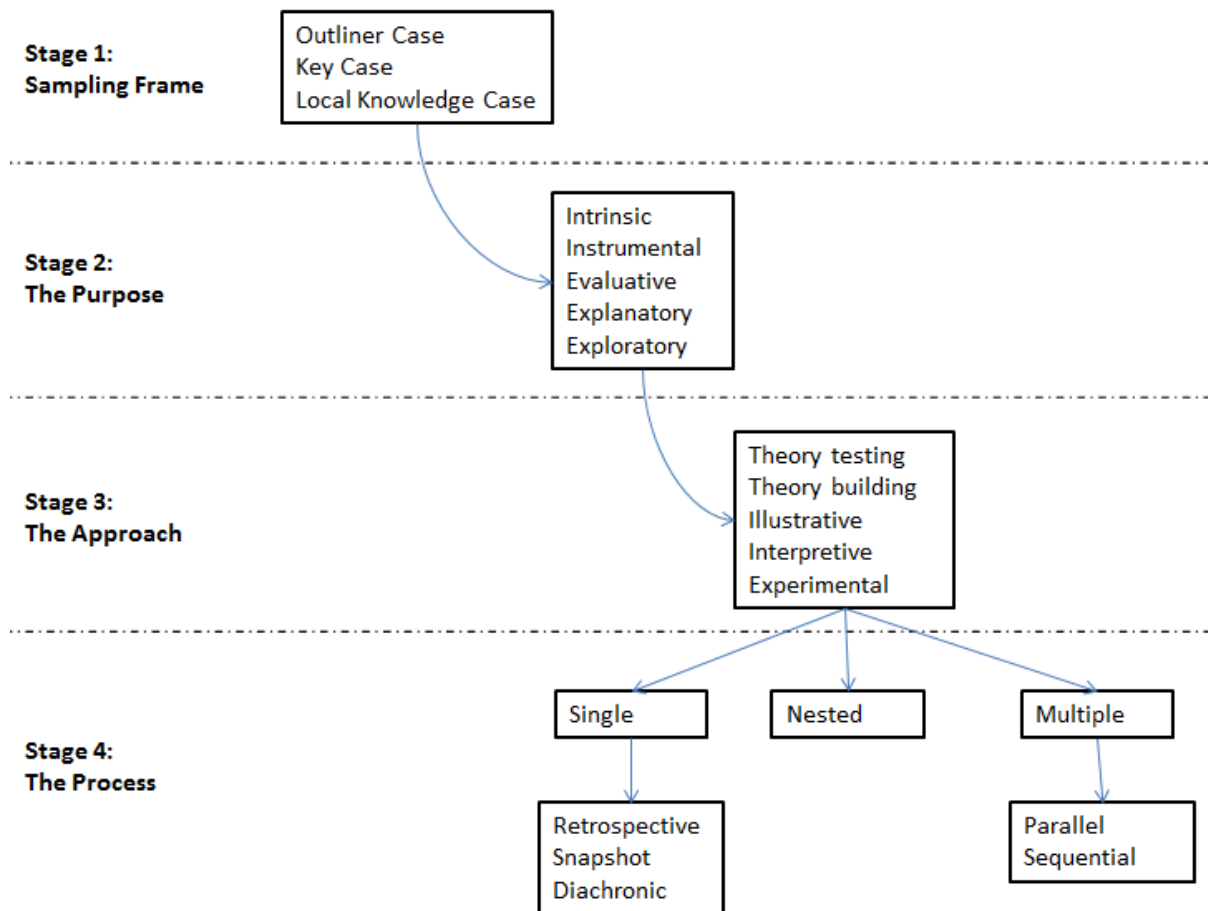
Similarly to Gendro and Bedard (2006), Sarens et al. (2009), and Turley and Zaman (2007) this thesis adopts the case study research strategy, as the aim of the study is to provide in-depth details on the ways governance actors interact (i.e., engage with each other and behave) within their firm's corporate eco-system. It aims to understand and to get as close as possible to the reality of

governance actor behaviours, with a vested interest in audit committee operations. Additionally, the case study strategy is useful for describing, exploring, comparing, explaining, or illustrating a particular phenomenon, individual, event, process or relationship (Denscombe 2007). Thomas (2011, p.23) offers the below definition for case study research:

“Case studies are analyses of persons, events, decisions, periods, projects, policies, institutions or other systems which are studied holistically by one or more methods. The case that is the subject of the inquiry will be an instance of a class of phenomena that provides an analytical frame-an object – within which that study is conducted and which that case illuminates and explicates”.

Moreover, the case study strategy will enable this study to undertake an in-depth holistic view of the audit committee in particular, by examining the organisational structures and networks in which it resides. Case study research can probe the relationships and interactions of and within a particular firm (Denscombe 2007). However, Thomas (2011) believes that case studies serve the particular and not the general, i.e., the researcher generally cannot draw out generalisations about the phenomena studied from the case study strategy. On the other hand, the case study strategy allows the use of multiple data sources (Denscombe 2007). This enables the validation of data through triangulation (Denscombe 2007). Thomas (2011) presents a taxonomy for the undertaking of a case study strategy. This taxonomy is illustrated in Figure 3.1.

Figure 3.1: Case Study Taxonomy



Source: Thomas 2011

Figure 3.1 illustrates the case study taxonomy developed by Thomas (2011). Each of the four stages in Figure 3.1 is now explained in turn. The first stage involves determining the case subject; i.e., the social researcher is to determine the sampling frame of the case (Thomas 2011). The social researcher is to decide whether the case study will be an *outliner case*, depicting something interesting because of its divergence from the norm; a *key case*, something which is exemplary; or a *local knowledge case*, something which is based on personal experience or knowledge that the researcher wants to explore further (Stake 2005; Thomas 2011).

In the second stage the social researcher will identify the purpose of the case (Thomas 2011). The purpose for the case study may be:

- *Intrinsic*, the study is undertaken to better understand a particular case, and therefore the case itself is of interest;
- *Instrumental*, the study is to provide insight into a particular issue, the case study acts in an instrument which facilitates the understanding of the issue;
- *Evaluative*, the study is undertaken to evaluate how something is working or has worked;
- *Explanatory*, the study serves as a means of providing an explanation for some kind of paradoxical finding; or
- *Exploratory*, the study serves as a means of further exploring the 'what and why' of a known problem (Thomas 2011).

In the third stage the social researcher decides how to approach the study (Thomas 2011). The researcher's approach may be:

- *Theory testing*: the research relies on some previously established explanatory framework for the phenomenon, the researcher is to make a number of assumptions based on literature and their own knowledge;
- *Theory building*: the researcher is to develop some form of explanatory framework from scratch which explains the phenomenon, without relying on pre-existing ideas, models or frameworks;
- *Illustrative*: the researcher uses pictures to illustrate a phenomena;
- *Interpretative*: the researcher observes, examines and then interprets the events or the journey which leads up to the phenomenon in natural settings, this approach is similar to and may be called ethnography; or

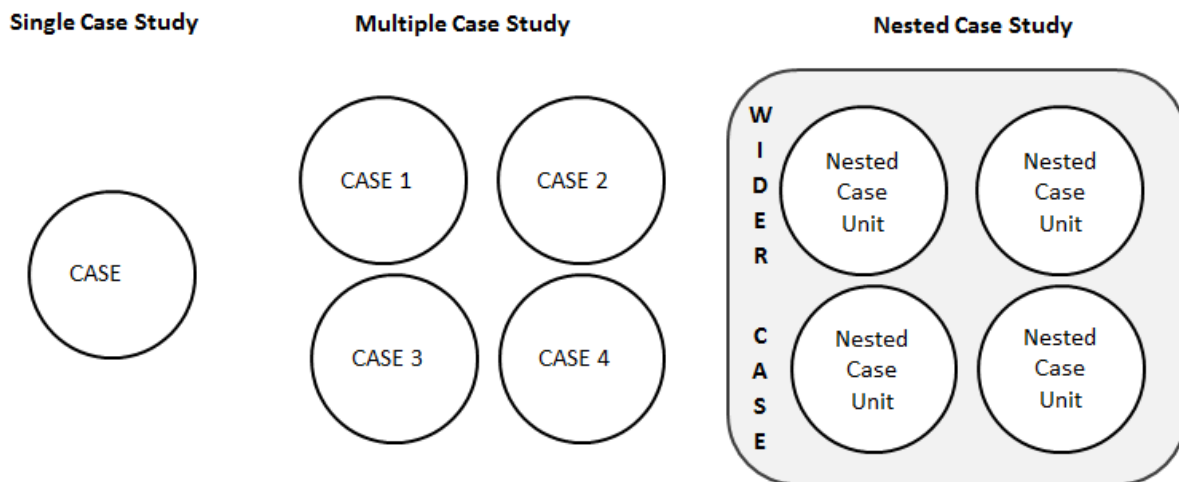
- *Experimental*: this approach is considered an non-textbook case study as it involves some form of trial, traditional experiments involve some form of ‘control and compare’ or ‘repeated measures’, the experimental case study approach is concerned with the ‘repeated measures’ as it focuses on the phenomena in its natural setting (Thomas 2011).

The final stage involves the social researcher deciding on the process for the case study; including the analysis method (Thomas 2011). Therefore, the researcher will decide whether the study will encompass a single case study, multiple case studies or nested case units (Stake 2005; Thomas 2011). A single case study may be further segmented into three types. The first is *retrospective*, involving the collecting of data relating to a past phenomenon, situation or event. Second is the *snapshot*, involving a ‘here and now’ study in which the case is bound by time rather than a phenomenon, situation, event or being. The third type is *diachronic*, involving a study which reveals differences as it proceeds, i.e., shows change over time (Thomas 2011).

A multiple case study process may be segmented into two types. First is a *parallel* case study in which cases are simultaneously occurring. Second is a *sequential* type involving cases that occur sequentially, i.e., what happens in one affects the other (Thomas 2011; Yin 2003).

A nested case study gains its completeness from a wider case. Each individual case unit is part of the wider case, i.e., each case is embedded in the wider case (Thomas 2011; Yin 2003). Figure 3.2 illustrates the difference between a single case study, multiple case studies and a nested case study.

Figure 3.2: Difference between Case Study Processes



Source: Thomas 2011

Returning to the stages required to undertake case study research as shown in Figure 3.1, the specific approaches chosen for this study regarding the sampling frame, purpose, approach, process and evidence gathering are now detailed.

3.3.1 Stage One: Sampling Frame

The first step in adopting the case study strategy is to select specific cases which investigate and clarify a phenomenon and not rely on random sampling techniques (Thomas 2011). It is important to note that the purpose of a case study is not to identify a case which demonstrates the quality of the whole but rather of a particular (Thomas 2011). Consequently, this study adopts the *key case* sampling method, as the key case method will seek the selection of an exemplar case which appears to have very sound governance practices. To identify such a key case company, a preliminary review can be made of the comprehensiveness of disclosures of corporate governance practice through annual reports and other governance disclosers (e.g., audit committee charter, board charter, governance policies). The selection of a case company that has comprehensive disclosure of sound governance policies is an indication that the case company is perceived as having a strong commitment to the protection of shareholder interests. In addition, the key case company should be listed on the ASX 300 index. This will mean it is drawn from companies that are required to have an

audit committee and, because it is amongst the larger listed companies in Australia, its audit committee will operate within a relatively complex corporate eco-system.

3.3.2 Stage Two: The Purpose

From the taxonomy in Figure 3.1, this thesis will classify its case study purpose as instrumental, explanatory and exploratory. Consequently, the case firm serves as an instrument which facilitates the understanding of the governance phenomenon (Thomas 2011). Additionally, the purpose of the case-study approach in this thesis has an explanatory element. The key case firm can serve as a means of discovering and interpreting circumstances that could explain the conflicting findings found in the quantitative governance literature (Thomas 2011), as earlier discussed in Chapter 2, the literature review chapter. Finally, the case study approach would have an exploratory purpose of serving as a means of further exploring the ‘what and why’ of the governance phenomenon so it may be better theoretically defined (Thomas 2011).

3.3.3 Stage Three: The Approach

The case study approach to be used for this thesis is characterised as theory testing and interpretive. It has a theory testing aspect because it relies on concepts and assumptions from previously established conceptual frameworks (i.e., agency theory and institutional theory). The interpretive aspect is also part of the case study approach for this thesis, as the aim is to examine and then interpret the governance phenomena in natural settings (Thomas 2011). Therefore, while interviews and document gathering will require access to a large volume of textual data from the case company, the interpretation of this textual data will be critical.

3.3.4 Stage Four: The Process

The thesis will adopt a nested case unit process, as it focuses on the interface of governance structures and the interactions of actors within a wide corporate eco-system. The case firm is merely to facilitate the understanding of the interactions of governance structures and their actors within the wider internal and external corporate eco-system. In this sense, it acts as a single case unit that

is nested within a wider case. Consequently, the case study gains its completeness from the wider case.

3.3.5 Gathering Evidence

Thomas (2011) notes the difference between data and evidence; he defines data as bits of information while evidence is derived from the data to support or refute a proposition. Further Thomas (2011, p. 162) states that a “case study without a tightly constructed theory or set of propositions ... will seek data ... which emerge as the study progresses”. However, a case study with clear hypotheses or a well-defined theory will have propositions which will be either supported or refuted by the gathered data, suggesting the researcher will seek evidence (Thomas 2011). In this thesis, the intention is to seek evidence to the extent that data will draw out the prevalence or absence of well-defined theoretical assumptions deemed to underlie various practices and policies.

A case study researcher could have many forms of evidence gathering methods (Creswell 2007; Thomas 2011; Yin 2003). These include but are not limited to interviews, focus groups, observation, diaries, questionnaires and surveys (Creswell 2007; Denscombe 2007; Thomas 2011). This thesis will conduct interviews as its primary approach because interviews are able to provide insights into opinions, feelings, emotions and experiences; as they are able to provide insider type information (Denscombe 2007). An interview may be structured, semi-structured or unstructured; in addition they may be conducted on a group, one-on-one or panel basis (Denscombe 2007). In this study, evidence on the interactions of governance structures and actors (with an emphasis on the audit committee) is gathered through a series of semi-structured single-sitting panel interviews. These semi-structured interviews will remain theme structured, yet simultaneously unstructured and conversation-like to allow for the discussion of emergent issues and further probes (Thomas 2011). The interviews are to be single-sitting panel interviews because gaining second interviews with company directors and senior management has proven difficult. To gain the most from single-sitting interviews, the approach in this study has been to use two interviewers for each single interviewee.

This improves the conducting of the conversation-like interviews and is more likely to gather and deliver the desired quality of evidence.

In this study, my senior supervisor, Professor Dennis Taylor, BEc(Hons), MBA, PhD, chose to be the second interviewer who accompanied me in conducting each of the interviews. He has international standing in the field of corporate governance research. Having the supervisor as second interviewer provides several advantages. First, when interviewing the chosen directors and top executives, the presence of a professor gives appropriate authority to the interview team. Second, two interviewers with intimate knowledge of the research project enables in-depth questioning arising from open-ended questions to be more completely pursued. Third, the time during interviews can be more efficiently used because, when one interviewer is leading the questioning, the other can be taking notes or checking the audio-recorder.

Given, the case study strategy, multiple data sources need to be collected to improve the validity of the data (Denscombe 2007; Thomas 2011). In addressing validity, potential interview participants will include current or former directors (i.e., audit committee, board, or any other board sub-committee members), executive managers and auditors of the chosen ASX 300 listed company. Additionally, current or former directors, executive managers and auditors of other ASX 300 companies or local governments may also be interviewed. In addition to the semi-structured interviews, other evidence will be gathered through various public disclosures, i.e., annual reports, charters of the board and its sub-committees, media releases, or other available documents.

Denscombe (2007) noted that the concern over validity is about dealing with the accuracy and precision of evidence. Denscombe (2007) suggests that in addressing the validity problem the researcher may improve finding validity by respondent validation and triangulation. Respondent validation is the processes where the researcher is submit findings to participants, so they may check their factual accuracy (Denscombe 2007). Triangulation is the process which aims to strengthen the research design by using contrasting sources for evidence to bolster confidence in findings by

considering a contrasting view (Bitsch 2005; Denscombe 2007; Thomas 2011). In addressing triangulation, this thesis preforms 'between-methods triangulation', this is achieved by using contrasting methods in gathering evidence; i.e., evidence is gathered from semi-structured interviews and both internal and external documents (Denscombe 2007). Further, it performs 'data triangulation' by using a contrasting source of evidence from a different cultural, social or geographic context; i.e., the key corporate case being contracted by the local government case and previous literature (Denscombe 2007). However, key methods and analysis should be mapped out to ensure the issue of reliability is addressed (Denscombe 2007). Consequently, the primary purpose of this chapter is to address this reliability issue.

3.4 IDENTIFYING THE CASE UNITS

This section explains the methods and strategies used in gathering evidence. In identifying potential case firms, certain considerations were taken into account in order to ensure the feasibility of completing the case study. In addition to selecting a firm demonstrating sound governance practices and a listing on the ASX 300 index, the case firm needed to have its head office based in Melbourne. The Melbourne location is required because firm directors and their executive team hold busy schedules and arranging of interview times would prove to be problematic if the interviewers were required to take multiple trips interstate.

In relation to the case firms' compliance with the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations, this will increase confidence that the selected firm is transparent to allow for an academic probe. The selected firm must comply with principles 1, 2, 4, 5, 7 and 8 of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (refer to Table 3.3 for the principles) because compliance with these principles is likely to indicate that the firm is serious about ensuring its governance structures and policies are committed to the protection of shareholder interests. Consequently, selecting such a firm will certify its 'key case' status within the wider case of 'best practice' firms. In relation to principles 3 and 6

given in Table 3.3, these principles are considered to be beyond the scope of the thesis; therefore it is not essential for the case firm to comply with these principles. However, sub-section 1 of principle 3 is considered within the boundaries of the study. Therefore the case firm must also comply with principle 3 sub-section 1. While these are merely recommendations to all listed companies, ASX 300 listed firms must comply or given just reason why they have deviated from compliance, which suggests a higher degree of regulative coercive isomorphic pressure on top-300 companies.

Table 3.3: ASX Corporate Governance Principles and Recommendations

ASX Principle	
Principle 1	<i>Lay solid foundations for management and oversight</i>
1.1	Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions.
1.2	Companies should disclose the process for evaluating the performance of senior executives.
1.3	Companies should provide the information indicated in the Guide to reporting on Principle 1.
Principle 2	<i>Structure the board to add value</i>
2.1	A majority of the board should be independent directors.
2.2	The chair should be an independent director.
2.3	The roles of chair and chief executive officer should not be exercised by the same individual.
2.4	The board should establish a nomination committee.
2.5	Companies should disclose the process for evaluating the performance of the board, its committees and individual directors.
2.6	Companies should provide the information indicated in the Guide to reporting on Principle 2.
Principle 3	<i>Promote ethical and responsible decision making</i>
3.1	Companies should establish a code of conduct and disclose the code or a summary of the code as to the: <ul style="list-style-type: none"> • practices necessary to maintain confidence in the Company's integrity • practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders responsibility and accountability of individuals for reporting and investigating reports of unethical practices
3.2*	Companies should establish a policy concerning diversity and disclose the policy or summary of that policy. The policy should include requirements for the board to establish measurable objectives for achieving gender diversity and for the board to assess annually both the objectives and progress in achieving them.

3.3*	Companies should disclose in each annual report the measurable objectives for achieving gender diversity set by the board in accordance with the diversity policy and progress towards achieving them.
3.4*	Companies should disclose in each annual report the proportion of women employees in the whole organisation, women in senior executive positions and women on the board.
3.5	Companies should provide the information indicated in the Guide to reporting on Principle 3.
Principle 4	<i>Safeguard integrity in financial reporting</i>
4.1	The board should establish an audit committee.
4.2	The audit committee should be structured so that it: <ul style="list-style-type: none"> • consists only of non-executive directors • consists of a majority of independent directors • is chaired by an independent chair, who is not chair of the board • has at least three members
4.3	The audit committee should have a formal charter.
4.4	Companies should provide the information indicated in the Guide to reporting on Principle 4.
Principle 5	<i>Make timely and balanced disclosure</i>
5.1	Companies should establish written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose those policies or a summary of those policies.
5.2	Companies should provide the information indicated in the Guide to reporting on Principle 5.
Principle 6*	<i>Respect the rights of shareholders</i>
6.1*	Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.
6.2*	Companies should provide the information indicated in the Guide to reporting on Principle 6.
Principle 7	<i>Recognise and manage risk</i>
7.1	Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies.
7.2	The board should require management to design and implement the risk management and internal control system to manage the Company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the Company's management of its material business risks.
7.3	The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that, the declaration provided in accordance with section 295A of the Corporations Act is founded on a sound system of risk

	management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks.
7.4	Companies should provide the information indicated in the Guide to reporting on Principle 7.
Principle 8	<i>Remunerate fairly and responsibly</i>
8.1	The board should establish a remuneration committee
8.2	The remuneration committee should be structured so that it: <ul style="list-style-type: none"> • consists of a majority of independent directors • is chaired by an independent chair • has at least three members
8.3	Companies should clearly distinguish the structure of non-executive directors' remuneration from that of executive directors and senior executives.
8.4	Companies should provide the information indicated in the Guide to reporting on Principle 8.
Source: ASX 2010a, pp. 12-14	
*Principles are considered as unnecessary for the boundaries of the thesis and in addressing the research problem.	

Principles 1 and 2 will ensure that the case firm will disclose board and executive management functions. In a broader sense, principles 1 and 2 add substance to the expectations of the corporate eco-system as to the way boards and executive management should function. In respect of compliance with principle 4, this will ensure that the case firm has established an audit committee. Principles 5, 7 and 8 will ensure that information is relevant and timely; additionally it will ensure that the case firm discloses much of the evidence required for the write up of the firm as a case unit in this thesis.

The first stage of selecting a 'key case' has involved a trawl of ASX 300 listed firms. These firms were first checked to identify the location of their head office. Once established that the firm's head office is located in Melbourne, the firm's annual report was sought to ensure its compliance with the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations. An initial fifteen potential case firms were identified. Of these firms it was decided to approach and engage five firms at a given time, until one granted access. After ethics was sought and approved. The engagement strategy involved making the initial contact with the company secretary, as the contact

details of company directors and executive managers is not readily available. A call was made to the potential case firm's head office, and a request to speak with the company secretary was sought. Once contact was made with the company secretary, the research overview was verbally presented and a formal research proposal and ethically approved invitation was emailed. This invitation contained the interview schedule (see Appendix One for the invitation).

Of the potential case firms, six firms rejected via a return email or on the second engagement attempt. However, two potential case firms agreed to participate, one fell through due to time constraints and busy scheduling.

The remaining participating firm agreed to an initial audio-taped interview to be conducted with the company secretary. This interview was scheduled for one hour to be conducted at the firm's head office (see Appendix One for interview question schedule). At the end of the interview additional interview participants were requested. Requested for interviews with the external and outsourced-internal audit partners and audit committee chair were particularly sought. The company secretary was happy to provide the contact details of the audit partners and make the arrangements for the interview with the audit committee chair. The audit committee chair agreed to the taped interview and the company secretary made all the arrangements. The interview was conducted at the firm's head office and scheduled for an hour.

Subsequently, contact was made with the audit partners. The external audit partner agreed to a taped interview, while the internal auditor politely but firmly declined the interview request. The interview with the external audit partner was conducted at the office of the big-4 audit firm and was also scheduled for an hour. Additional interviews were sought with the CFO and board chair. However, despite all efforts by the researcher and supervisor, the interview requests were declined. The consistent reason given was busy scheduling.

These additional two top level interview participants would have provided enhanced evidence for this case study. However, given the considerable depth and breadth of information obtained from the already conducted interviews with the key governance players (i.e., the company secretary, audit committee chair/independent director, and the external audit partner), the researcher proceeded with this ASX 300 company as the 'key case'. Apart from the interviews obtained, multiple sources of documentary information on the governance of this company, including audit committee agenda papers, charters and policy statements were accessed. It was believed that saturation of information for this case study had been largely reached for qualitative analysis of data from the three key interviewees and various company documents.

Saturation is regarded to be the point of diminishing returns, where there becomes little need for more sampling (Mason 2010; O'Reilly and Parker 2012). In summary, saturation is the point where new evidence or data and their sorting only confirm the categories, themes and conclusions already reached; i.e., evidence should be collected until little that is new can be generated (O'Reilly and Parker 2012). This point of saturation, according to Strauss and Corbin (cited in Mason 2010) is a *matter of degree* based on the researchers' subjective judgement. As such, the number of participants required is dependent upon two main factors: the nature of the topic and the resources available (O'Reilly and Parker 2012). This is guided by two key considerations appropriateness and adequacy of data; i.e., saturation (O'Reilly and Parker 2012).

The empirical findings in this study have been structured to flow as a narrative story which includes a qualitative analysis of the text obtained from publicly available company documents (annual report, board and board sub-committee charters, governance policies), interview notes and transcripts, and audit committee meeting agendas. Table 3.4 (below) presents a summary for the sources of evidence used for the case unit write up. Upon the formal write up of the firm as a case unit, it was sent to the participants for their review and possible additions and corrections. The case unit write

up was sent back with minor adjustments made. The empirical findings of this key case unit are presented in the next chapter.

Table 3.4: Summary of Evidence Used for Firm Case Unit		
Acquisition Method	Sources of Evidence	
Semi-structured interviews	Firm directors	Audit committee chair
	Executive management	Company secretary
	External audit	External audit partner
Documents	2011 Annual report	
	2005 Board and 2010 board sub-committee charters	
	Various governance policies (from 2009)	
	The 2011 and 2012 agenda's for audit committee meetings	
See Appendix 5 for the array of documents analysed under each case and the theme(s) derived, in whole or part, from content in the related document		

In terms of the research strategy for this study, it sought the possibility of a comparative case study approach using multiple case studies. Other ASX 300 listed firms were approached to obtain initial interview participants. In particular a potentially comparable case firm by size and industry was identified. However they declined an interview. What was interesting about this particular case firm was that unlike the participating case firm, it failed to meet the ASX 300 listing requirements. In particular it did not meet principle 2, sub-section 3; “roles of chair and chief executive officer should not be exercised by the same individual” (ASX 2010a, p. 12). The inference is that access to company corporate governance-related inside information is problematic for non-compliant ASX 300 companies.

Co-operation from the Institute of Internal Auditors – Australia (IIA) was obtained in seeking potential interviewees who hold an appointment as an audit committee member (see Appendix Two). During 2012 the IIA held a formal member dinner, where an opportunity was presented to interview an audit committee chair from local government. The interview with the local government

audit committee chair revealed insightful perspectives. Therefore, additional interview participants were sought to gain additional evidence on governance policies, practices and interfaces of local governments, as the purpose of this case study is to gain insights into the governance phenomenon. Subsequently, to gain a wider understanding of the governance phenomenon additional local government audit committee chairs were sought in order to develop a nested case of local (city) governments centred on the audit committee and its interfaces to the wider governance system. The first interview participant arranged for an additional two interviews to be held with other local government audit committee chairs. One accepted, while scheduling issues forced the cancelation of the other.

Both local government audit committee chairs have extensive experience and hold multiple engagements in various local governments and have previously held senior management and leading audit roles. Therefore, the interviewees' knowledge arises from their varied experiences and opinions regarding governance 'best practices' and governance actor interactions from both their experiences in local governments and ASX 300 firms. Both these interviewees were audio-taped and scheduled for an hour. However, due to their interest in this research each lasted for an average of an hour and a half. Further, both interview participants had amalgamated their responses drawing from their multiple experiences. Additionally, the interview participant referred to as PH has previously served on the Australian auditing standards board. These two interviews provided facts and reflections that both complemented and broadened the evidence obtained from the 'key case' company. This further helped in striving for saturation due to the multiple sources of collected evidence.

Given the use of a nested case study process, the additional interviews with the local government audit committee chairs are able to serve as another individual case unit within the wider case. Since it serves as a supplementary case unit it is based on the general governance nature of local governments. Therefore, the company case unit can act as the key case unit as it demonstrates,

through its disclosers, a comprehensively documented and professionally managed governance ecosystem, while the local government case unit serves as a supplementary case unit. This will also enhance the validity of the second step analysis of the empirical findings through triangulation (Denscombe 2007).

The empirical findings from the local government case have been structured to flow as a narrative story, similar to the company case. For comparability reasons, this includes a qualitative analysis of the text obtained from publicly available documents as well as interview transcripts. Upon the formal write up of the city governments case unit, it was sent to the participants for their review and possible additions and corrections. Researcher received no response; therefore agreement with the narrative story for city governments was implied. The empirical findings of this city governments' case unit are presented in chapter 6.

Table 3.5 (below) summarises some of the key similarities and differences between corporate entities and local governments to mainly illustrate their structural similarity. The table is structured around the agency concepts as depicted in Figure 2.3 of Chapter 2. This allows for an easier intergration of local government and corporate concepts and structures into Figure 3.5. In summary, Table 3.5 shows that there is a strong structural similarity between the governance mechanisms of corporate entities and local governments. Therefore, the local government case unit can provide an alternative perspective on the governance phenomenon.

Table 3.5: Key Similarities and Differences between Corporate Entities and Local Governments

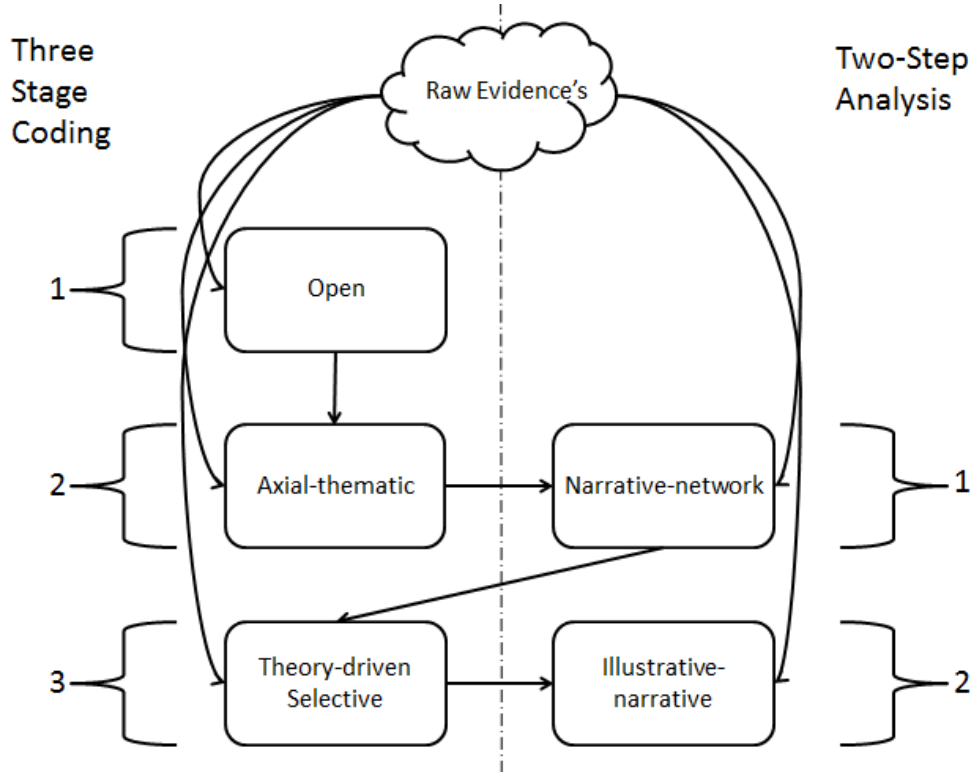
Corporate Entities	Local Governments	Similarity
Firm	City Council	An Entity
Decision Control		
Board	Council	Governing body equivalent
Directors Elected business politicians – directors are nominated by the board, but are elected by shareholders	Councillors Elected politicians – councillors may be self-nominated, but are elected by residents	Equivalent, except for specialised knowledge and experience.
Board Chair	Council Mayor	Role equivalence
Independents and executive members	Pure independents by definition	Governing body composition
CEO is a member of the Board	CEO is not a member of Council but is the interface	Equivalent relationship
Audit Committee composed of board members	Audit committee composed of independent advisors and councillors	Established to assist the governing body (Advisory)
Decision Management		
Executive management	City management	Role equivalence
Principal		
Shareholders – generally concerned about capital return	Residents – generally concerned about sustainable living and efficient services	Relationship equivalence
Source: Interview with PH on 10th May 2012; Interview with JA on 27th March 2012; Department of Planning and Community Development 2012e		

3.5 EVIDENCE CODING AND ANALYSIS APPROACHES

As stated earlier this thesis adopts a qualitative approach for its evidence collection and presents the thesis as a case study. Consequently, the thesis also adopts a qualitative approach for the coding and analysis of its evidences. The coding and analysis approaches are outlined in Figure 3.3 and discussed in the next sub-sections. As Figure 3.3 shows, the thesis adopts a three stage coding scheme and a two-step analysis approach. Reviewing the raw evidence's (i.e., review interview audio-tapes, annual

report, charters, etc.) at the end of each coding stage and analysis step (MacFarlane and O'Reilly-de Brun 2012; Neuman 2011).

Figure 3.3: Adopted Approaches for Evidence Coding and Analysis



3.5.1 Three Stages of Coding

As mentioned above, this thesis adopts a three stage coding scheme. Neuman (2011) suggests that there are three stages in qualitative coding and, at each stage a different coding approach is to be used. At the first stage an open coding approach is usually adopted (Neuman 2011). Open coding attempts to condense the raw evidence into broad preliminary categories (Neuman 2011). These broad preliminary categories or themes are based on a low level of abstraction, and may come from initial research question(s), concepts embedded in the literature or stimulated by evidence immersion (Neuman 2011). In open coding the researcher moves back and forth between abstract concepts and specific details focusing on the actual evidence (Neuman 2011). This back and forth ensures that the raw evidence is not forced into predetermined categories (MacFarlane and O'Reilly-de Brun 2012). The goal of open coding is not on the predetermined categories, but rather, on evidence interpretation and category development primarily driven by the conceptual patterns in

the evidence (Kendall 1999). Kendall (1999) identifies open coding as an approach which aims to generate an emergent set of categories. Consequently, the approach therefore remains inherently inductive.

The second coding stage adopts an axial-thematic coding approach, because in axial-thematic coding the focus is simultaneously on the categories or themes and on the evidence (Neuman 2011). Therefore, the primary concern in this coding stage is on making connections among the previously emerged inductive themes from the first coding stage and looking for new themes between themes (Bitsch 2005; Neuman 2011). It “focuses on the relationships between categories and subcategories, including conditions, cause-and-effect relationships, and interactions” (Bitsch 2005, p. 79). In summary, the researcher is: (1) to look for categories or themes which cluster together; (2) to divide existing themes or categories into subcategories; and (3) to combine several closely related concepts (Neuman 2011). Incorporating the thematic coding with axial coding will ensure that emergent themes are important to the description of the phenomenon and are evidence driven (Fereday and Muir-Cochrane 2006; MacFarlane and O’Reilly-de Brun 2012). Therefore, the axial-thematic coding approach will ensure that the initial categories are reviewed to make further comparisons which describe the relationship between categories (Jones and McEwen 2000).

The final coding stage adopts an theory-driven selective coding approach, because this mixed coding approach is better suited for addressing this thesis’s research questions and objectives (MacFarlane and O’Reilly-de Brun 2012; Neuman 2011). Selective coding involves rescanning the raw evidence and previous codes to look for selective cases which support the developed conceptual coding (Neuman 2011). To better address research questions and objectives, this third coding stage is adapted to shift its focus from the raw evidence to the empirical findings of the first step analysis (MacFarlane and O’Reilly-de Brun 2012). This theory-driven selective coding approach is a process which integrates previous categories into a selection of core categories which are determined as central to theoretical constructions (Kendall 1999). Therefore, in this study, the empirical findings

represent mappings from a deductive prior theoretical template of codes approach (Fereday and Muir-Cochrane 2006; MacFarlane and O'Reilly-de Brun 2012).

3.5.2 Two-steps of Analysis

The first step of the two step analysis adopts a narrative-network analysis based on the inductive axial-thematic coding, i.e., the first and second coding stages. Adopting this form of coding and analysis will ensure that empirical findings are evidence driven (MacFarlane and O'Reilly-de Brun 2012). Neuman (2011) describes the narrative as a type of writing which tells a story and presents a linked chain of events in which individual or collective social actors have an important role. The narrative analysis is a way to examine the world as a set of connected relationships among parts which form part of a plot (Neuman 2011). It serves as an outline for organising and explaining the evidence (Neuman 2011). While the network analysis aims to discover, analyses and then display sets of relationships (Neuman 2011), it also helps to show and understand the structure of complex social relations (Neuman 2011). Therefore combining both these forms analysis will ensure that at the empirical findings from the first step analysis is an inductive story of complex social relations. Further the inductive axial-thematic coding scheme applied ensures that the analysis is based on the emerged themes and categories (Fereday and Muir-Cochrane 2006).

The second and final analysis step involves mapping the findings of the first step narrative analysis into theory-driven selective narrative analysis (MacFarlane and O'Reilly-de Brun 2012). In this thesis, the assumptions underlying agency theory and institutional theory, respectively, are selected for the illustrative-narrative analysis. Therefore, the findings from the first stage of network-narrative evidence analysis are to become the evidence's for the second stage of illustrative narrative analysis (Fereday and Muir-Cochrane 2006). In summary, the thesis adopts an illustrative-narrative analysis method. The illustrative method is a form of qualitative evidence analysis which takes theoretical concepts and treats them as empty boxes which need to be filled by using specific empirical examples and descriptions (Neuman 2011). It applies theory to a social setting by organising evidence based on theory (Neuman 2011). Consequently, pre-existing theory provides the

conceptual categories which are filled with empirical evidence (Neuman 2011). Adopting this two-step analysis method will ensure that the second step empirical findings are guided by theoretical assumptions while being simultaneously organised and explained in a story like manner.

3.6 CHAPTER SUMMARY

This chapter has provided a summary into the research design and strategy adopted for this study. It further explains the methods used to gather evidence. This study adopts a qualitative research design, as the research problem resides more towards the qualitative end of the methods continuum. The qualitative research approach provides an enhanced means of exploring and understanding the interactions of governance structures within a corporate eco-system.

An interpretivist ontological philosophical assumption is adopted, as the study seeks to embrace the notion of multiple realities in addressing the corporate governance phenomenon. With the interpretivist stance the governance phenomenon can be theoretically defined by adopting both or either the agency or institutional theoretical lens. The study adopts multiple inquiry paradigms, post-positivism, constructivism and pragmatism, to address the research problem. Consequently, the governance phenomenon is bounded by causality and is shaped by prior events and theories, yet it remains simultaneously evolutionary. Further, it is underpinned by the notion of multiple realities as per the varied perspectives of participants.

The study adopts the case study research strategy, because this will enable an in-depth holistic focus on the governance relationships and interactions within a particular firm by examining its corporate eco-system. The sampling frame adopted for the study is the key case method, as it will ensure the selected case demonstrates sound governance practices and models and by inference, a strong commitment to the protection of shareholder interests. The purpose of the case study is a combination of instrumental, explanatory and exploratory. In this thesis the approach of the case study is theory testing and interpretive, where the researcher relies on agency theory and

institutional theory to interpret the governance phenomenon. The thesis adopts a nested case unit process; therefore it will gain its completeness from the wider case.

The evidence obtained from the main case unit is sourced using semi-structured audio-taped interviews conducted with the company secretary, audit committee chair and external audit partner. Additionally, evidence is collected from multiple documents available online. The complementary case unit's evidence has also been collected from semi-structured audio-taped interviews conducted with two local government audit committee chairs. In coding and analysing this evidence, the thesis adopts a three stage coding scheme and a two-step analysis approach.

"The ancient teachers of this science ... promised impossibilities, and performed nothing. The modern masters promise very little ... [but] performed miracles" (Shelley 1818, p. 36)

“On every point of general literature he displays unbounded knowledge, and a quick and piercing apprehension” (Shelley 1818, p. 189).

CHAPTER FOUR

A CASE STUDY OF CORPORATE GOVERNANCE POLICIES AND PRACTICES FOCUSING ON THE AUDIT COMMITTEE

4.1 INTRODUCTION

The purpose of this chapter is to provide a detailed understanding of the policies, practices and interfaces of key governance actors and mechanisms within their corporate eco-system of a listed Australian company. The focus is centred primarily on the audit committee of the board of the case company. These policies, practices and interfaces will be interpreted from alternative theoretical perspectives drawn from agency and neo-institutional theories, as reviewed in Chapter 2. This theory-grounded interpretative stage will be undertaken in Chapter 6.

This chapter presents the empirical findings on the case company from a narrative-network analysis of the text obtained from company documents and interview transcripts. It is based on information extracted from the various public disclosures made by this Australian listed company readily available through its website. Additionally, it is based on information extracted from semi-structured interviews conducted with the audit committee chair, company secretary and external audit partner.

It was a formal condition and request that the name of the company and identities of participants be kept confidential. As such the company shall be referenced as Case One. Given the qualitative nature of this study this chapter acknowledges the sources of the various information presented, however withholds from formally referencing due to confidentiality and ethical purposes. This Chapter extracts information from Case One’s 2011 annual report; board charter; audit, business risk and compliance committee charter; nomination committee charter; remuneration committee charter; risk oversight and management policy; continuous disclosure policy; and the audit, business risk and compliance

committee's policy on non-audit services and auditor rotation. These various sources ensured that saturation reached.

This chapter is structured to flow as a story which begins by introducing the company (i.e., Case One), its directors, executive management and auditors. The story continues by describing the responsibilities and functions of the board, the audit, business risk and compliance committee, the remuneration committee, the nomination committee and audit programmes. It concludes by describing some of Case One's key corporate governance policies. Through this structure, a detailed understanding can be gained about the policies, operations and interactions of Case One's corporate governance mechanisms.

4.2 THE COMPANY

Case One is an ASX 300 listed company operating in the 'Retailing' GICS Industry Group. Case One's principle activity is the management of consumer brands and outlets, with a net asset worth of approximately 1.8 billion, a net debt/equity ratio of approximately 19%, and a return on capital of approximately 13.5% (Case One 2011a).

Case One, was selected as its approach to corporate governance is one that complies with the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations. In addition its public disclosures and reports demonstrate high standards of ethical and corporate governance excellence and the ease of access implies transparency. Case One highlights its commitment to sound governance practices in its governance statement which states that the directors and management are committed to conducting the Company's business ethically and in accordance to the highest standards of governance (Case One 2011a). In addition it notes that good governance structures encourage companies to create value for shareholders through the promotion of sensible risk taking, while providing the accountability and systems of control to match the risks involved (Case One 2011a).

4.3 BOARD OF DIRECTORS

The Case One board is currently composed of six directors, one executive and five non-executive independent directors (Case One 2011a). A brief background of current Case One directors is provided below.

4.3.1 Jay

Jay is currently the board chair and is an independent non-executive director; Jay joined Case One mid-2008 and was appointed as chairman late-2008 (Case One 2011a). A Fellow Chartered Accountant (FCA) with previous experience as a partner in one of the big four audit firms in Australia and Asia (Case One 2011a). Table 4.1, lists some of Jay's current and previous directorships.

Directorships	Position	GICS Industry Group	Appointment
Current	Chair	Real Estate	2005
	Chair	Materials	Mid 2009
	Director	Consumer Services	Early 2008
Previous	Director	Software & Services	2006 to 2008
	Director	Pharmaceuticals, Biotechnology & Life Sciences	2002 to 2008
	Director	Diversified Financials	2005 to 2007
	Director	Pharmaceuticals, Biotechnology & Life Sciences	2005 to 2006
	Director	Health Care Equipment & Services	2004 to 2005
	Director	Real Estate	2001 to 2005

Source: Case One 2011a; ASX 2012

4.3.2 June

June is currently the chair of the audit, business risk and compliance committee, further June is an independent and non-executive director; June joined Case One mid-2009 (Case One 2011a). June has extensive experience on boards, having served as a non-executive chair and director of various companies from a range of Industry Groups in public, private, and government sectors (Case One 2011a). Further, June is a Fellow of the Australian Institute of Company Directors (FAICD) and an Associate Professor of business from a major Australian University (Case One 2011a). Table 4.2, lists some of June's current and previous directorships.

Table 4.2: June

Directorships	Position	GICS Industry Group	Appointment
Current	Director	Insurance	2003
	Director	Materials	2005
	Director	Telecommunication Services	2010
Previous	Director	Materials	2000 to 2007
	Director	Pharmaceuticals, Biotechnology & Life Sciences	2005 to 2007
	Director	Capital Goods	2000 to 2009

Source: Case One 2011a; ASX 2012

4.3.3 Sam

Sam is the CEO and an executive director; Sam joined Case One in 1996 as general manager of various Case One divisions, Sam was appointed as CEO early-2008 (Case One 2011a).

4.3.4 Ben

Ben is an independent and non-executive director; Ben joined Case One mid-2010 (Case One 2011a). Previously Ben ran a strategic consultancy business for six years with clients from various GICS Industry Groups, which include transportation, telecommunication services, media, and consumer services (Case One 2011a). Table 4.3 lists some of Ben’s current and previous directorships and senior executive engagements.

Table 4.3: Ben

Directorships	Position	GICS Industry Group	Appointment
Current and Previous	Executive	Household & Personal Products	
	Executive	Household & Personal Products	
	Executive	Energy	
	Executive	Food, Beverage & Tobacco	
	CEO	Household & Personal Products	
	CEO	Consumer Services	2003 to 2010
	Director	Food, Beverage & Tobacco	
	Director	Consumer Services	
	Director	Food, Beverage & Tobacco	2005 to 2009

Source: Case One 2011a; ASX 2012

4.3.5 Ken

Ken is an independent and non-executive director; Ken joined Case One late-2009 (Case One 2011a).

Ken is a FAICD and has over 25 years' experience with multi-national corporations (Case One 2011a).

Below is Table 4.4 which lists some of Ken's current and previous directorships.

Table 4.4: Ken			
Directorships	Position	GICS Industry Group	Appointment
Current	Director	Retailing	2003
	Director	Consumer Services	2004
	Director	Diversified Financials	2007
Previous	Managing Director	Food, Beverage & Tobacco	
	Managing Director	Food, Beverage & Tobacco	
	Managing Director	Food, Beverage & Tobacco	
	Managing Director	Food, Beverage & Tobacco	

Source: Case One 2011a; ASX 2012

4.3.6 May

May is an independent and non-executive director; May joined Case One early-2010 (Case One 2011a). May has over 25 years' experience as a senior executive in various industries (Case One 2011a). In addition, May is a FAICD, holds a Masters of Business Administration and a Bachelors of Commerce (Case One 2011a). Table 4.5 lists some of May's current and previous directorships.

Table 4.5: May			
Directorships	Position	GICS Industry Group	Appointment
Current	Director	Materials	2011
	Director	Real Estate	
Previous	Director	Real Estate	2007 to 2008
	Director	Transportation	2006 to 2007
	Director	Energy	1999 to 2006
	Managing Director	Banks	10 years
	Managing Director	Banks	10 years

Source: Case One 2011a; ASX 2012

4.4 SENIOR MANAGEMENT

4.4.1 Sam

As mentioned earlier under the previous section (under the company's directors), Sam is the CEO and an executive director; Sam joined Case One in 1996 as general manager of various Case One divisions, Sam was appointed as CEO early-2008 (Case One 2011a).

4.4.2 Tim

Tim is the CFO and Chief Operating Officer formally the Chief Financial and Operating Officer (CFOO); Tim joined Case One Mid-2009 (Case One 2011a). Prior to Tim's appointment at Case One, Tim served as a Chief Strategy Officer (CSO) at CompOne which operates in the Food, Beverage & Tobacco GICS Industry Group, Tim's responsibilities included corporate strategy and financial planning (Case One 2011a). Tim has considerable experience in retailing and diversified financials GICS industry groups, having held senior consultancy roles in strategy, operations and finance at a major management consultancy firm and one of the big four audit firms (Case One 2011a).

4.4.3 Joe

Joe is the general counsel and company secretary of Case One and was appointed this role in late-2003 (Case One 2011a). Prior to Joe's appointment Joe held senior corporate legal roles and an eight year career with a major Australian law firm (Case One 2011a).

The company secretary should have a legal background as the company secretary is a statutory officer under the Corporation Act. The company secretary is also the board secretary. The role of a board secretary is a boarder role as opposed to being the secretary to a board sub-committee. As secretary to the board have a duty to assist the directors in fulfilling their legal obligations under the Corporations Act, source outside advice in fulfilling their roles as directors, advise on technical legal papers presented to the board, assist and advise the board in relation to the legal implementation of remuneration policies. The role as the secretary to a board sub-committee, it is more of an administrative role; duties include taking minutes at

meetings, aiding in the preparation of meeting agenda, the distribution of meeting papers and agenda, and organising meetings. Interview with Joe on 8th March 2012

The role of the company secretary is an interesting balancing act due to its dual accountabilities one as a company employee who is to report to the CEO and CFO and two as a statutory officer (with obligations to and an instrument of the board) under the Corporations Act. The company secretary does not have a separate formal accountability to board sub-committees, accountability remains to the board as a statutory officer. Interview with Joe on 8th March 2012

4.5 THE AUDITORS

4.5.1 Outsourced-Internal Auditor Partner

Lee is the outsourced-internal auditor partner of Case One. Lee is a partner at one of the big four audit firms and was appointed in 2010 as part of Case One's evolving corporate needs which required the establishment of an internal control framework (Interview with Joe on 8th March 2012).

4.5.2 External Auditor Partner

Cat is the external auditor partner at Case One, Cat was appointed in 2011 (Interview with Cat on 01st May 2012). Cat has over 18 years' experience as a partner at one of the big four audit firms in risk and audit advisory services (Audit Firm 2004). Cat brings a wide range of expertise in accounting, assurance and advisory, and due diligence investigation (Audit Firm 2004). Cat's experience includes external audit; review of internal controls, fraud assessment and budgeting processes; due diligence investigation and joint venture reporting; and advice and implementation of International Financial Reporting Standards (Audit Firm 2004).

4.6 THE BOARD

The board is committed to maximising operational performance, financial returns and creating shareholder value (Case One 2011a). The board is also committed to ensuring that its constitutional

powers and responsibilities are exercised and discharged, adopting best practice governance principles and applicable laws (Case One 2005; 2011a). The board retains the ultimate responsibility for the strategic direction and control of Case One (Case One 2005).

The board is responsible for ensuring Case One is properly managed to protect and enhance shareholder interests, and that directors, officers, and employees operate in a sound governance environment (Case One 2011a). The board is responsible for the review and oversight of the administration, management, and governance of Case One (Case One 2005). The board has the ultimate responsibility over setting and ensuring policies regarding the business and affairs of Case One are to the benefit of shareholders and stakeholders, however the board remains accountable to shareholders regarding the overall performance of Case One (Case One 2005; 2011a).

4.6.1 Key Board Roles and Responsibilities

- Protection of shareholder interests, through the adoption and maintenance of best practice governance standards;
- Ensure the establishment, monitoring and review of a risk management and compliance framework;
- Authorise Case One accounts policies and annual financial statements;
- Approve annual budgets;
- Approve significant acquisitions and divestments;
- Approve the Strategic direction of Case One;
- Engage, appointment, review, and when necessary replace the CEO;
- Ensure executive management and director succession planning;
- Establish goals for management and monitor their achievement; and
- Evaluate and review Case One performance against strategies and budgets (Case One 2005; 2011a).

4.6.2 Key Director Responsibilities

- Act honestly, fairly, and diligently;
- Abide to laws, regulations, and Case One policies; and
- Avoid potential conflicts of interest by promptly disclosing interests in contracts, other directorships or offices held, possible related party transactions, and the sale or purchase of Case One shares (Case One 2005).

4.6.3 Composition

The board is to be composed of a minimum of six directors to a maximum of ten directors, in the event of the identification of an outstanding candidate or when additional expertise are required to diligently discharge board responsibilities and functions (Case One 2005). In addition, the board is to be composed of directors with an appropriate range and mix of qualifications, expertise, and experience which will enable the effective functional discharge of board responsibilities (Case One 2005; 2011a). Further, it is to be composed of a majority of independent and non-executive directors (Case One 2005).

An *independent director* is a director who is not and was not within the last three years a member of executive management; and is free from any business, affiliation or engagement which could or be reasonably perceived to materially interfere with his or her ability to, execute an unfettered and independent judgment or act in best interest of Case One (Case One 2005; 2011a). The materiality of any engagement or relationship is considered on a case by case basis based on adopted materiality guidelines (Case One 2011a). The guidelines define a material engagement or relationship as: (1) holding $\geq 5\%$ of Case One shares; or (2) a business affiliation accounting for $\geq 5\%$ of Case One's revenue or expenses (Case One 2011a). However, ultimately the board will make an qualitative assessment of any factors and considerations which may be reasonably perceived to materially interfere with a directors ability to, execute an unfettered and independent judgment or act in best interest of Case One (Case One 2005; 2011a).

As an additional safeguard in preserving its independence, the board chair is to be an independent and non-executive director (Case One 2005; 2011a). The board chair acts as the official spokesperson of the full board, unless the full board determines otherwise (Case One 2005). In the absence of the board chair another director may should they choose chair all or part of the Board meeting (Case One 2005).

All directors except the CEO are subject to shareholder re-election every three years (Case One 2011a). A director should not hold office for more than nine years, unless under the board determines otherwise due to exceptional circumstances (Case One 2005).

4.6.4 Board responsibilities and Functions

Below lists some key responsibilities and functions of the board:

Executive Appointments

- The appointment, authority delegation, and performance review of the CEO;
- The appointment and performance review of other executive directors;
- Ratification of the hierarchical matrix for executive management includes the CEO (Case One 2005).

The Board and Executives

- Approve the terms of appointment of executive management;
- Executive management evaluation and remuneration, including their incentive policies;
- Executive management and director succession planning;
- The performance assessment of Case One and its board and directors, including the CEO;
- Ensure the continuous education and information follow to directors regarding:
 - The various businesses of Case One, and
 - The board's role and its functions and obligations;

- The performance evaluations of individual directors prior to their standing for re-election (Case One 2005).

The Strategic Direction

- Approve the strategic plan and budget;
- Evaluate the performance of Case One against its business strategies and plans to:
 - Monitor the performance of executive management delegated functions; and
 - Assess Case One's sustainability and suitability of its overall resource allocation and business strategies and plans;
- Approve the capital and operating expenditure budget, including any modifications;
- Approve all significant and material mergers, acquisitions or divestitures;
- Approve significant leasing or purchase of buildings or property; and
- Approve any capital and operating expenditure or any other material transaction outside the boundary of the budget or ordinary course of business (Case One 2005).

Financial Accounts and Reporting

- Approve Case One's annual accounts and directors' reports;
- Approve accounting policies;
- Approve the audit plan of both the internal and external audit;
- Approve audit reports including management letters; and
- Approve any borrowings or the use of Case One assets as security (Case One 2005).

Miscellaneous

- Approve the use of the company seal or execution without the seal; and
- Approve donations and sponsorships if above approved limits (Case One 2005).

4.6.5 Authority Delegation

As noted earlier the board has retained the ultimate responsibility for the strategic direction and control of Case One, however the board delegates the day-to-day management of Case One resources to the executive management, including the CEO (Case One 2005; 2011a). In addition, the board may delegate some its responsibilities and functions to its sub-committees (Case One 2005).

4.6.5.1 To the Executive Team

The board delegates the day-to-day management of Case One's resources to the executive management team under the leadership of the CEO, to deliver the strategic direction and goals of Case One as determined by the board, however agreed between the board and executive management (Case One 2005; 2011a). A key board function is to monitor the executive management team's performance in regards to deliverance of the strategic direction and goals of Case One (Case One 2005; 2011a). The Executive management team's annual performance evaluation occurs in accordance with the processes described in Remuneration report (Case One 2011a).

The board will monitor the decisions and actions of the CEO and the overall performance of Case One to gain assurance that process is being made towards the attainment of approved strategies, goals and plans (Case One 2011a). The CEO however will conduct a formal review each year, which assesses the overall performance of the executive management team and report back to the board (Case One 2005).

4.6.5.2 To Board Sub-committees

The board may establish sub-committees to *streamline* the discharge of its responsibilities and functions (Case One 2005). Each standing sub-committee is to adopt a formal charter which sets out matters regarding its composition, responsibilities, functions and administration (Case One 2005). In addition, each board sub-committee is to be composed of a minimum of three non-executive directors, majority of which are independent and further the chair is to be an independent and non-

executive director and shall not be the chair of the board (Case One 2011a). Currently the board has established three sub-committees:

- Audit, business risk and compliance committee;
- Nomination committee; and
- Remuneration committee (Case One 2005; 2011a).

The board may also delegate specific functions or issues to these sub-committees on an *as needs* basis, any additional powers to be delegated to these sub-committees will be determined in board resolutions (Case One 2005). Any other governance issues not specifically dealt or delegated to one of these sub-committees is the responsibility of the full board (Case One 2011a).

In relation to issue delegation to a board sub-committee, if an identified issue is delegated to a board sub-committee. That sub-committee is then responsible for making a recommendation to the board therefore executive management is to deal with the sub-committee regarding the issue and not the board. As such executive management have indirect accountabilities to board sub-committees. Interview with Joe on 8th March 2012

4.6.6 Board Processes

The board is to determine its meeting schedule at the beginning of each year and it currently schedules nine meetings per year (Case One 2005; 2011a). It is Case One practice that one or more of these meetings coincide with site visits at key operating sites, to assist the board in its understanding of operational issues and to continually educate and inform directors regarding various Case One businesses (Case One 2005; 2011a). The company secretary is to attend all board meetings as a minute secretary (Case One 2005). Members of the executive team may be invited to attend all or part of meetings whenever the board requires their *involvement of assistance* in consideration of issues before the board (Case One 2005). A majority presence of board members shall form a quorum (Case One 2005).

The meeting agenda of the board is prepared by the company secretary in conjunction with the board chair, CEO and the CFOO with periodic input from the full board (Case One 2011a; Interview with Joe on 8th March 2012). All board papers are to be distributed prior to board meetings (Case One 2011a). Further, whenever necessary the board may hold additional meetings to address specific issues which arise and require attention between scheduled meetings (Case One 2005; 2011a). The meeting agenda of board sub-committees is similarly prepared by the company secretary in conjunction with the respective chair (Interview with Joe on 8th March 2012). The frequency of Board meetings and that of its sub-committees is largely dependent on the issues raised and their complexity (Interview with Joe on 8th March 2012).

All directors and other attendees of board meetings are as fiduciaries and officers of Case One, they are required to keep all written or oral information presented or discussed at board meetings confidential (Case One 2005). All the minutes of board sub-committees are to be entered into the minute book, which is open for inspection by any director, further the minutes are to be signed by each board sub-committee chairs as a true and correct record (Case One 2005).

It is good practice to have the CEO lead the discussion at the start of board meetings by providing a summary regarding the issues faced by the company and the manner in which these issues have been translated into the financial results and statements. Interview with June on 27th March 2012

4.6.7 Access to Information and Independent Advice

Each director has the right to access Case One information and Case One's executive management, external advisors and auditors (Case One 2011a). Further, directors may also seek independent professional advice at the expense of Case One, however seeking such advice requires a formal request issued to the board or its chair (Case One 2011a). In the event that the board chair requires such advice a formal request shall be made to the chair of the audit, business risk and compliance

committee (Case One 2011a). All Directors shall also have full access to all documents presented or prepared for meetings of the board or its sub-committees (Case One 2011a).

4.6.8 Conflict with Executive Management

Conflict between the board and executive management are generally in relation to when issues should be disclosed rather than what or how. Further, the board is prepared to take a different view from that executive management in these conflict situations. Directors drawn upon their knowledge and experience in executing their judgement, for example if the issue was a matter of goodwill write-down, directors would consider whether the materiality of the goodwill value. The board is a collegiate body. If a decision could not be reached at the meeting it would be deferred and raised at the next meeting. It would never force a resolution and see who had the most votes by the end. Interview with Joe on 8th March 2012

4.6.9 External Communication

Board directors do not have direct communication with external regulators or parties, except for the board chair who will have external communication to and with major shareholders. External communication from regulators to board directors is through the company secretary, and the secretary is to pass the information down to directors. There is no direct communication between directors or regulators, unless the regulatory body demanded direct communication. Interview with Joe on 8th March 2012

4.6.10 Review

The Case One board with the assistance of the nomination committee and an external advisor will bi-annually, review the performance, membership and charters of the board and its sub-committees to determine their adequacy in the then current circumstances and to determine whether their processes are adequate to ensure they are able to carry out their functions in the most effective

manner (Case One 2005; 2011a). This review will include individual performance evaluations for the board chair and each director (Case One 2011a).

As part of the 2011 review process, all directors completed a questionnaire in which they were able to make comments and raise issues relating to the operation of the board or its sub-committees (Case One 2011a). In addition, executive management input was also sought and included in the review process (Case One 2011a). This information was then analysed adopting both qualitative and quantitative methods, in which the results were compiled into a report prepared by an external adviser (Case One 2011a). The external adviser in conjunction with the board chair provided feedback to the board and privately to individual directors (Case One 2011a).

Each director is required to undergo a performance review prior to their standing for election (Case One 2011a). This review is performed by the board chair in consultation with other directors, while the board's chairs performance review is performed by a board chosen non-executive director (Case One 2011a). The details of the executive management performance review processes are disclosed in the remuneration Report (Case One 2011a).

4.7 AUDIT, BUSINESS RISK AND COMPLIANCE COMMITTEE

Table 4.6: Members of the audit, business risk and compliance committee

Members	Non-executive and Independent	Meeting frequency
June (Chair)	Yes	5 of 5
Ben	Yes	4 of 4
Ken	Yes	5 of 5
Jay (Board Chair)	Yes	5 of 5
Source: Case One 2011a		

4.7.1 Purpose

The primary purpose of the audit, business risk and compliance committee (ARC) is to assist the board in the effective discharge of its responsibilities across board delegated functions (Case One 2010a; 2011a). Delegated functions cover the vetting of financial reporting processes and the oversight of the financial risk framework includes compliance, internal controls, the maintenance of

the insurance and assurance provided by the internal auditor, and the relationship with external auditors (Case One 2010a).

It is important to note that the primary purpose of the ARC is to assist the board. It is not a decision making sub-committee nor is it to make decisions on behalf of the board. Its role is to assist the board in the discharge of its responsibilities across functions delegated by board. As a non-decision making committee, the ARC is to make key recommendations around financial processes and reporting, internal controls, risk management framework and both the external and internal audit programmes. In doing so, the committee needs to work hard to ensure potential or bubbling issues are identified and acknowledged, this is achieved by constructing a culture which allows executive management to raise issues early. This will ensure that management raises these issues early and directors are kept up to date. Information papers are prepared and made available, and information sessions are organised and conducted prior to ARC meetings. Therefore board meetings are as per agenda and *free of surprises*. This will ensure a comprehension of issues, consequently the recommendation of the ARC and ultimately the decision of the board will be based on a comprehensive comprehension of issues. Interview with June on 27th March 2012

The ARC's primary purpose is to make recommendations to the full board which benefit for all stakeholders in relation to the financial statements, internal controls and risk management framework. The ARC is to oversee: (1) the internal control structure and framework to ensure that financial records are maintained; (2) the financial statements which are an output of those records are true and correct; and (3) the risk framework which is a broader role as it includes financial risk and environmental and social compliance which indirectly have a financial element. As

the business of Case One is about brands and intellectual property and through poor environmental and social compliance; brand damage is inevitable and Case One may lose its ability to supply retailers and considering the current technological social age the end consumer may boycott brands, as such Case One considers good environmental and social compliance practices as a core business element. Interview with Joe on 8th March 2012

In comprehending the purpose of the ARC, it is apparent that the ARC's sole accountability is to the board, its purpose is to assist and provide support to the board. The ARC's oversight function is to provide the board with *recommendations*; because the board has retained the ultimate responsibility and accountability over the oversight function. The ARC does not have a separate accountability to shareholders or other stakeholders; however ARC members have separate and direct accountabilities, not as ARC members but as *directors* of a corporate entity. Interview with June on 27th March 2012; Interview with Cat on 01st May 2012

4.7.1.1 Importance of an ARC

An Audit Committee can be considered as a key governance mechanism second to the board, especially if it is an audit and business risk committee which would have its claws in every element of a company's operations except for the people element. The ARC looks at, considers and makes a recommendation to the board in relation to the overall director report including the remuneration report, further, it receives assurance from the remuneration committee that it supports the remuneration report. Interview with Joe on 8th March 2012

4.7.1.2 The Role of the ARC Chair

The chair of an audit committee should be cautious not to pre-empt the audit committee in making a decision; as the chair is not the committee's decision maker. Interview with June on 27th March 2012

The main role of the ARC chair is to facilitate the work of the ARC and to act as a *bridge* between ARC and non-ARC directors and the external auditor, internal auditor, and executive management. As the bridge the ARC chair should meet with key presenters prior to ARC meetings (pre-meetings), to go through information papers, request for addition papers, identify issues, raise questions, and make a judgement to facilitate information sessions. These pre-meeting provide the opportunity for a pre-discussion over financial processes and reporting, internal controls, risk management and the external and internal audit programmes. This provides the benefit of freeing up meeting time to allow other ARC members to raise issues and concerns and have the presenters address their issues and concerns. Presenters may include executive management, auditors, or other persons requested to address the ARC. Interview with June on 27th March 2012

An observed informal activity of the ARC chair is the chair's willingness to meet with key presenters prior to ARC meetings to stay on top of issues (usually comprising of the ARC chair, board chair, external auditor, internal auditor and CFOO). This activity is critical to overall ARC success as these pre-meetings provide the opportunity for executive management, the external auditor and the internal auditor, to refine proposals, documents or information papers to better target and address potential ARC or director concerns. Interview with Joe on 8th March 2012; Interview with Cat on 01st May 2012

Pre-meetings act as a tool which ensures any bubbling issues are identified and acknowledged. This ensures that board and ARC meetings remain free of surprises. Pre-meetings also enable the preparation and distribution of information papers and the potential conducting of information sessions.

Acting as a bridge to management is not a threat to director independence but rather an opportunity for a more brutal battering and probe of flaky proposals, without the embarrassment of having it done in front of a broader forum, i.e., in front of full ARC or board. This provides executive management with the opportunity for an early reaction and probe; not to *false stage manage* but to: (1) be across any bubbling issues; and (2) assist executive management to better respond to ARC concerns. This ensures a productive and detailed presentation, followed by a thorough discussion. Interview with June on 27th March 2012

The ARC chair can be considered to have an informal accountability to executive management in assisting executive management (1) in the preparation of the board agenda; and (2) to better comprehend what the ARC is looking for and what it needs to perform its role. This is to ensure that executive management presents and distributes information papers in a clear and comprehensive yet concise manner which meets the needs of all directors and not only those of the ARC. If ARC directors have any issues in relation to the distributed papers, they are free and advised to directly contact members of executive management to seek clarity, justifications or request for additional papers and information. Interview with June on 27th March 2012

An observed informal role of the ARC chair is as a coach to executive management. Through this informal coaching role the ARC chair is able to aid executive management in the improvement in the quality of distributed financial papers and is better able to improve director issue comprehension, through the ARC chair's pre-meetings and ability to recognise the potential need for information sessions. Interview with Cat on 01st May 2012

A major informal role of an audit committee chair is to ensure clarity of expectations and understanding in relation to the purpose and role of an audit committee, not

only to its members but the broader forum, i.e., non-audit committee directors, executive management and the auditors. A major concern of the ARC chair is that implicitly there may be greater, unrealistic and inappropriate expectations in the minds of non-audit committee directors regarding the purpose of audit committees' and that its presence alters their roles and responsibilities as directors over the integrity of financial reports. As such, these directors are potentially more likely to ignore certain director responsibilities particularly those over the integrity of financial accounts and reporting. It is important to note that the integrity of company accounts is the responsibility of all directors and not only of those of the audit committee. Interview with June on 27th March 2012

4.7.2 Composition

All persons appointed to the ARC must have the ability to comprehend and interpret financial statements (i.e., be financially literate) and have sufficient financial knowledge and understanding to allow for the diligent discharge of ARC functions and responsibilities (Case One 2010a). The board shall appoint the ARC chair and its members or by resolution remove and replace members (Case One 2010a). The ARC is to be comprised of a minimum of three members, all of whom shall be independent non-executive directors, unless the board determines otherwise (Case One 2010a). Further, the ARC chair cannot be the board chair (Case One 2010a).

The presence of the board chair as a formal member of the audit committee is common practice. Further, if the board chair is not already a formal member of the audit committee, the board chair does and should regularly attend Audit Committee meetings, in particular those regarding the year-end accounts. Interview with June on 27th March 2012; Interview with Cat on 01st May 2012

The board chair's addition on the audit committee could potentially improve the audit committee's ability to perform its oversight function, by informally strengthening the audit committee through

the board chair's authority and influence. However, the board chair should be able to comprehend the potential financial issues that an audit committee may potentially face, i.e., ideally the board chair should be financially literate.

The role of the ARC secretary is a process type role and does not require an accounting expert. The role involves working with the ARC chair to determine agenda, take minutes during ARC meetings and assist the finance team with ARC papers. Interview with Joe on 8th March 2012

4.7.3 Meetings

The ARC will meet at least four times per year, or as often as the ARC deems necessary to fulfil its responsibilities and objectives (Case One 2010a). Two ARC members shall form a quorum for ARC meetings and the company secretary shall act as the ARC secretary (Case One 2010a). The ARC secretary will arrange ARC meetings as directed by the ARC chair or at the request of any other director (Case One 2010a).

The Meeting frequency of this and other audit committees is largely dependent on the complexity of the issues and also the way in which both the board and audit committee meetings are structured and organised. Interview with June on 27th March 2012

The frequency of ARC meetings is dependent on the issues raised and their complexity. Very issue raised constitutes both an informal and formal process. The informal process involves discussions regarding the issue(s) between the key persons (typically including the ARC chair, board chair, CFOO and external audit partner). The ARC chair will then advise on the preparation of papers to be brought to the ARC and inviting persons of interest to ARC meetings to discuss issues with ARC directors so they may gain clarity on issues. The formal process involves the ARC directors reaching a decision at an ARC meeting, and the chair making a formal

recommendation to the board at the next board meeting. Interview with Joe on 8th March 2012

The CEO, senior risk executive, CFOO, head of internal audit (whether in-house or outsourced) and external audit partner may by invitation, attend ARC meetings (Case One 2010a). The non-ARC non-executive directors are free to attend ARC meetings (Case One 2010a). The ARC is to meet with the external and/or internal auditors in the absence of executive management whenever it is deemed appropriate but not less than twice a year to ensure that the auditors have had the full cooperation of executive management in conducting the audit, in addition to providing each auditor with the opportunity to raise matters of concern (Case One 2010a; 2011a).

Informal ARC meetings are not considered a good practice as ARC members would meet in absence of auditors raises issues. Further informal meetings in the presence of auditors is also bad practice as they are external professionals who need time to prepare nor should one spring or bounce between issues. However the chair of the audit committee should meet with key presenters prior to audit committee meetings to go over papers. Interview with June on 27th March 2012

The ARC had four meetings this year two were around the half and full year results, the other two were in-between to address various issues. Meetings last for about three hours which move at a reasonable pace. However everyone is expected to have read and digested papers. The CEO, CFOO, and the risk officer regularly attend ARC meetings; other members of the executive team by invitation attend to address particular issues. In addressing issues raised at ARC meetings the ARC chair will say “right we have heard what management has had to say, would any director like to make a comment?”, from there the ARC chair will action a resolution. Both the board and the ARC are a collegiate body, i.e., if votes were hung, the issue(s) would be

deferred to the next meeting, and the directors would not base a decision on majority rules basis. Interview with Joe on 8th March 2012

4.7.3.1 ARC Meetings Structure

ARC meetings are structured as follows:

1. Discussion of the previous meetings minutes lead by the ARC chair;
2. The ARC chair will run through the action items for the meeting;
3. The executive management team will go through their papers, agenda items may include:
 - a. Review of accounting issues;
 - b. Review of financial statements;
 - c. Dividends; and
 - d. Accounting standards update (lead by the external auditor's assistant);
4. The external auditors will present agenda items typically regarding:
 - a. External Audit update or report;
 - b. Non-audit service review;
 - c. Independence statement (CFOO as presenter);
 - d. Management letters;
 - e. Audit Plan; and
 - f. Engagement letter and fee proposal;
5. The General Manger of Risk and Internal Auditor will lead the risk and compliance agenda items, that typically includes:
 - a. Report on risk and social and environmental compliance;
 - b. Risk control plan and strategy; and
 - c. Internal Audit update and report;
6. The CEO and CFOO will lead the investor communications agenda items, which typically include draft ASX releases and investor presentations; and

7. The ARC chair will commence the *private session*, with both the internal and external auditors to attend (Case One 2011b; 2011c; 2011d; 2012).

It is beneficial to have any executives, including the company secretary and any executive directors, leave at the end of an agenda, to commence a closed private session between the non-executive directors and the lead internal auditor and external audit partner. This provides the opportunity for the non-executive directors to probe auditors and provides these auditors the opportunity to raise concerns in the absence of executive management. The next part of the process is to ask the lead internal auditor to leave, and continue the private session between the non-executive directors and external audit partner. Finally, the external audit partner is to leave to allow for a private session between the non-executive directors. No minutes should be taken during these closed private sessions. The formal documentation and distribution will require vetting from the auditors which may cause restrictions in the discussion during these sessions. This may potentially obstruct the purpose of these sessions. Sessions are kept open to allow the expression of human emotion. However the chair of the audit committee should take notes on issues and concerns, not names, in order to organise and facilitate appropriate follow-ups. This may include debriefing executive management. Interview with June on 27th March 2012

The *director private session* is a formal process of the ARC to eye-ball the Auditors to ensure that the auditors have nothing else to add in the absence of executive management. It should not be a scary process for executive management if appropriate controls and processes are in place. Further it is expected that if the auditors have had any concerns they would have been already escalated through the appropriate channels. Interview with Joe on 8th March 2012

4.7.4 Responsibilities and Functions

The ARC's key responsibilities and functions are to review, oversee and report to the board on the following:

Financial Processes and Reporting

- Ensure processes are in place to provide shareholders with financial information which is accurate, complete and reliable in all material aspects;
- Evaluate the processes in place which ensure that accounting records are properly maintained and are in accordance with statutory requirements; and
- The overall accounting policies and financial accounts and reporting of Case One (Case One 2010a, 2011a).

Audit Programmes

- The scope of both the internal and external audit programmes, their function and performance, and any other material issues arising from these audits;
- The performance and relationship with the external auditor, including their independence and determining rotation procedures for personnel of the external auditor;
- Review the reports of the internal auditor and oversee managements implantation of internal audit recommendations; and
- Make a recommendation to the board regarding the appointment, termination and fees of the external audit (Case One 2010a; 2011a).

The practice is that the ARC is to make a recommendation up to the board regarding the external audit firm and partner which covers their appointment, termination and fees.

Interview with June on 27th March 2012

While it is the audit committee's role to oversee the independence of the external auditor and this overwhelming concern (as with Case One) is valued and beneficial, as it

reinforces the client's commitment to ensuring the highest quality external audit. However, as auditors we should ever be vigilant and concerned with maintaining our independence. The reason is a loss of independence threatens and damages the integrity of the client company's accounts and the audit firm, including the professional reputation of the lead auditor and colleagues. Further, if an audit committee is to ever lose trust in or distrusts their external auditor, the external audit engagement is likely to be discontinued and a valuable client lost. Interview with Cat on 01st May 2012

The company outsources the internal audit function and it is a management engagement. However this union would not take place without the express blessing or agreement of the ARC. Therefore in a sense the ARC has an informal decision making authority regarding the appointment of the outsourced-internal audit function. Interview with June on 27th March 2012

Internal Controls and Risk Management

- Case One's accounting systems and internal controls;
- The processes used by the executive management team to monitor and ensure compliance with laws, regulations, ethical guidelines and other requirements that relate to the preparation and reporting of external financial information;
- Assess the adequacy of processes and controls established by the executive management to identify and manage actual or potential risk exposures and safeguard Case One assets;
- Review the process which provide assurance to the certifications provided by executive management;
- The risk management framework, which includes the identification and management of actual or potential material risk exposures; and
- The social compliance policies and practices (Case One 2010a; 2011a).

Executive management has a formal accountability to the ARC for ensuring an appropriate risk and internal control framework is designed and put in place. The general manager of risk and internal auditors also have an accountability to the ARC, as the ARC relies on the risk framework and internal controls information provided by the general manager of risk and internal auditor. The testing and assessment of the internal controls is the primary function of the internal auditors, while the external auditor is charged with compliance testing. Interview with Joe on 8th March 2012; Interview with June on 27th March 2012

Miscellaneous

- Any other matter the board determines appropriate to be referred to the committee; and
- Review the appointment and dismissal of the general manager of risk and any outsourced internal audit function (Case One 2010a).

In terms of the scope of responsibilities, audit committees are already overburdened with numerous formal roles and responsibilities. Therefore the audit committee chair should to some extent avoid accepting additional functions delegated by the board chair which are not necessarily performed by an audit committee. Unless, the audit committee is clearly the ideal candidate for these additional functions based on expertise, experience or are remotely related to the formal functions of the audit committee.

Interview with June on 27th March 2012

4.7.5 Reporting

The ARC chair will report to the board following each ARC meeting (Case One 2010a). A copy of ARC meeting minutes shall be included with the board papers at the next scheduled board meeting following the ARC meeting (Case One 2010a).

4.7.6 Authority

ARC is to have the authority to directly discuss with the auditors (in the absence of executive management if the ARC deems necessary) and executive management any issue within its remit (Case One 2010a). The ARC is also able to request reports, explanations and information in relation to any Case One activity, process, procedure or account (Case One 2010a). The ARC may also seek the advice of Case One's auditors, solicitors or any other independent adviser(s) regarding as to any matter pertaining to the powers, its duties or responsibilities, as the ARC may require (Case One 2010a).

The board is in sync with the ARC on issues. As such the board is prepared to take a different view than executive management in situations where the ARC makes a recommendation which opposes the view of executive management. Interview with Joe on 8th March 2012

4.7.7 Tension with Executive Management

Similarly to the board tension between the ARC and executive management is generally in relation to when issues should be disclosed rather than what or how. Interview with June on 27th March 2012

4.7.7 Review

The ARC will review its performance and charter at least once a year (Case One 2010a).

4.7.8 ARC Policy on Non-audit Services and Auditor Rotation

A key responsibility and function of the ARC is to oversee the relationship with the external auditor, which includes their independence and procedures for the rotation of external audit personal (Case One 2009a). This policy is intended to guide and assist the ARC in fulfilling its role of maintaining external auditor independence by regulating the provision of non-services, in reference to: (1) services the auditor may not provide; and (2) services the auditor may provide subject to the ARC's approval (Case One 2009a). As a general principle the external auditor is prohibited from providing any non-audit service which would create a perceived or real threat to their independence (Case

One 2009a). Further, the policy defines the term *non-audit services* to encompass any service the auditor may provide which is not necessarily incidental to or included in the terms of the audit engagement (Case One 2009a).

As the ARC chair have a clear view on what is acceptable in relation to non-audit services as it may potentially threaten auditor independence, therefore, black and white on the issue, there always exists that loving tension between auditors wanting to do more non-audit work. Interview with June on 27th March 2012

4.7.8.1 Services requiring approval

The policy recognises that there may be circumstances where the auditor may perform non-audit services without creating a perceived or real threat to their independence (Case One 2009a). Such circumstances may include situations where the auditor is uniquely positioned to perform such a services or minor tasks of assurance and compliance (Case One 2009a). However, such tasks are subject to the below approval limits (Case One 2009a).

- Where the engagement fee for the non-audit service does not exceed \$25,000 it may be approved by the CFOO and advised to the ARC chair;
- Where the engagement fee for the non-audit service exceeds \$25,000 but less than \$100,000 it may be approved by the CFOO and the ARC chair;
- Where the engagement fee for the non-audit service exceeds \$100,000 is to be approved by the ARC; and
- In addition, to the above approval limits, where the annual fees for all non-audit services exceeds or is likely to exceed 50% of the annual audit fee (i.e., non-audit service fee ratio of >50%), approval must be sought from the board to ensure the independence of the external auditor is not compromised (Case One 2009a).

For the 2011 financial year Case One's non-audit service fee ratio was 8.8%, i.e., total non-audit service fees to total audit service fees (Case One 2011a).

4.7.8.2 Prohibited services

Unless otherwise determined by the ARC, the auditor is prohibited from providing the following services:

- Financial system design and implementation;
- Appraisal or valuation services and fairness opinions;
- Internal audit services;
- Tax advisory or IT services;
- Executive recruitment or extensive human resources;
- Deal structuring advice or related documentation;
- Broker-dealer, investment advisor or underwriter;
- Legal services, including litigation; and
- Corporate strategy or other non-audit expert service (Case One 2009a).

4.7.8.3 Role of the Auditor

Unless otherwise determined by the ARC, the auditor may not:

- Authorise or execute a transaction and exercise authority on behalf of Case One or have the authority to do so;
- Report to the board or its sub-committees in a role belonging to executive management; or
- Engage in any other activity prohibited by legislation (Case One 2009a).

4.7.8.4 Auditor Rotation

The managing audit partner of the external audit is to be rotated every 5 years from date of appointment (Case One 2009a).

4.8 REMUNERATION COMMITTEE

Table 4.7: Members of the Remuneration Committee

Members	Non-executive and Independent	Meeting frequency
Ken (Chair)	Yes	4 of 4
Jay (Board Chair)	Yes	4 of 4
May	Yes	4 of 4

Source: Case One 2011a

The role of the remuneration committee (RC) is to assist and advise the board on matters relating to the appointment and recruitment, remuneration and succession planning of the executive team which includes the CEO and employees of Case One (Case One 2010c; 2011a). The RC is primarily responsible for:

- Overseeing the selection and appointment practices for executive management including the CEO;
- Overseeing the development of succession plans by the CEO for the CEO's executive management team; and
- Assisting the board in determining remuneration policies for all Case One employees (Case One 2010c).

4.8.1 Key responsibilities and functions

The RC's key responsibilities and functions are to:

- Review and make recommendations to the board in relation to the total remuneration package including short and long term incentives of the CEO;
- Review and approve recommendations of the CEO in relation to the total remuneration packages including participation in short and long term incentives of the CEO's executive management team;
- Review the performance targets of the CEO's executive management team;

- Review the policies and practices regarding human resources and remuneration of Case One brought forward by the CEO or the human resource manager and where appropriate recommend adoption by the board;
- Review the general management succession planning of Case One, but specifically for executive management including the CEO;
- Oversee the selection and appointment practices of the executive management team; and
- Review the appointments and terminations of the executive management team (Case One 2010c; 2011a).

4.9 THE NOMINATION COMMITTEE

Table 4.8: Members of the Nomination Committee		
Members	Non-executive and Independent	Meeting frequency
Jay (Chair and Board Chair)	Yes	1 of 1
June	Yes	1 of 1
Source: Case One 2011a		

The role of the nomination committee (NC) is to assist and advise the board on matters in relation to the appointment and recruitment, remuneration and succession planning of Case One non-executive directors (Case One 2010b; 2011a). In making recommendations the NC is to periodically assess the mix of skills, experience and expertise required by the board and assess the extent to which these mix of skills, experience and expertise are represented on the board (Case One 2011a). In addition the NC is to account for qualitative factors such as diversity and cultural fit, however nominations for appointment are approved by the board (Case One 2011a). The NC is primarily responsible for:

- Reviewing, assessing and making recommendations to the board on the necessary and desirable competencies for the non-executive members of the board;
- Overseeing the appointment and selection practices for the non-executive members of the board;
- Developing succession plans for the non-executive members of the board; and

- Assisting the board in determining appropriate remuneration policies for the non-executive members of the board (Case One 2010b).

4.9.1 Key responsibilities and functions

The NC's key responsibilities and functions are to:

- Review and make recommendations to the board in relation to the total level of remuneration of non-executive directors, including:
 - Individual fees of non-executive directors and the board chair; and
 - Any additional fees payable for membership to board sub-committees;
- Oversee, review and make recommendations to the board in relation to the selection and appointment practices of non-executive directors, including:
 - Periodically assessing the appropriate mix of skills, experience and expertise required on the board and the extent to which these mix of skills, experience and expertise are represented on the board;
 - Establish identification processes of suitable candidates for appointment to the board, including:
 - Establishing the criteria of board membership;
 - Engaging appropriate recruitment or search firms to assist in identifying potential candidates; and
 - Nominating appropriate candidates for non-executive directorship;
- Establish processes for reviewing the performance of non-executive directors, the board and its sub-committees;
- The design of induction, ongoing training and education programs for the board to ensure non-executive directors are provided with adequate information regarding business operations, the industry and their legal responsibilities and duties; and

- Monitor current non-executive board members length of service, considering succession planning issues and identifying the likely order of retirement by rotation (Case One 2010b; 2011a).

4.10 THE EXTERNAL AUDIT

The main purpose of the external audit is to form and provide an objective view on the published financial reports. It is to form views on company process and controls which lead to reliable financial systems, which ultimately lead to reliable financial reports. While the role of the external auditor is to form an objective view and provide feedback to the board on published financial reports, it is also to provide constructive feedback to executive management in relation ways to improve the quality of management reports and papers. Therefore, in a sense the purpose of the external auditor is to form a *trusted relationship* with the board and executive management. As Audit professionals “our goal is to build trust”. Interview with Cat on 01st May 2012

The audit committee chair typically signs the external audit engagement letter and an audit committee is expected to rely on the audit work performed by external auditors. Therefore, there is an existence of a formal relationship and front-line accountability to an audit committee. However the ultimate responsibility and accountability of the external auditor is to the board and its directors not just the audit committee. In relation to shareholders, the external auditor’s responsibility is to provide an objective view on the published financial reports. Interview with Joe on 8th March 2012; Interview with June on 27th March 2012; Interview with Cat on 01st May 2012

In conducting the external audit, audit firms typically use *Best Practice Templates* which are developed by the audit firm, and it is the lead audit partner’s responsibility

to tailor these *Best Practice Templates* for their client. The external audit should only be focused on the audit process. The external audit typically has two main tasks, the financial papers and financial reports. Interview with Cat on 01st May 2012

Major conflict with executive management typically surrounds disclosure issues, not *what* or *how* but rather *when*. It is in such conflict situations an audit committee is fundamental in ensuring financial reports are true and fair, as the audit committee is the ultimate authority for the external auditor. However, it is better to try to convince executive management than use an audit committee as an authority, because this may ruin the relationship with executive management. It is critical for the audit committee and the full board to ensure that executive management is and remains open towards the external auditor. However, the external auditor should have a trusted relationship with executive management particularly with the CFO, as too much independence is not a good thing for the external audit because the purpose of the external audit is to form and provide an objective view on the published financial reports, and this view requires a trusted communication with executive management. Interview with Cat on 01st May 2012

... I am from a view that some non-audit tasks should not be performed by the external auditor. However there are situations which arise which is it better for the external auditor to perform typical non-audit tasks for productivity reasons, as long as these tasks are audit related and independence is maintained. As stated earlier I do not consider it the main task of an audit committee to monitor auditor independence as it is an auditor's fundamental responsibility and duty whether external or internal to maintain independence; the main reason being professional integrity and reputation. Interview with Cat on 01st May 2012

The external audit also serves as a means of board member education and development. As part of the audit report to the board we: (1) highlight and explain new accounting and governance regulatory changes; (2) provide feedback to the board on their governance practices; and (3) provide advice on the governance practices of other companies. Accounting or governance regulatory practice updates or changes (i.e., changes mandated by the ASX or Australian Accounting Standards Board) are typically passed through by the audit firm to executive management (typically CFO). Executive management should debrief the board in relation to these changes as executive management could tailor the secession to company operations. However at times we may pass this information directly to the directors. Interview with Cat on 01st May 2012

The external auditor's role is to keep both company directors and its executive management in good shape, as audit professionals we have a professional reputation to maintain. Interview with Cat on 01st May 2012

The audit fee is typically a circular communication channel between the CFOO, external audit partner and ARC. In determining the audit fee the CFOO will typically try to keep the fee as low as possible, while the ARC will look at the scope of the audit and determine whether it is satisfactory. The ARC is concerned with the quality and scope of the audit program and is unwilling to compromise quality to keep audit fees down. Every director is mindful of their personal liability and damage, and as such they want to ensure a detailed audit. Once the ARC is satisfied with the scope of the audit program it will make a recommendation to the board. Interview with Joe on 8th March 2012

4.11 THE OUTSOURCED-INTERNAL AUDIT

In my view the internal audit program is more of a tool of executive management rather than a tool of the ARC or the board. It aids and supports the ARC's assessment of the internal control framework. However its scope is developed in consultation with executive management based on their view of risk. Interview with June on 27th March 2012

An outsourced-internal audit program in my view works well as it provides good structure and discipline. However, it may be better to have both an in-house and outsourced internal audit function especially for corporations who operate in various countries. Interview with Cat on 01st May 2012

The scope of the internal audit program does not ordinarily overlap with that of the external audit. The internal audit has a strong focus on internal controls and executive management's decisions and implementation of internal controls. However in situations when the scope of the audit programs does overlap, the external audit is able to rely on the working papers of the internal auditor which is agreed upon in initial external audit engagement and subject to the rules in relation to reliance on another auditor's work. Interview with Cat on 01st May 2012

Summarily to the engagement of the external auditor, the engagement of the outsourced-internal auditor is to be approved by the ARC. Its scope is developed in consultation with executive management, after which, the outsourced-internal auditor is to present their scope and fee to the ARC; and the ARC is to not recommended to the board but approve the fee. Interview with Joe on 8th March 2012

The benefit of sourcing an outsourced-internal audit program is it narrows the focus of the external audit program to the actual audit. The external auditor is able to better rely on the audit work performed by the internal auditor, and perform less

compliance testing. In addition, it also provides Case One with access to a broader range of expertise than could be provided by solely an in-house internal program. Each audit firm has particular areas of expertise in addition to resources which are used to provide a better scope of internal audit program and framework for internal controls. With an outsourced-internal audit program executive management and the board are able to gain access to relevant experts rather than executive management outsourcing for specific expertise. Interview with Joe on 8th March 2012

4.12 KEY GOVERNANCE POLICIES

4.12.1 Risk oversight and management Policy

4.12.1.1 Purpose

This policy is intended to set out, formalise and communicate Case One's approach to risk oversight and management (Case One n.d). The policy is to provide an effective framework for the management of risk (Case One n.d). Further it is also to demonstrate compliance with Principle 7 of the ASX Corporate Governance Council Principles of Good Corporate Governance and Best Practice Recommendations, which requires the establishment of a framework for risk oversight, management and control (Case One n.d; 2011a). In meeting this principle the board and executive team have implemented a formal risk management framework (Case One 2011a). It services to:

- Provide a formal framework and methodology for determining Case One's risk profile;
- Facilitate organisational wide awareness and adoption of risk management culture;
- Ensure both strategic and operational risks are formally and regularly assessed; and
- Provide the management process and infrastructure for the review and monitoring of controls, risks and management incentives for improving risk management (Case One 2011a).

Material business risks are documented in a risk control plan along with mitigation priorities and planned management actions, this plan is monitored by the ARC (Case One 2011a). In order to properly determine and maintain an acceptable risk profile, Case One is committed to the ongoing

processes of identification, assessment, monitoring and management of risk and for the reporting and consolidation of risk assessments to the board and the ARC on a consistent presentation basis (Case One n.d). Further Case One has adopted a range of policies to address key risk areas such as capital management, stock control and treasury (Case One n.d).

4.12.1.2 The roles and accountabilities of key mechanisms within the risk management framework

The Board

The oversight of the risk management framework is the responsibility of the board (Case One n.d).

The Audit, Business Risk and Compliance Committee

The ARC's role is to advise and assist the board in fulfilling its risk management and oversight responsibilities (Case One n.d). The ARC is charged with the oversight of risk management processes, it is: (1) to monitor and review Case One's risk profile; and (2) the progress and performance of risk management strategies (Case One 2011a).

Executive Management

Executive management team and the CEO are responsible and accountable for ensuring that systems, procedures, and controls are in place for the management of risks to an acceptable level (Case One n.d). The general manager of risk (riskGM) holds the functional responsibility of the risk management framework and it to report to the CFOO (Case One 2011a). The riskGM is responsible for: (1) assisting in the development of risk management methodologies and processes for corporate functions and operating groups; and (2) advising and monitoring their ongoing implementation (Case One 2011a).

External Audit

External audit is responsible for reviewing compliance with internal controls and assessing their effectiveness (includes specific risk policies and procedures) and providing an opinion regarding the truth and fairness of annual financial reports (Case One n.d). As such the Case One ARC has adopted a policy on the provision of non-audit services and rotation of external audit personnel to ensure and maintain their independence; details of this policy are provided earlier in this Chapter in section 4.7.8 (Case One 2011a).

Internal Audit

The internal audit function is performed by a major accounting firm. The role of the internal audit function is to: (1) assess risks and controls; (2) enhance processes; and (3) monitor controls to provide assurance to the board and the ARC that there is an effective system of internal controls designed to ensure material risks are being managed and compliance obligations are met (Case One 2011a). The lead internal auditor and riskGM have access to the ARC and its chair (Case One 2011a). The internal audit plan is reviewed bi-annually, the review is directed at: (1) reviewing controls which may materially impact operations; and (2) ensuring appropriate action by the executive management is undertaken upon an identified risk (Case One 2011a).

4.12.1.3 Reporting Requirements

Any and all risks with a pre-tax earnings impact greater than \$250,000 that have not been brought to account, must be reported to the group chief accountant and general managers (Case One n.d). Therefore, these managers through a *Controls Assurance Checklist* must quarterly certify that all financial systems and controls are operating effectively and as designed in accordance to Case One policies and procedures (Case One n.d). Reports regarding business risks and management strategies employed to mitigate risks are received by the ARC (Case One 2011a).

Bi-annually the executive team mainly the CEO and CFOO are to provide compliance certificates to the ARC in relation to the integrity and compliance to relevant accounting standards of Case One's financial and reporting control systems and financial records and results (Case One n.d; 2011a). In addition, the executive management team also provides a declaration in relation to Case One's financial statements and to the board that in their opinion Case One (1) has a sound system of risk management and internal compliance and control; and (2) the system is operating effectively in all material aspects regarding financial reporting risks, therefore financial statements and notes present a true and fair view of Case One's financial position and performance (Case One 2011a).

Declarations are based on attestations of signoffs made by each operating group's general manager and their commercial finance group manager; i.e., through the *Controls Assurance Checklist* (Case One n.d; 2011a).

4.12.1.4 Internal control framework

Internal controls are processes designed to address risks and provide reasonable assurance that in pursuing its objectives Case One is complying with applicable laws and regulations and safeguarding resources against loss, damage and misuse (Case One 2011a).

The internal controls cover a broad platform, including people, policies and processes across the operating structure, which underpin the integrity of risk management processes and ultimately financial reporting (Case One 2011a). Within internal control framework Case One has established policies and practices designed to ensure:

- Business transactions are authorised and executed by delegated authorities and limits;
- Financial reporting accuracy and compliance;
- Ethical practice and conduct for suppliers; and
- Environmental regulation compliance (Case One 2011a).

A Code of Conduct has been adopted to illustrate Case One's commitment to maintaining high level of integrity and ethical standards in all business practices (Case One 2011a). The Code of Conduct sets out the standards of behaviour for all directors, executives, employees and contractors (Case One 2011a).

4.12.1.5 Access to and Review of the Risk Oversight and Management Policy

This policy is to be made available for viewing by any person through Case One's website (Case One n.d). The Policy is to be subject to a regular review by the board and shall be amended, as appropriate to continually reflect current best practices and changes in regulatory requirements (Case One n.d).

4.12.2 Continuous disclosure and keeping shareholders informed

Case One aims to ensure shareholders are well informed of all major developments affecting state of affairs of Case One (Case One 2011a). It aims to ensure shareholders can gain access to a wide range of information regarding Case One's operations through its website (e.g., annual report, key policies, governance documents, relevant ASX industry announcements and media releases) (Case One 2011a). In addition, Case One invites the external auditor to attend Annual General Meetings to address shareholder concerns in relation to the audit in addition to the preparation and content of the Auditors Report (Case One 2011a).

Case One had adopted a policy that establishes procedures that ensure directors and management are aware of and fulfil their obligation regarding to the timely disclosure of material price-sensitive information. Directors and executive management must notify the company secretary as soon as they are aware of such information. The company secretary is responsible for communicating to ASX or the CFOO in the absence or inability of the company secretary to perform his or her responsibilities (Case One 2009b; 2011a).

The company secretary will: (1) review material information; (2) determine in consultation with the CFOO, CEO, board chair, other members of the executive management team which the company

secretary deems necessary to reach a decision to whether the information is truly material, required and should be disclosed to ASX; and (3) coordinate the actual disclosure with the CFOO, CEO and board chair (Case One 2009b).

4.12.3 Ethical standards and Code of Conduct

The board deems it necessary to provide employees or agents with a clear set of values that highlight ethical conduct, sound business practices and promote a culture of strong governance (Case One 2011a). The key highlights of the Code of Conduct are that directors, agents or employees are to:

- Behave with integrity in their dealings with customers, shareholders, suppliers and other Case One stakeholders;
- Act in best interest of Case One and avoid perceived or real conflicts of interests; and
- Protect Case One assets under their control and not use assets for personal use without approval (Case One 2011a).

4.12.4 Fraud and Corruption

The Implementation of fraud and corruption controls is part of good governance and management practice, such controls minimise risk of financial loss and damaged to Case One reputation and that of its board, executive management and employees. As reinforcement to the Code of Conduct, Case One has developed and implemented a separate policy for fraud and corruption, a key objective of this policy is to support and enable an organisational culture which proactively prevents fraud and corruption. This policy is aligned with the risk management framework (Case One 2011a).

4.13 CHAPTER SUMMARY

This chapter provided an introduction to Case One, its directors, executive management and auditors. It then described the responsibilities and functions of the board, the ARC, the RC, NC and audit programmes. It concluded by describing some of Case One's key corporate governance policies. Its purpose has been to provide a detailed understanding about the policies, operations and

other practices and interfaces of Case One's corporate governance mechanisms and their actors with Case One's corporate eco-system.

Chapter 6 will present an interpretation and evaluation of Case One's governance mosaic as presented in this chapter. Overall this chapter presents a picture of a company that has in place a comprehensively documented and professionally managed governance system with particular reference to its audit committee. Following the empirical findings as presented in this chapter, governance mechanisms operate within a bureaucratic governance structure, however interactions appear to be interdependent. The establishment of governance mechanisms appears to be in response to both compliance pressures and productivity improvement. Further, actors appear to hold their professional reputation in high value.

The information presented in this chapter has been extracted from the various public disclosures made by Case One available through its website in addition to semi-structure audio-taped interviews conducted with the audit committee chair, company secretary and external audit partner. This chapter acknowledges the source of the information presented, however withholds from formally referencing for confidently and ethical reasons.

“The resources of his mind on this occasion were truly astonishing: his conversation was full of imagination” (Shelley 1818, p. 57).

CHAPTER FIVE

A CASE STUDY OF LOCAL GOVERNMENT CORPORATE GOVERNANCE FOCUSING ON THE AUDIT COMMITTEE

5.1 CHAPTER OVERVIEW

The purpose of this chapter is to provide a detailed understanding of the policies, practices and interfaces of corporate governance mechanisms and actors of four Victorian local governments within their corporate eco-system, i.e., superordinate social system. The focus of this case-based analysis is centred primarily on the audit committee. The chapter presents the findings from the narrative-network analysis of these policies, practices and interfaces; this chapter provides the prelude to an illustrative-narrative analysis presented in the next chapter. That is, in the next chapter the findings from this chapter will be interpreted from alternative theoretical perspectives drawn from agency and neo-institutional theories, as reviewed in Chapter 2.

This chapter presents the findings on four Victorian local governments from a narrative-network analysis of the text obtained from interview transcripts and documents. It is based on information extracted from the various public disclosures made by Victorian local governments readily available through their websites. Additionally, it is based on information extracted from semi-structured audio-taped interviews conducted with the two local government audit committee chairs and documents presented during and after the interview.

It was a formal condition and request that the identities of participants and consequently the names of the Victorian local governments be kept confidential. As such the Victorian local governments shall be referenced to as CouncilA, CouncilB, CouncilC and CouncilD. Given the qualitative nature of this study this chapter acknowledges the sources of the various presented information. However it withholds specific names in the referencing due to confidently and ethical purposes. This chapter

extracts information from annual reports, audit committee charters, draft audit committee charters, audit committee work plans and audit committee information packages. These various sources ensured that saturation reached.

This chapter is structured to flow in a similar manner to the previous case chapter (i.e., the Case One case). It begins by providing an introduction to Victorian local governments. It continues by describing the responsibilities and functions of the audit committee. It concludes by briefly describing the responsibilities and functions of the audit programmes of local governments. Through this structure, a detailed understanding can be gained about the policies, operations and interactions of corporate governance mechanisms of Victorian local governments.

5.2 INTRODUCTION TO LOCAL GOVERNMENTS

In Australia a local government is also identified as a city council. It is a third tier form of government after federal and state; it is regarded as the closest level of government to the community (CouncilB 2012; Department of Planning and Community Development 2012a). A city council is held to be a democratically elected governing body which serves a specific municipality within a State (Department of Planning and Community Development 2012a). City councils work in partnership with federal and state Governments, and other agencies: (1) to provide a municipality's community with services and programs; and (2) to advocate on behalf of the municipality's residents on a wide range of issues (CouncilB 2012). The main purpose of a city council is: (1) to effectively and efficiently use resources to ensure that the community is engaged and well-connected; and (2) to work with the community to provide the best possible service to residents (CouncilA 2012; CouncilC 2012a).

City councils are composed of an elected administrative arm, i.e., democratically elected community councillors (Council); and an operational or managerial arm, i.e., council staff (Department of Planning and Community Development 2012b; Interview with PH on 10th May 2012). The managerial arm holds the responsibility for implementing Council decisions (Department of Planning and Community Development 2012b). Moreover, the managerial arm houses city council officers

who are to implement and manage systems; as well as to provide advice and expertise to aid its Council members in forming policy decisions and delivering services for the community (Department of Planning and Community Development 2012b).

While the administrative arm houses elected community representatives; these elected councillors are involved in establishing the strategic direction and determining the priorities and policies of city council (CouncilA 2012). In broad terms the elected Council sets the overall direction for the municipality through long-term planning (Department of Planning and Community Development 2012b). It adopts a strategic view for the desired future for its municipality and creates plans and policies for its achievement (Department of Planning and Community Development 2012b). A Council tracks its activities progress through monitoring and reporting processes (Department of Planning and Community Development 2012b). A Council's major operational activities include: (1) the maintenance and improvement of community services; and (2) the establishment of governance and business functions necessary for an effective and publicly accountable body (CouncilA 2012).

Key Council Roles and Responsibilities:

- Ensuring responsible and accountable governance;
- Accounting for the diverse needs of the local community in making decisions;
- Establishing strategic objectives and monitoring their achievements;
- Ensuring that resources are managed in a responsible and accountable manner; and
- Promoting local community interests to other communities and governments (CouncilA 2012).

Key Councillor Responsibilities:

- Review and debate on issues before council and engage in decision making processes;
- Review council policies and objectives to ensure municipality suitability;

- Review council activities, expenditure and resource allocation, against the efficiency and effectiveness of service delivery (Department of Planning and Community Development 2012b).

The Council is to be composed of elected councillors meeting as a whole; i.e., individual councillors, including the mayor do not have individual authority to make decisions (CouncilC 2012a; Department of Planning and Community Development 2012b). Provided a quorum is present, decisions (known as resolutions) are reached through majority vote during Council meetings, which are open to the public unless formally closed under the Local Government Act (CouncilC 2012a; Department of Planning and Community Development 2012b; 2012c). Council will typically consider the advice from experts, recommendations from Council officers, advice from the audit committee and feedback from its community before reaching a resolution (CouncilC 2012a). However, in the event of a tied vote the mayor, has a second casting vote; conventionally used to maintain the status quo, however the mayor is under no obligation to maintain the status quo (CouncilC 2012a; Department of Planning and Community Development 2012d).

Generally in Victoria, the city mayor is elected each December from and by the municipality's councillors for a one-year term; however, the incumbent mayor may be re-elected each year should Council choose (CouncilB 2012; CouncilC 2012a; Department of Planning and Community Development 2012b). The mayor holds the responsibility for chairing Council meetings; in the absence of the mayor the Council must appoint an acting mayor from its members (Department of Planning and Community Development 2012b). The acting mayor is to perform any function and exercise any power conferred to the mayor (Department of Planning and Community Development 2012b).

The principle function of Council meetings is to consider and exercise decisions on matters that impact the municipality and to review the operational and financial achievements against targets (CouncilA 2012). Councils typically hold one to two meetings per month, to discharge general city

council business (Department of Planning and Community Development 2012d). Each Council is to schedule a regular meeting cycle and publicly advertise meeting details (Department of Planning and Community Development 2012d). The size of any given Council is dependent on the size of the municipality (CouncilA 2012; CouncilC 2012a).

The Local Government Act requires a Council to: (1) appoint; (2) negotiate the contract of; (3) delegate authority to; and (4) annually review the performance of the CEO (CouncilA 2012; CouncilB 2012; Department of Planning and Community Development 2012c). Accordingly, the CEO is the only member of city staff who is directly appointed by, responsible and accountable to, and is formally required to report to city council (CouncilA 2012; CouncilB 2012; Department of Planning and Community Development 2012b; 2012c). The CEO is to be appointed for no more than five years, on a performance based contract; the incumbent CEO may be re-appointed for a further term (Department of Planning and Community Development 2012c).

Consequently, the CEO is responsible for implementing Council decisions, ensuring Council achieves its Council Plan objectives, and managing the day-to-day operations, resources and city council staff (CouncilA 2012; CouncilB 2012; Department of Planning and Community Development 2012b; 2012c). Accordingly, the CEO is responsible for the appointment, authority delegation, management and dismissal of city council staff and for all other issues in relation to city council staff to enable an accountable, efficient and effective function of a city council (CouncilA 2012; CouncilB 2012; Department of Planning and Community Development 2012c). City Council officers are accountable to Council through the CEO. (Department of Planning and Community Development 2012b)

Key responsibilities of the CEO

- Establishing and maintaining an appropriate organisational structure of the city council;
- Implementation of Council decisions without undue delay;

- The day-to-day management of city council operations in accordance with the Council Plan; and
- Providing timely advice to Council (Department of Planning and Community Development 2012c).

An interviewee states:

Similarly to corporate entities city councils have governance guidelines to follow in relation to the formation and composition of audit committees. The voluntary adoption of audit committees in city councils dates back to 1998. These guidelines are merely the extension of the corporate guidelines, but are politically focused. It is the general consensus that these guidelines are *best practice* and therefore should be *conformed* with. Interview with JA on 27th March 2012

Corporate governance is defined as a process which ensures that a city council operates in a manner which is open, honest, communicative and accountable (CouncilA 2012). However, virtuous governance is dependent on comprehensive and continuous accountability (CouncilC 2012a). Accordingly, sound governance practices guide the way in which a Council represents, consults and communicates with the community; it ensures (1) adherence to legislation; (2) accountable and transparent control; and (3) continuous improvement (CouncilA 2012).

5.3 AUDIT COMMITTEES OF LOCAL GOVERNMENTS

The main purpose of corporate governance in its current form is to project audit assurance. Interview with PH on 10th May 2012

5.3.1 Purpose

Established by Council, the audit committee is held to be an independent advisory committee (CouncilA 2011b; CouncilB 2011a; 2011b; Interview with PH on 10th May 2012). The primary role of the audit committee is to assist Council in the effective discharge of its corporate governance responsibilities over accounting and financial reporting, risk management, governance and reliable

internal controls (CouncilA 2011b; CouncilB 2011a; 2011b). The audit committee assists by: (1) providing an independent review of its city council's financial management and reporting systems; (2) ensuring and overseeing an effective and efficient internal and external audit process; and (3) developing procedures to promote transparency, accountability and preparedness (CouncilA 2011a; 2012; CouncilD 2008). The audit committee is to closely monitor the activities of its Council and provide it with detailed advice (1) to ensure sound financial management and ongoing legislative compliance; and (2) in the development and maintenance of internal controls (CouncilC 2012a; CouncilD 2008).

The audit committee also acts as an effective means of communication between the external auditor, internal auditor, city management and Council (CouncilA 2011a; 2012; CouncilB 2011b). The audit committee's role is also to enhance the credibility and objectivity of both internal and external financial reports, and enhance the effectiveness of audit functions (CouncilB 2011a; 2011b). The audit committee is to work with both the auditors and Council to ensure the municipality community's needs are protected at all times (CouncilD 2008).

5.3.2 Composition

Audit committees of city councils typically consists of five members; three independent experts and two city councillors (CouncilA 2011a; 2011b; 2012; Council B 2011a; CouncilC 2012a). With all members having full voting rights (Council B 2011a). The councillor members are appointed by Council for a two year term with one retiring annually (CouncilA 2011a; 2012). Alternatively, some city councils appoint the mayor and one other councillor nominated by council (CouncilB 2011a). However, the terms of appointment should ensure the continuity and orderly rotation despite changes in Council members (CouncilA 2011b; CouncilB 2011a). On the other hand, the independent members are appointed for a three year term and are eligible for re-appointment (CouncilA 2011a; 2011b; 2012). Moreover, the appointment of prospective independent members typically involves the audit committee chair, mayor, CEO and director of corporate services (CouncilA 2011b; CouncilB 2011a).

The role of the independent members is a coaching role to both Council and city management, the coaching role involves providing advice based on corporate knowledge and experience (Interview with JA on 27th March 2012). The audit committee is aiming to build a constructive relationship with city management rather than an overly independent relationship (Interview with PH on 10th May 2012).

As a collective the audit committee is to have a broad range of skills and experience relevant to city council operations (CouncilC 2012b). Independent members are to have executive management, audit or financial management and reporting knowledge and experience (CouncilA 2011b; CouncilB 2011a, 2011b). Because such knowledge and experience is considered readily transferable, however it needs to be merged into the culture (Interview with JA on 27th March 2012). The chair of the audit committee is to be an independent member and appointed annually by its members (CouncilA 2011a; 2011b; 2012; CouncilC 2012b). To be eligible for independent membership, a prospective individual must be free from any conflict of interest or any relationship which could or could reasonably be perceived to materially interfere with the individual's ability to act in the best interest of Council (CouncilB 2011b). However, being a ratepayer does not constitute a conflict of interest (CouncilB 2011b).

5.3.3 Meetings

As stated earlier, the principle function of Council meetings is to consider and exercise decisions on matters that impact the municipality and to review the operational and financial achievements against targets (CouncilA 2012). Accordingly audit committee meetings serve that same principle function (CouncilA 2012; CouncilD 2008). Typically five meetings are held annually; the meeting schedule is developed and agreed on by its members (CouncilA 2011a; 2011b; CouncilB 2011a). Audit committee members are expected to attend every scheduled meeting (CouncilA 2011b).

The presence of the majority of audit committee members shall form a quorum, unless no councillor members are present (CouncilA 2011b; CouncilB 2011a; CouncilC 2012b). All members have full and

equal voting rights (CouncilA 2011b). Audit committee resolutions (or decision recommendations) pass through majority vote (CouncilA 2011b). In the event of the absence of the audit committee chair, the audit committee will appoint a chair from its independent members to chair the meeting (CouncilA 2011b; CouncilB 2011a).

The CEO, director of corporate services, finance manager, governance manager and internal auditors may by invitation attend audit committee meetings (CouncilA 2011a; 2012; CouncilB 2011a). These attendees do not have voting rights, attendees are to assist the audit committee in fulfilling its purpose by presenting reports, updates or information (CouncilA 2011a; 2011b; 2012). However, it is expected that the CEO and internal auditor attend all audit committee meetings unless the audit committee believes that matters should be discussed privately in the absence of one or both (CouncilB 2011a).The external auditor attends audit committee meetings to present the external audit plan and the audited financial reports (CouncilA 2011a; 2012). At each meeting the audit committee is provided with the opportunity to meet with the auditors in the absence of city management (CouncilA 2011a; 2012). The audit committee is annually expected to meet with external and internal auditors (separately) in the absence of city management (CouncilA 2011b; CouncilD 2008).

The meeting agenda and administration of audit committee meetings is handed by a member of city management, that member is responsible for collecting and distributing all required documents and specialist reports. Interview with PH on 10th May 2012

The audit committee meets to monitor and review the following matters: internal audit scope and reports, external audit reports, implementation status of audit recommendations (both internal and external), financial reports, reports on governance, legislative compliance and risk management framework and issues (CouncilA 2010; 2011a; 2011c; CouncilC 2011).

Any informal meetings or discussions of the audit committee are between its members, and are in relation to agenda items or bubbling issues; they are usually held prior or after formal audit committee meetings. Interview with PH on 10th May 2012

5.3.3.1 Audit Committee Meeting Agenda items

Audit committee meeting agenda items include:

1. Discussion and confirmation of the previous meetings minutes;
2. Annual review of audit committee performance, composition and charter;
3. Internal audit and control framework agenda items may include:
 - a. Internal audit update and report
 - b. Review internal audit scope , performance and audit plan;
 - c. Review of internal audit charter and adequacy of resource allocation;
 - d. Review of key internal controls, policies, procedures and delegations; and
 - e. Assess the adequacy and effectiveness of internal controls;
4. External audit agenda items may include:
 - a. Review external audit scope, plan, approach, reports and performance;
 - b. Discuss the appropriateness of accounting policies applied in financial reports;
 - c. Discuss matters arising from the external audit;
 - d. Review city management implementation of external auditor recommendations;
 - e. Provide feedback to external auditors on financial reports and compliance with accounting standards;
5. The manager of risk will lead the risk agenda items, which may include:
 - a. Report on risk and social and environmental compliance; and
 - b. Risk control plan and strategy;
6. Council reporting agenda items may include:
 - a. Review of financial reports and recommendation to Council;

- b. Report to Council on significant accounting policies, internal controls and performance review of audit programmes; and
- c. Report to Council on matters or findings of audit programmes (CouncilA 2010; 2011c; CouncilC 2011).

5.3.4 Responsibilities and Functions

The key responsibilities and functions of local government audit committees are to review, oversee and report to Council on the following:

Financial Processes and Reporting

- Annually review the financial reports and provide Council with a recommendation;
- Ensure processes are in place to ensure financial information is accurate, complete and reliable in all material aspects;
- Evaluate the processes in place which ensure that accounting records are properly maintained and are in accordance with statutory requirements;
- Review, highlight and inform Council in relation to major accounting and reporting issues and changes both regulatory and of city management;
- Advise city management in relation to its responsibility to ensure that Council receives financial information which is accurate, complete and reliable;
- Review and provide Council with a recommendation in relation to the overall accounting policies, financial accounts and reporting of city council; and
- Review the long term financial strategy of Council (Case One 2010a, 2011a; CouncilA 2010; 2011a; 2011c; CouncilB 2011a).

External Audit Program

- The scope of the external audit program, its function and performance, and any other material issues arising from the audit;

- Review the reports from the external auditor and ensure managements implantation of external audit recommendations;
- Review the audit reports issued by Victorian Auditor-General's Office;
- Consider the independence of the external auditor in relation to other services provided to city council;
- Ensure that critical accounting policies and judgements, material adjustments and disagreements with city management are discussed with the external auditor;
- Ensure that the external auditor has access to the audit committee chair when required;
- Liaison between the external and internal auditors to promote appropriate compatibility and reliance; and
- Meet separately with the external auditor to discuss matters that the audit committee or external auditor deem should be discussed privately (Case One 2010a; 2011a; CouncilA 2011a; 2011b; 2011c; 2012; CouncilB 2011a; CouncilC 2012b).

In relation to the private discussions with the external auditor, it is more form than substance; it is to ensure that city management is not intimidating the auditors.

Interview with PH on 10th May 2012

Internal Audit Program

- The scope and fees of the internal audit program, its function and performance, and any other material issues arising from the audit;
- Consider the independence of the internal auditor in relation to other services provided to city council;
- Annually review the performance of the internal auditor, including their termination upon an unsatisfactory audit;
- Review the reports of the internal auditor and oversee city managements implantation of internal audit recommendations; and

- Meet separately with the internal auditor to discuss matters that the audit committee or internal auditor deem should be discussed privately;
- Ensure there are no unjustified restrictions or limitations placed on the internal auditor;
- Liaison between the internal and external auditors to promote appropriate compatibility and reliance;
- Actively engage in and make a recommendation to Council and city management regarding the appointment, termination and fees of the internal audit (Case One 2010a; 2011a; CouncilA 2010; 2011a; 2011c; CouncilB 2011a).

The audit committee regularly receives its reports from the internal audit function; therefore the audit committee is heavily engaged in the internal audit work programme to either approve or modify. If city management is resistant to modifications, the audit committee is able to rely on the authority of the mayor; however the audit committee is looking to work constructively with city management and Council. Interview with PH on 10th May 2012

Internal Controls and Risk Management

- City councils accounting systems and internal controls;
- The processes used by city management to monitor and ensure compliance with laws and regulations, ethical guidelines and other requirements that relate to the preparation and reporting of external financial information;
- Assess the adequacy of processes and controls established by city management to identify and manage actual or potential risk exposures and safeguard city council assets;
- The risk management framework, which includes the identification and management of actual or potential material risk exposures; and
- Ensure social and ethical compliance with best practice guidelines (Case One 2010a; 2011a; CouncilA 2010; 2011a; 2011c; 2012; CouncilB 2011a; CouncilC 2012b).

Miscellaneous

- Monitor the statutory compliance and ethical standards of city council;
- Review the audit committee charter at least every two years and submit proposed changes to Council; and
- Annually undertake a self-assessment and review performance against charter (CouncilA 2011a; 2011b; 2011c; CouncilB 2011a).

5.3.5 Reporting

The audit committee is to regularly report to Council within an advisory capacity, to provide advice and recommendations on matters of financial reporting, risk management and the reliability of internal controls (CouncilA 2011a; CouncilB 2011a). The audit committee chair is to annually summarise audit committee activities, recommendations and key outcomes and report to Council (CouncilA 2011b; CouncilB 2011a).

As a governance arm of Council the audit committee is to report, direct its activities and provide assurance to Council; accordingly its accountability is to Council, not the municipality's community nor its management. City management is required to handle the administration of and report to the audit committee; however it holds no such formal accountability. No structure or mechanism within city councils holds a formal or informal accountability to the audit committee. Consequently, an effective execution of audit committee responsibilities requires a good relationship, communication and cooperation with city management. Interview with JA on 27th March 2012; Interview with PH on 10th May 2012

5.3.6 Authority

As a formally appointed advisory committee of Council, the audit committee is accountable to its Council (CouncilA 2011b; CouncilB 2011a; Interview with JA on 27th March 2012). The audit committee is responsible for the effective discharge of its responsibilities as defined by its charter,

which is approved by Council (Council B 2011a). The audit committee does not have: (1) any executive powers; (2) any delegated financial responsibility; (3) authority to direct city council resources; and (4) authority to assume any city management functions (CouncilA 2011b; CouncilB 2011a; CouncilD 2008; Interview with JA on 27th March 2012). The audit committee may request financial resources (through the CEO) to enable the committee to receive any necessary legal, accounting or other professional advice (CouncilA 2001b; CouncilB 2011a).

In order for audit committees to function effectively, the both Council and particularly city management need to be supportive of audit committees and governance processes. Particularly, because Council is under no formal obligation to act on audit committee advice; however it holds strong persuasiveness as ignoring such advice is viewed as negligent. Interview with JA on 27th March 2012

Council retains the authority to appoint and remove audit committee members (CouncilB 2011a; Interview with PH on 10th May 2012). In the event that Council purposes to remove a member of the audit committee prior to their term expiry, Council must provide that member with written notice and the opportunity to be heard at a Council meeting (CouncilA 2011b; CouncilB 2011a; Interview with PH on 10th May 2012).

As an advisory committee the audit committee holds no executive powers or formal authority, however in situations of material disputes they audit committee may rely on the formal powers of Council (dispute with city management) and the external auditor/ auditor general (dispute with council). Interview with PH on 10th May 2012

5.3.7 Access to Information and Independent Advice

The audit committee may seek information and expert advice on matters of concern within the scope of its responsibilities subject to approve from the CEO (CouncilB 2011a; CouncilD 2008).

The majority of the information which is received by the audit committee is developed and provided by city management. However the audit committee may request city management to provide additional information. Interview with JA on 27th March 2012

5.3.8 External Communication

As independent advisers, the audit committee has no direct communication with external stakeholders unless legally required. The engagement of the independent members with the wider business community is with their capacity as professionals.

Interview with PH on 10th May 2012

5.3.9 Review

The audit committee will annually review its charter and performance (CouncilA 2011a; 2011b). The audit committee is also to annually review and approve its work plan (CouncilA 2011a; CouncilD 2008).

In general terms the composition for the audit committee of city councils is modelled after best practice guidelines, which are modelled after corporate firms. Importantly these guidelines are derived from the accounting profession which provides an overly accounting perspective (ignores operations and focuses on financials), where the accounting firms have a nested interest. However, in regards to the overall adoption of these best practices into any entity it is imperative to consider the purpose of the guideline(s), what are the guidelines covering and what they do not. Ultimately, I am very doubtful about current standards or best practices because of accounting failures, why does the accounting fail to pick them up? Interview with PH on 10th May 2012

5.4 THE EXTERNAL AUDIT

The external audit program of city councils is governed by the Victorian Auditor-General's Office (VAGO) (CouncilA 2012; CouncilB 2012). The primary focus of the external audit program is to provide an assurance that annual financial reports are fairly presented (CouncilA 2012; CouncilD 2008). In providing this assurance VAGO will externally contract the external audit function (CouncilB 2012). The contracted auditor is responsible for providing a recommendation to VAGO that annual financial reports are fairly presented and are in accordance with applicable Accounting Standards (CouncilB 2012). VAGO will in turn, provide the audit report which confirms that annual financial reports have been prepared in accordance with relevant legislation and professional standards and represent a true and fair view of financial affairs (CouncilA 2012).

Representatives of the contracted auditor will initially meet with the audit committee to brief the audit committee on how their audit will be conducted and will finally meet with the audit committee to report on their findings from their examination of city council's financial records (CouncilB 2012; CouncilD 2008). The external auditor typically reviews the internal audit program to better understand the internal control framework (CouncilB 2012).

Generally speaking the reliance of the external auditor on the work of internal auditors is governed by the accounting profession and traditional accounting conformism. However internal auditors are far more knowledgeable of day-to-day operations than the external auditors. In general terms the external audit function is to project assurance, it is more form than real substance; it merely issues an assurance opinion as to whether firms are complying with accounting standards.

Interview with PH on 10th May 2012

5.5 THE OUTSOURCED-INTERNAL AUDIT

The audit committee is responsible for reviewing and endorsing the annual internal audit plan, which is developed and approved by Council in consultation with city management based on Council's strategic and operational risks (CouncilA 2012; CouncilB 2012). The internal auditor is usually appointed for a three year term with an option for a one year extension (CouncilA 2011a; CouncilD 2008).

The purpose of the internal audit function is to provide Council with an independent review of the effectiveness and efficiency of governance, risk management and selected internal control processes; and to assist both Council and city management in the achievement of sound municipality management and control (CouncilA 2011a; 2012; CouncilB 2012). The scope of the internal audit does not involve the day-to-day checking of internal transactions (CouncilB 2012).

The internal audit function is regarded as a vital component within a city council's governance and risk management framework (CouncilA 2012). The audit committee holds responsibility for the annual formal review of the performance of the internal auditor (CouncilB 2012).

City councils generally always outsource the internal audit function, because this tends to be more efficient and cost effective. It strengthens external auditor's reliance on the work of the internal auditors which avoids duplication. The outsourced internal auditor is formally appointed by Council, but this decision is heavily influenced by the recommendation of the audit committee chair and city management. Interview with PH on 10th May 2012

5.6 CHAPTER SUMMARY

This chapter has provided an introduction to Australian local governments in Victoria. It then describes the responsibilities and functions of the audit committee and audit programmes. Its purpose has been to provide a detailed understanding about the policies, operations and other

practices and interfaces of corporate governance mechanisms and actors of Victorian city councils within their superordinate social system.

The next chapter will present an interpretation and evaluation of the governance mosaic of the Victorian city councils as presented in this chapter. Overall this chapter identifies that the four examined Victorian city councils have in place a professionally managed and comprehensively documented governance system with particular reference to the audit committee.

Following the empirical findings as presented in this chapter, similarly to corporate entities local government governance mechanisms operate within a bureaucratic governance structure, however interactions appear to be interdependent. However, the establishment of governance mechanisms appears to be more of a response to compliance pressures, than productivity improvement. Further, actors also appear to hold their professional reputation in high value. Interestingly, is the view of the external audit, in terms of its purpose and usefulness. Participants revealed that the external audit is more form than real substance.

The information presented in this chapter has been extracted from the various public disclosures made by the city councils available through their websites in addition to semi-structured audio-taped interviews conducted with audit committee chairs and the documentary information presented during or after the interview. Similarly, to the previous chapter this chapter acknowledges the source of the information presented, however withholds from formally referencing for confidently and ethical reasons.

“whither does your senseless curiosity lead you?” (Shelley 1818, p. 188).

CHAPTER SIX

DISCUSSION OF FINDINGS AND THE GENERATION OF AN EXPANDED GOVERNANCE MODEL

6.1 INTRODUCTION

The purpose of this chapter is to interpret the policies, practices and interfaces that were presented as findings in Chapters 4 and 5. These previous two chapters presented the findings of illustrative-narrative. This illustrative-narrative has been developed from a theory-driven selective coding analysis of the text of interviews and source documents from case organisations. The theoretical perspectives chosen to drive the selective coding have come from agency and institutional theories. In Chapter 2, attention was given to the traditional behavioural assumptions underpinning agency theory compared to the traditional behavioural assumptions underpinning institutional theory.

In this chapter, the sets of assumptions from agency theory and institutional theory, as articulated in Chapter 2, will be used to provide the structure for the chapter. As mentioned, this chapter will seek to explain and interpret the findings regarding the governance policies, practices and interfaces from the case organisations, as presented in Chapters 4 and 5. Hence, this explanation and interpretation of findings from Chapters 4 and 5 will be structured around the respective assumptions established in Chapter 2. Consequently, this chapter begins by examining each of the agency assumptions in terms of what empirical insights the findings can provide. It continues in a similar way with the examination of each of the institutional assumptions.

Once the evidence is interpreted in respect of all of these assumptions, the chapter then re-visits the ‘The Governance Model’ initially put forward in Figure 2.3 in Chapter 2. By summarising the interpreted case evidence regarding the application of the various behavioural assumptions from agency and institutional theories, an ‘Expanded Governance Model’ can be developed in this chapter. This expanded model becomes a new dual-theory representation of an exemplar case

organisation's governance policies, practices and interfaces. It is a model that is able to more pluralistically address the governance phenomena.

6.2 AGENCY ASSUMPTIONS

As stated in Chapter 2, the initial framework for a governance model given in Figure 2.3 was used to guide the examination of governance phenomena centred on the audit committee. In doing so, the agency assumptions underlying this framework, as drawn from the agency literature, can be empirically tested through the gathering and interpreting of evidence about the governance policies, practices and interfaces as presented in the case unit chapters (i.e., Chapters 4 and 5). This interpretation of evidence from Chapters 4 and 5 is now undertaken in the following sub-sections for each agency assumption in turn.

In the below sub-sections, reference will frequently be made to 'the evidence' or 'the findings' as a recap on relevant paraphrases from the analysis in the previous chapters. Reference to 'the evidence' or 'the findings' indicates that a paraphrased statement has been derived from the source interview text, case unit document content or both. Attributing these recapped paraphrases to specific interviewees or specific organisation documents is only sparingly undertaken in this chapter because several paraphrases are drawn from an amalgam of text from the interviews and case unit documents. To make these specific attributions would be tedious, repetitive and distracting to the main purpose of this chapter, which is to provide a critical interpretation of 'the evidence' presented in the previous two chapters.

6.2.1 Governance actors are self-interested

As previously mentioned, corporate governance has been driven by financial scandal and corporate collapses, seemingly due largely to the self-interested decisions and behaviours of control agents (Mallin 2010a). That is, these financial scandals and corporate collapses appear to be driven by actors reacting to economic self-interested behaviour.

Dechow et al. (1996) find no evidence to support the notion that actors manipulate earnings for self-interest. Moreover, Defond et al.'s (2002) and Srinivasan's (2005) findings suggest that market based institutional incentives (e.g., reputational loss and career stability) outweigh any potential economic behaviour. Alternatively, Jensen (2001a) argues that self-interested behaviour is driven by personal preference and this preference may be economic, social or political. Consequently, self-interested motivations for actor decisions or behaviours are considered to be on a unique continuum; hidden from other actors.

6.2.1.1 Case One

The policy documents identify the board as being responsible for ensuring Case One is properly managed to protect and enhance shareholder interests, and that directors, officers, and employees operate in a sound governance environment. Additionally, the documented evidence identifies that the adoption and maintenance of best practice governance standards can ensure the protection of shareholder interests. Further, the company secretary states that through poor environmental and social compliance, brand damage is inevitable and Case One may lose its ability to supply retailers and ultimately the end consumer. These items of evidence suggest that the governance actors of Case One are not economically self-interested; however they do not imply they are not socially or politically self-interested.

Interview and document evidence identifies the audit committee's role is to assist the Board in the effective discharge of its responsibilities across Board delegated functions. However, the board remains accountable to shareholders regarding the overall performance of Case One. Further, the board is committed to ensuring that its constitutional powers and responsibilities are exercised and discharged by adopting best practice governance principles and applicable laws. These items of evidence point to a similar conclusion that the governance actors of Case One are not economically self-interested. The interview text also suggests that every director is mindful of his or her personal liability and damage, and as such will want to ensure a detailed audit. Once the audit committee is satisfied with the scope of the Audit program it will make a recommendation to the Board. This

suggests that every director is somewhat self-interested by means of personal preference to reduce personal liability. Additionally, the interview and document evidence identifies the importance of the audit committee's role of overseeing auditor independence. It is an auditor's fundamental responsibility and duty to maintain independence; the main reason put forward is professional integrity and reputation. An interviewee indicated that the auditor is concerned with maintaining independence because a loss of independence threatens and damages the integrity of the client and the audit firm. This suggests that the external auditor partner is self-interested in terms of maintaining his or her professional integrity and reputation. By being concerned with the integrity of the client, the audit firm ensures the maintenance of the auditor's professional integrity and reputation.

6.2.1.1 Local Government

Evidence from policy documents reveal that a Council's major operational activities include the establishment of governance and business functions necessary for an effective and publicly accountable body. Additionally, a key Council responsibility is ensuring that resources are managed in a responsible and accountable manner. However, the evidence also identifies that Council is under no formal obligation to act on audit committee advice. Nevertheless the audit committee is found to hold strong persuasiveness, so ignoring its advice is viewed as negligent by the Council. This suggests that there is low or no tolerance for governance actors of city councils to act in their own economic self-interested. However the other dimensions of self-interested behaviour are seen in the finding that city council actors are concerned with maintaining sound governance practices which can both enhance their professional reputation and reduce their personal liability.

6.2.1.3 Assumption Conclusion

In summary the Case One evidence identifies that the firm, the board, its various actors and the external auditor are concerned with maintaining their integrity and reputation and limiting their personal liability. Likewise, the evidence suggests that city councils' and their actors hold similar concerns for maintaining their integrity, reputation and avoidance of personal liability. Such

concerns trigger self-preservation behaviours which are regarded as the resulting equilibriumisation of the self-interest continuum. While such behaviours do not lead to selfish choices, it is evident that actor behaviour or choice is driven by personal preference. Consequently, actors are more likely to behave or make choices based on the hidden self-interest continuum.

Moreover, the establishment and maintenance of effective and accountable governance mechanisms are considered the result of the self-interest continuum because such choices improve professional integrity and reputation, while reducing personal liability. This supports Carcello et al.'s (2002) and Raghunandan et al.'s (2003) findings which identify governance actors as seeking to protect their reputational capital to avoid legal liability and promote principal interests. As further support for the interpretation of the finding in this study, Abbott et al. (2003a; 2003b), Fama and Jensen (1983) and Sirinivasan (2005) consider governance actors to benefit from prestige, reputational enhancement, learning opportunities, networking and liability minimisation.

Therefore, the agency assumption of the model that governance actors are self-interested is supported. Other than the need to avoid direct economic self-interest, no evidence is found to suggest that the behaviours and decisions of governance actor are not self-interested.

6.2.2 Governance actors are solely economic utility maximisers

As previously mentioned, corporate governance has been driven by financial scandal and corporate collapses due largely to the self-interested decisions and behaviours of control agents (Mallin 2010a). However, as previously discussed in the above section 6.2.1 the evidence identifies that governance actors are concerned with maintaining their integrity and reputation while minimising their liability. Such behaviours are regarded as the result of the equilibriumisation of the self-interest continuum. Therefore governance actors remain self-interested driven by personal preference. This preference may be economic, social or political (Jensen 2001a). Jensen's (2001a) suggestion of social or political self-interest could allow the possibility in a business context for rational economic self-interest which does not preclude strategic shorter-term social or political self-serving behaviour.

Beasley et al.'s (2000) results suggest that different and unique fraud opportunities exist for each industry. Defond and Jiambalvo (1991) find that financial reporting errors appear to be a result of managers responding to economic incentives. However, Dechow et al. (1996) find no evidence to support the notion that actors manipulate earnings for self-interest. Moreover, Defond et al. (2002) and Srinivasan (2005) find that market based institutional incentives (e.g., reputational loss and career stability) outweigh any potential economic behaviour.

Therefore, considering the literature and the evidence, the agency assumption which identifies governance actors as being purely economically self-interested is not unequivocally supported.

6.2.3 The firm (or city council) is a contract nexus, i.e. a series of contractual relationships

6.2.3.1 Case One

The various document disclosures made by Case One regarding its board reveal that the board is responsible for ensuring that Case One is properly managed to protect and enhance shareholder interests, and that directors, officers, and employees operate in a sound governance environment. As an additional feature of its specified role, the evidence indicates that the board is responsible for the review and oversight of Case One administration, management and governance. In terms of board composition, it is found that there are six directors, one executive and five non-executive independent directors. These facts about the board's role and composition suggest that the board is empowered and structured to perform its wide-ranging responsibilities. This implies the existence of contractual obligations.

The findings also indicate that the audit committee of Case One has a contractual obligation to assist the board in the discharge of the board's responsibilities across functions delegated by the board. However, the board remains accountable to shareholders regarding the overall performance of Case One. While the audit committees' sole accountability is to its board, its main purpose is to assist and provide support to the board. These document and interview statements suggest there exists a contract between the board and the audit committee and between the board and shareholders.

Audit committee members are required to have separate and direct accountabilities to shareholders and other stakeholders, not as audit committee members but as *directors* of a corporate entity. This finding suggests that no formal contract exists between the audit committee and shareholders. However, there does exist a formal expectation and contract between audit committee members, as directors, and the shareholders.

The audit committee chair is considered by the interviewees, to have an informal accountability to executive management in assisting executive management. The chair's main role following the evidence is to as facilitate the work of the audit committee and acting as a *bridge* between audit committee and non-audit committee directors and the external auditor, internal auditor, and executive management. It is found that the audit committee chair meets with key presenters prior to audit committee meetings, to go through information papers, request addition papers, identify issues, raise questions, and make a judgement to facilitate information sessions. This evidence of the role and activities of the audit committee chair suggests that the chair has an informal contract with executive management to assist with the improvement in the quality of distributed papers by meeting with key audit committee meeting presenters prior to the meeting.

Further, a practice in Case One revealed by the interview evidence is that if the board delegates an issue to one of its sub-committees, the executive management team is expected to deal with that sub-committee and not the board on that issue. This practice implies that if the board delegates an issue to a sub-committee an informal contract is entered into. Additionally, a formal contractual requirement adopted by Case One is that both the CEO and the CFO are to provide compliance certificates to the audit committee in relation to the integrity and compliance to relevant accounting standards in relation to company accounts. Another set of contractual relationships is identified concerning all standing sub-committees of the board. Each sub-committee is required to adopt a formal charter which sets out matters regarding its composition, responsibilities, functions and

administration. Such charters indicate a contractual arrangement with the board because each standing sub-committee is under a formal obligation to adopt a charter.

There are various other governance policies to suggest that Case One is a contract nexus. For example the risk oversight and management policy sets out the roles and accountabilities of *key* governance mechanisms within the risk management framework. Further, the continuous disclosure policy obligates the company secretary to review all material information to ensure that Case One keeps shareholders well informed.

Another relevant finding concerns the preparation of meeting agendas of the board and its sub-committees. Board agendas are prepared by the company secretary in conjunction with the board chair, CEO and the CFO with periodic input of the full board. Additionally, the company secretary prepares the meeting agendas of all board sub-committees in conjunction with the respective chair. Clearly there is a formal obligation on the company secretary to prepare the meeting agenda of the board and its sub-committees. Preparation of minutes of the board and its sub-committees is also a contractual obligation of the company secretary's office.

In terms of relationships with governance players external to Case One, the findings reveal there is no direct communication between board directors and external regulators, unless the regulatory body demands direct communication. External communication from regulators to board directors is found to pass through, and be filtered by, the company secretary, i.e., the company secretary is to pass the information on to directors if deemed necessary. The practice infers that no direct contract exists between directors and regulators. However, it suggests that a contract exists between Case One as an entity and regulators, processed in practice through the company secretary. In terms of communications with shareholders, it is found that directors do not normally have direct communication with individual shareholders, except for the board chair who will have external communication to and with major shareholders. While there exists a contractual relationship

between directors and shareholders, no direct communication takes place with individual shareholders, except by the board chair.

The external auditor will have a formal audit engagement contract with a client company. It is found for Case One that the main purpose of the external audit is to form and provide an objective view on financial reports, and to provide feedback to the board and executive management team on financial reports. Additionally, the external auditor is responsible for reviewing Case One compliance with internal controls and assessing their effectiveness to provide an opinion regarding the truth and fairness of financial reports. However, the external auditor is prohibited from providing any non-audit service which would create a perceived or real threat to their independence, although, the audit committee may allow the auditor to provide and perform a non-audit service. *Non-audit services* encompass any service the auditor may provide which is not necessarily incidental to or included in the terms of the audit engagement. These findings reveal that there exist contractual obligations between the external auditor and the board and audit committee. However, the findings identify that the formal contract of the external auditor is only between the external auditor and the board. But the findings also identify that the external auditor has a formal relationship and front-line accountability to the audit committee, even though its ultimate responsibility and accountability is to the board. Within the contract, the external auditor has an obligation to the shareholders to provide them with an objective view on the published financial reports.

In relation to the internal audit, its engagement is similar to the external auditor. However, the internal audit function is regarded as a contract with executive management rather than of the audit committee or the board. Although, when the scope of the audit programs overlap, the external auditor is able to rely on the working papers of the internal auditor as agreed upon in the initial external audit engagement, i.e. the formal contractual agreement.

6.2.3.2 Local Government

The findings indicate that a Council's major operational activities include the establishment of governance and business functions necessary for an effective and publicly accountable body. This suggests that a Council can be regarded as having a contracted function.

The role of the audit committee, as given in the evidence, is to assist Council by providing an independent review of its municipality's financial management and reporting systems. Further, the audit committee is to regularly report to Council within an advisory capacity, to provide advice and recommendations on matters of financial reporting, risk management and the reliability of internal controls. The findings also identify the audit committee's accountability is to its Council. It is responsible for the effective discharge of its responsibilities as defined by its charter. The audit committee does not have any delegated financial responsibilities under its charter. The charter is approved by the Council. This arrangement does indicate the existence of a contract between council and its audit committee. This contract, implicit in the charter, identifies the audit committee as an advisory committee. It holds no executive powers or formal authority. However in situations of material disputes the audit committee may rely on the formal powers of Council for a dispute with city management or on the State auditor general for a dispute with Council.

The findings identify the audit committee as an independent adviser. Therefore members are to have no direct communication with external stakeholders unless legally required. This suggests that no contract exists between the audit committee and external stakeholders.

The CEO is found to be the only member of city staff who is directly appointed by, responsible and accountable to, and is formally required to report to Council. This suggests that there exists an employment contract between the CEO and Council. Under the CEO contract, the CEO is found to be responsible for implementing Council decisions, ensuring Council achieves its Council Plan objectives, and managing the day-to-day operations, resources and staff of a city council.

City management, including the CEO are also found to have the responsibility of handling the administration of and reporting to the audit committee. However city management is under no formal or informal obligation to be accountable to the audit committee. As such the findings suggest that the audit committee seeks to work constructively with city management and Council.

The purpose of the internal audit function, according to policy documents, is to provide Council with an independent review of the effectiveness and efficiency of governance, risk management and selected internal control processes; and to assist both Council and city management in the achievement of sound municipality management and control. This policy statement suggests that there exists a contractual relationship between Council, city management and the head of the internal audit function.

6.2.3.3 Assumption Conclusion

Following the above interpretations of the findings, the agency assumption which identifies a firm is a contract nexus is supported. The evidence identifies both Case One and city councils are contract nexuses, composed of both formal and informal contractual relationships. There is evidence of explicitly formal contractual relationships (e.g., between the external auditor and the board, and between the audit committee and the board). There is also evidence of less explicitly formal contractual relationships (e.g., between the company secretary and external regulators, between the internal audit function and the audit committee, and between executive management and the chair of audit committee). These less explicit contractual relationships are, nevertheless, often documented as roles and responsibilities contained in charters and policies. Therefore, it is concluded that actors within a firm or city council while operating collectively towards shared organisational responsibilities and objectives, will do so on the basis of their separately designated responsibilities and accountabilities as formally and less formally established in a nexus of contractual relationships. The agency assumption that a business entity is a nexus of contractual relationships is supported.

6.2.4 There exists a separation between decision control and decision management

Fama and Jensen (1983) identify two main types of agents within the contractual nexus of a firm (or city council); the decision controllers and the decision managers. The decision controllers hold responsibility for the ratification and monitoring of decisions, while the decision managers are responsible for the initiation and implementation of decisions (Fama and Jensen 1983).

6.2.4.1 Case One

The evidence identifies the board as responsible for ensuring Case One is properly managed in order to protect and enhance shareholder interests, and to enable directors, officers, and employees to operate in a sound governance environment. Further, the board has the ultimate responsibility over setting and ensuring policies regarding the business and affairs of Case One are to the benefit of shareholders and stakeholders. Also the policy documents state that the board is responsible for the review and oversight of Case One administration, management and governance.

The need for the board to delegate the day-to-day management of Case One's resources to the executive management team is also identified by the policy documents. However, it is found that the board retains the ultimate responsibility for the strategic direction and control of Case One. And the board holds responsibility for the establishment of goals for management and monitoring their achievement. Therefore the evidence indicates that a key function of the board is to monitor the executive management team's performance. But the board remains accountable to shareholders regarding the overall performance of Case One.

It is evident following these findings that a separation between decision control and decision management is embedded in the policies and practices of Case One. Specifically, the board is revealed as the decision controller, since its functions are associated with the responsibilities of ratification and monitoring. On the other hand, the executive management team is revealed as being the decision managers as their responsibilities are associated with initiation and implementation.

6.2.4.2 Local Government

City councils are seen to be composed of an elected administrative (or legislative) arm and a managerial arm. The evidence reveals that the administrative arm holds the responsibility for establishing the strategic direction and determining the priorities, policies and the laws of city council. Alternatively, the managerial arm holds the responsibility for implementing decisions. Council is the elected arm which is responsible for establishing strategic objectives and monitoring their achievement. The managerial arm houses city management under the control of the CEO. The CEO is identified as ultimately being responsible for the implementation of Council decisions and the day-to-day management of city council operations.

This evidence clearly points to a separation between decision control and decision management in local governments. In particular, Council is identified as the decision controller, having functions associated with the responsibilities of ratification and monitoring. City management is identified as the decision managers, having responsibilities associated with initiation and implementation.

6.2.4.3 Assumption Conclusion

In summary the evidence provides support for Fama and Jensen's (1983) finding and for the agency assumption that there exists a separation between decision management and control. Boards and councils are found to have responsibility over their organisation's strategic direction and monitoring. Alternatively, executive and city management are responsible for implementing board and Council decisions, including the day-to-day management of resources. Based on the case evidence there exists a clear separation between the two aspects of control, i.e., decision management (executive and city management) and decision control (board and Council).

6.2.5 The board is the decision controller, and it then delegates the decision management and some decision control functions to internal agents

As established in the previous agency assumption there is a separation between decision control and decision management. The board and Council have been identified as the decision controllers and executive management and city management have been identified as the decision managers. The

purpose this next assumption is to determine whether the board (and Council) is the primary agent in the agency separation. The assumption has some parallels with the previous agency assumption in terms of its evidence reliance.

6.2.5.1 Case One

As previously indicated, evidence reveals the board is responsible for ensuring Case One is properly managed to protect and enhance shareholder interests, and that directors, officers, and employees operate in a sound governance environment. Within this remit, the board has the ultimate responsibility over setting policies for Case One in order to benefit shareholders and stakeholders. And the board is responsible for the review and oversight of Case One administration, management and governance.

Further, it has previously been identified from the evidence that the board delegates the day-to-day management of Case One resources to the executive management team under the leadership of the CEO. The board holds responsibility for the engagement, appointment, review and, when necessary, replacement of the CEO. The CEO is required to conduct a formal review each year, to assess the overall performance of the executive management team and report back to the board. However, the board has retained the ultimate responsibility for the strategic direction and control of Case One. The board holds responsibility for the establishment of goals for management and monitoring their achievement. Therefore, the evidence makes it apparent that a key function of the board is to monitor the executive management team's performance. Moreover, it identifies the board as remaining accountable to shareholders regarding the overall performance of Case One.

In terms of fulfilling its decision controller role, the board of Case One establishes sub-committees to streamline the discharge of its responsibilities and functions. The board is given authority to delegate specific functions or issues to these sub-committees on an on-going and an *as needs* basis. The evidence identifies that if the board decides to delegate an issue to one of its sub-committees, the executive management team is to deal with that sub-committee and not the board on that issue.

Regarding the audit committee, the evidence indicates that this committee is to assist the board in the discharge of its responsibilities across particular functions delegated by board. These functions involve the reviewing, overseeing and reporting to the board in the following three primary areas: financial processes and reporting; audit programmes; and internal controls and risk management. However, its primary purpose is to assist the board, it is not a strategic decision making committee nor is it to make decisions on behalf of the board. Similarly, in relation to the engagement of the external auditor, this engagement decision is to be approved by the board. The board is able to engage an external auditor without the audit committees' approval. However executive management cannot engage an internal auditor without the audit committees' approval.

It is found that the RC's responsibility is to assist and advise the board on matters relating to the appointment and recruitment, remuneration and succession planning of the executive team including the CEO and Case One employees. Similarly, the NC is required to assist and advise the board on matters in relation to the appointment and recruitment, remuneration and succession planning of Case One non-executive directors.

In summary the evidence identifies the board as the decision controller, and it delegates decision management functions to the executive management team. Also the board delegates some of its decision control responsibility to internal agents (i.e., its sub-committees). While the board delegates some of its decision control monitoring responsibility to its sub-committees, it still retains the overall final decision control over any of its delegated responsibilities or functions.

6.2.5.2 Local Government

As previously mentioned, Council is identified as the elected administrative arm, which is responsible for the establishment of objectives including monitoring their achievement. In respect of the audit committee, it was previously mentioned that the evidence indicates that Council will establish an audit committee as an independent advisory committee. Therefore, the audit committee is to assist Council by providing an independent review of its municipality's financial management and

reporting systems. The audit committee is to regularly report to Council as to provide advice and recommendations on matters of financial reporting, risk management and the reliability of internal controls. In line with the private sector (Case One), the evidence identifies that key local government audit committee responsibilities and functions are to review, oversee and report to Council in the following areas: financial processes and reporting; the external audit program; the internal audit program; and internal controls and risk management.

The audit committee is accountable to its Council. The audit committee is responsible for the effective discharge of its responsibilities as defined by its charter, which is approved by Council. The audit committee does not have any delegated financial responsibility. Moreover, Council is under no formal obligation to act on audit committee advice; however it holds strong persuasiveness as ignoring such advice is viewed as negligent. While, the audit committee holds no executive powers or formal authority, in situations of material disputes it may rely on the formal powers of Council or could even appeal to the State government. However, Council retains the authority to appoint and remove audit committee members, provided it maintains a majority of independent experts.

In summary the evidence identifies the Council as the decision controller, delegates' decision management functions to city management. However, Councils typically delegate some of their decision control responsibility in terms of monitoring to external and internal agents. Nevertheless, Council retains the final decision control over any delegated responsibility or function.

6.2.5.3 Assumption Conclusion

Based on the evidence, the agency assumption that the board or Council is the decision controller and it delegates decision management and some decision control functions to internal agents is supported. Both boards and Councils were found to delegate the day-to-day management of resources to their management teams (i.e., executive management and city management). Moreover, both boards and Councils maintain audit committees to review, oversee and report on financial processes, regulatory compliance, external and internal audit programmes, internal

controls and risk management (primarily monitoring functions). This finding is consistent with the findings of DeZoort et al. (2002), Rezaee (2010) and Vera-Munoz (2005). Interestingly however, the Case One board delegates some decision control functions to agents internal to the board (i.e., audit committee, RC, NC are composed of board members), while Councils delegate the decision control functions to agents who are both external and internal to Council (i.e., the audit committee of Council is composed of independent advisors and councillor members).

6.2.6 Governance mechanisms act as monitors

Collier and Zaman (2005) suggest that the adoption of governance models and mechanisms may be a symbolic concept used to signal to stakeholders the addressing of monitoring and control. Further, Gendro and Bedard's (2006) findings suggest that the effectiveness of audit committees is dependent on symbolic processes and outcomes. Interestingly, Cohen et al. (2010) find that governance mechanisms are regarded as effective monitors as opposed to mere symbols of legitimacy based on external auditor experiences. This helps in understanding Turley and Zaman's (2007) finding which identifies the role of the audit committee as one of adaptability - at times it may be an ally, arbiter or threat.

6.2.6.1 Case One

As noted from the evidence, Case One board is responsible for the review and oversight of the company's administration, management and governance. It is stated in documents and interview statements that the board has ultimate responsibility over setting policies of the company and ensuring they are to the benefit of shareholders and stakeholders. Therefore, the board remains accountable to shareholders regarding the overall performance of Case One. As such, the board is also committed to ensuring that its constitutional powers and responsibilities are exercised and discharged, adopting best practice governance principles and applicable laws. The adoption and maintenance of best practice governance standards is accepted as the way to best protect shareholder interests. These articulated board responsibilities suggest that the Board acts as a

monitor and though its disclosures it appears to signal its commitment to effective monitoring through the adoption and maintenance of best practices.

Further, it is found that to ensure effective monitoring, each director has the right to access Case One information and Case One's executive management, external advisors and auditors. Moreover, the board will bi-annually with the assistance of the NC and an external advisor, review the performance, membership and charters of the board and its sub-committees to determine their adequacy in the current circumstances. This review seeks to determine whether the board and its committee's structures and processes are adequate for carrying out their functions in the most effective manner.

The evidence, as explained previously, relates to the board's delegation of day-to-day management of Case One's resources to the executive management team. Hence, a key function of the board is to monitor the executive management team's performance. In particular, the evidence identifies that the board will monitor the decisions and actions of the CEO and the overall performance of Case One. Consequently, the board holds responsibility for the hiring, reviewing and replacing of the CEO. Through this control over the CEO, the board retains ultimate responsibility for the strategic direction and control of Case One. While the evidence identifies the board as a monitor, there is also an inference that the board is more of a strategic partner with the CEO rather than solely a monitor; supporting Anderson et al.'s (2007) finding. Therefore the board is not purely monitoring.

The evidence shows that the board determines its meeting schedule at the beginning of each year and it currently schedules nine meetings per year. Moving towards the board meeting structure, the evidence identifies that in the absence of the board chair another director would be chosen to chair all or part of the board meeting. Members of the executive team may be invited to attend all or part of board meetings whenever the board requires their *involvement or assistance* in consideration of issues before the board. This further suggests that the board is acting as a monitor and through its

disclosures of policies and charters it signals its commitment to effective monitoring through the adoption and maintenance of best practice.

Conflict between the board and executive management is found to be more likely related to the question of when issues should be disclosed. Conflict over issues of what or how tend to dissolve, often in favour of management's view. However, the Board is more prepared to take a different view from that executive management on issues of when to make public disclosures. Directors draw upon their knowledge and experience in executing their judgement. The board is viewed as a collegiate body; if a decision is not reached by the end of the meeting, the decision is deferred to the next meeting. It is apparent that the Board would rarely, if ever, force a resolution. This latter point highlights the boards' commitment to vigilance in its decision making over monitoring matters.

The audit committee's primary purpose, as explained earlier, is specified as assisting the board, but not making decisions on behalf of its board. The integrity of company accounts is found to be the responsibility of all directors and not only members of the audit committee. Therefore the view is that the audit committee's sole accountability is to the board. However, its members are found to have separate and direct accountabilities to shareholders and other stakeholders, as *directors* of the corporate entity but not as audit committee members. With this role in mind, the evidence finds that the audit committee endeavours to ensure the early detection and acknowledgement of potential or bubbling issues. It has successfully constructed a culture which allows the executive management team to raise issues early. Further, it is found that the audit committee chair is focused on assisting the board in the discharge of its responsibilities across functions of financial report vetting, internal control systems monitoring and external audit quality and independence review. Additionally, both the CEO and the CFO are required to provide compliance certificates to the audit committee in relation to financial statements and related papers regarding their integrity and compliance to relevant accounting standards.

Moreover, the policy of Case One reveals that the audit committee will meet at least four times per year, or as often as the audit committee deems necessary to fulfil its responsibilities and objectives. However, the evidence shows that the meeting frequency of the audit committee is dependent on the complexity of issues and the structure of both board and audit committee meetings. At the end of the meeting agenda the audit committee will commence a closed private session between the non-executive directors and the lead internal auditor and external audit partner. The closed private session is a formal process for the audit committee to eye-ball the auditors in the absence of the executive management team. It is expected that the audit committee will meet with the external and internal auditors in the absence of executive management whenever it deems necessary but not less than twice a year.

To further, feature the monitoring role of the audit committee is the chair's main role as revealed by the interviewees, to facilitate the work of the audit committee and to act as a *bridge* between audit committee directors and non-audit committee directors as well as to the external auditor, internal auditor and executive management. As previously indicated, the chair meets with key presenters prior to audit committee meetings, to go through their papers, request addition papers, identify issues, raise questions, and make a judgement to facilitate information sessions. The audit committee chair is found to hold an informal coaching role in aiding executive management with the quality and relevance of the meetings financial papers. This coaching role is viewed as an opportunity for 'a more brutal battering and probe of flaky proposals'. This suggests that the audit committee chair is monitoring through actively engaging governance actors. This active engagement is believed to reflect a strong commitment towards sound governance.

The weight of evidence is that the audit committee acts as a monitoring mechanism. In particular, the audit committee chair is found to be independently participating with executive management in order to ensure the effective functioning of the audit committee meetings and ultimately

monitoring. As such the audit committee is found to be effectively monitoring and simultaneously signalling its commitment to sound governance.

The external auditor is responsible for reviewing Case One compliance with internal controls and assessing their effectiveness in order to provide an opinion regarding the truth and fairness of financial reports. The main purpose of the external audits is to form and provide an objective view and to provide feedback to the board and executive management team on financial reports. The external auditor is found to have a formal relationship and front-line accountability to the audit committee. But its ultimate responsibility and accountability as perceived by interviewees is to the board; in relation to shareholders the view is to provide an objective opinion on published financial reports.

Interestingly, the evidence suggests that the external auditor seeks to build trusted relationships with executive management. Too much independence of the external auditor from management is considered to lead to ineffective monitoring. The reason is that the purpose of the external audit is to form and provide an objective view on the published financial reports, which is dependent on trusted communication. Further, the view is that it is better to try to convince executive management on issues, rather than relying on the audit committee to exert its authority over management. The latter course has the potential to damage the trust in the external auditor's relationship with executive management according to the interview statements with the external audit partner. While the audit committee is to oversee auditor independence, it is the auditor's fundamental duty to maintain perceived independence in order to preserve professional integrity and reputation.

Based on the evidence, the external auditor can be regarded primarily as a monitoring mechanism. However, to enable effective monitoring, the auditor seeks to build trusted relationships with executive management and key directors that will determine the external auditor's re-engagement. Hence, the external auditor is considered to have monitoring effectiveness, while maintaining

perceived independence but simultaneously actively engaging with executive management and directors. In practice the audit partner eventually engages with the audit committee chair and the board chair. This active engagement is viewed as a signal of commitment to sound governance.

6.2.6.2 Local Government

The evidence identifies a Council's major operational activities as including the establishment of governance and business functions necessary for an effective and publicly accountable body. Council is responsible for: (1) determining the priorities and policies for the municipality; (2) establishing the strategic objectives for the municipality and monitoring their achievement; and (3) ensuring that resources are managed in a responsible and accountable manner. Further, the Local Government Act requires a Council to delegate authority to the CEO. This suggests that Councils act as monitors and through their disclosures they signal their commitment towards effective monitoring through the adoption and maintenance of best practice.

The audit committee is given the brief to review, oversee and report to Council in areas of financial, auditing and risk management areas. The audit committee is to assist Council by providing an independent review of its municipality's financial management and reporting systems. Further, the audit committee acts as an effective means of communication between the external auditor, internal auditor, city management and Council. Generally, the audit committee seeks to build a constructive relationship with city management rather than an overly independent relationship. Its rationale is that the effective execution of audit committee responsibilities is dependent on building trusted relationships, open communication and cooperation with city management. This is interesting because audit committee members may seek information and expert advice on matters of concern within the scope of their responsibilities subject to the CEO's approval. This suggests that the audit committee is both acting as a monitoring and signally mechanism through active engagement with governance actors.

In local governments the external audit program is stated as having the purpose of providing assurance that the financial reports are fairly presented. However, interviewees expressed their opinion that the external audit is undertaken more for form than real substance; “it merely issues an assurance opinion as to whether firms are complying with accounting standards”. The inference is that while the external auditor provides a monitoring function for compliance reporting purposes, this function appears to signal a failure of effective monitoring from the perspective of the interviewees (who are independent audit committee members).

6.2.6.3 Assumption Conclusion

Based on the case evidence, the agency assumption which identifies key governance mechanisms of the board (or Council), audit committee and external auditor, as acting as monitors is largely supported. These governance mechanisms while acting as monitors, also appear to be symbolic signally mechanisms. A common governance mechanism for boards and Councils is to delegate to their audit committee. Audit committees are given an advisory capacity. Although the board (or Council) remains externally accountable, its audit committee is found to act as a key monitoring mechanism and facilitates a signalling process amongst other governance actors (e.g., executive management team, directors and both external and internal auditors). Governance actors, by actively engaging with each other, are identified as fulfilling their monitoring roles and responsibilities, while simultaneously signalling to each other their commitment to sound governance outcomes and processes. This signalling conclusion is supported in the evidence of Case One and city council. Interestingly, however, it is not backed up in the city council evidence in respect to the external audit beyond its narrow role of compliance reporting monitoring.

6.2.7 Governance mechanisms evolve to better address agency problems

Dey’s (2008) results support the notion that the evolution, existence and roles of governance mechanisms are a function of the firm’s agency conflicts. Accordingly, the literature on audit committees consistently finds that those audit committees with greater independence, financial literacy, meeting frequency and composed of at least three directors, are better equipped to address

agency problems (Abbott et al. 2003a; 2004; Beasley 1996; Beasley et al. 2000; Bedard and Gendron 2010; Dezoort et al. 2002; Lary and Taylor 2012). However, both Bradbury (1996) and Kalbers and Fogarty (1998) contend that audit committees are not voluntarily employed to address the agency problems arising from the separation of ownership and control. Collier and Zaman (2005) suggest that the adoption of governance models and mechanisms may be a symbolic concept used to signal the addressing of agency problems. While, Kalbers and Fogarty (1998) purpose that in situations where information is difficult to verify (e.g., by shareholders), agents (e.g., the board or management) may mimic quality messages. Moreover, Anderson et al. (2007) find that the role of the board is evolving as a strategic partner to management, rather than a monitor of management.

6.2.7.1 Case One

The board, according to Case One's documents, is responsible for the review and oversight of Case One administration, management and governance. Further, the board is responsible for ensuring Case One is properly managed to protect and enhance shareholder interests, and that directors, officers, and employees operate in a sound governance environment. The board is also responsible for the engagement, appointment, review, and when necessary replacement of the CEO. The board is committed to maximising operational performance, financial returns and creating shareholder value. The board is to be composed of directors with an appropriate range and mix of qualifications, expertise, and experience which will enable the effective functional discharge of board responsibilities.

It is also documented that the board may establish sub-committees to streamline the discharge of its responsibilities and functions, by delegating some its responsibilities and functions to these sub-committees. Additionally, the board may delegate specific functions or issues to these sub-committees on an *as needs* basis. In such an event, the executive management team is to deal with that sub-committee and not the board regarding that issue.

In relation to the audit committee, to recap, its role is to assist the board in the discharge of its responsibilities across delegated functions. These delegated functions are to oversee, review and report to the board on financial processes and reporting, audit programmes, and internal controls and risk management. Authority is given to the audit committee to request reports, explanations and information in relation to any Case One activity, process, procedure or account. However, its primary purpose is to assist the board, not to make decisions on behalf of the board.

In terms of other board committees, it is found that the RC's role is also to assist and advise the board on matters relating to the appointment and recruitment, remuneration and succession planning of the executive team including the CEO and Case One employees. Similarly, the NC is also to assist and advise the board on matters in relation to the appointment and recruitment, remuneration and succession planning of Case One non-executive directors. As such, the board will bi-annually with the assistance of the NC and an external advisor, review the performance, membership and charters of the board and its sub-committees to determine their adequacy in the then current circumstances. This is to determine whether their processes are adequate for carrying out their functions in the most effective manner.

As earlier stated, the evidence shows that the external auditor seeks to build a trusted relationship with executive management. Too much independence is considered to lead to ineffective monitoring because the purpose of an external audit engagement is to form and provide an objective view on the published financial reports, where the view is dependent on trusted communication with executive management. Moreover, the evidence indicates that the external auditor can maintain a better relationship with executive management by trying to convince executive management on issues, rather than resorting to use of the audit committee as an authority over executive management.

In summary, the evidence suggests that the board, audit committee, remuneration RC, NC, external auditor and executive management have formal lines of authority that allow responsibilities to be

devolved and that need an ethos of engagement and trust in order to address agency problems. For example, the board has authority to replace the CEO; the board is able to delegate any functions or issue on an *as needs* basis to its sub-committees; and the board engages the NC in its bi-annual review of its own governance structure to determine its adequacy in the then current circumstances. The board's regular (bi-annual) review of governance structures indicates that Case One's governance mechanisms have the means to evolve.

This ability to evolve is likely to be used in a way that adapts Case One's governance structure to better conform and comply with generally accepted agency-driven governance practices. But the evolution is also seen to entail the building of trusted working relationships. Hence, an ability to evolve does not assume that evolutions will be exclusively agency driven, nonetheless they still may be agency driven. The interview with the company secretary revealed that Case One had over a two year period gone through a major change in terms of its governance structure with the replacement of most of the directors and replacement of the CEO in an attempt to improve the overall governance structure of Case One. This was a case of changing not only the governance structures but also the dynamics of the human relationships between the key players.

6.2.7.2 Local Government

The evidence identifies that a Council's major operational activities include the establishment of governance and business functions necessary for an effective and publicly accountable body. Council is responsible for: (1) determining the priorities and policies of City Council; (2) establishing the strategic objectives for a municipality and monitoring their achievement; and (3) ensuring that resources are managed in a responsible and accountable manner.

Interestingly, it is found that the audit committee acts as an effective means of communication between the external auditor, internal auditor, city management and Council. The independent members hold a coaching role to both Council and city management. This coaching role involves providing advice based on previous corporate knowledge and experience. Generally, the audit

committee aims to build a constructive relationship with city management rather than an overly independent relationship. Because the effective execution of audit committee responsibilities is dependent on building trusted relationships, there has evolved open communications and cooperation with city management. This is interesting because audit committee members may seek information and both internal and external expert advice on matters of concern within the scope of their responsibilities subject to CEO approval. Further, similar to corporate entities, local governments have governance guidelines to follow in relation to the formation and composition of audit committees. These guidelines are found to be merely the extension of the corporate guidelines, but are politically focused. There was found to be general consensus that these guidelines are *best practice* and therefore should be *conformed* with.

The conclusion is drawn from the evidence that the governance mosaic of local governments has to some extent evolved to address agency problems. However, this evolution is not purely agency driven. Interestingly, it appears to be driven by conformity.

6.2.7.3 Assumption Conclusion

Following the evidence, the agency assumption that governance mechanisms evolve to better address agency concerns is partially supported. It is found that governance mechanisms have the authority and capability of evolving to better address agency problems. However, this authority and capability may also be used to better adapt governance structures towards achieving business efficiency, conformity and political needs. An ability to evolve does not assume that evolutions will be exclusively agency driven, nonetheless they still may be agency driven. As explained, governance mechanisms are found to entail the building and forming of trusted relationships with open communication systems as opposed to purely independent monitoring focused relationships. This notion of a trusted relationship and open communication systems does not align with the typical independent monitoring focused agency solutions.

6.2.8 The external audit function is external (independent) yet simultaneously internal to the client

This assumption seeks to identify whether the external audit function is a purely independent monitoring focused relationship or whether it remains independent yet fundamentally critical to the day-to-day operations of a client. Further, it suggests that while the external audit is internal to the contract nexus it remains external. Consequently, this would support Raghunandan et al.'s (2003) conclusion that external auditors have an overarching concern over their professional reputation which acts as an incentive in maintaining their independence and audit quality.

6.2.8.1 Case One

It is found that, in conducting the external audit, the auditor uses Best Practice Templates which are developed by the audit firm, and it is the lead audit partner's responsibility to tailor these templates for their client. As previously mentioned, the main purpose of the external audit is to form and provide an objective view on financial reports; and to provide feedback to the board and executive management team on financial reports. Additionally, the external auditor is responsible for reviewing Case One's compliance with, and effectiveness of, internal controls. This helps to enable the external auditor to provide an opinion regarding the truth and fairness of financial reports.

The external auditor is prohibited from providing any non-audit services which would create a perceived or real threat to their independence. *Non-audit services* encompass any service the auditor may provide which is not necessarily incidental to or included in the terms of the audit engagement, unless otherwise determined by the audit committee. In terms of the negotiation of the audit fee, this is typically a circular communication channel between the CFO, external auditor and audit committee chair. Therefore, once the audit committee is satisfied with the scope of the audit program it will make a recommendation to the board.

In terms of accountability, the external auditor has ultimate responsibility to the board. However, the external auditor has a formal relationship and front-line accountability to the audit committee.

The external auditor's accountability towards shareholders is in providing an objective view on the published financial reports.

Moreover, regulatory practice updates or changes are typically passed through by the audit firm to executive management (i.e., CFO). In turn, executive management should debrief the board in relation to these changes as executive management is in a position to tailor the information to company operations. However, at times the external auditor may directly pass this information to the directors. Therefore, the external audit function also serves as a means of education and development of management and board members.

At the end of the audit committee's meeting agenda the audit committee will typically commence a closed private session between the non-executive directors and the lead internal auditor and external audit partner. The closed private session is a formal process for the audit committee to eyeball the auditors in the absence of the executive management team. Regardless of this practice, it is expected that if the auditors had any concerns they would have already explicated their concerns through the appropriate channels prior to meetings.

As previously indicated, the evidence shows that the external auditor seeks to build a trusted relationship with executive management, to facilitate effective monitoring which is regarded as being dependent on trusted communication. While it is the audit committee's role to oversee auditor independence, is an external auditor's fundamental professional responsibility and duty to maintain independence from executive management.

From the evidence, the external auditor gives high importance to acting with independent in carrying out the audit function for Case One. However other evidence suggests that the external audit function simultaneously remains fundamentally integral to the day-to-day operations of Case One. As such the external audit activity is external yet internal to the day-to-day operations of Case One.

6.2.8.2 Local Government

The evidence identifies the external audit program for city councils as being under the jurisdiction of the VAGO. The primary focus of the external audit program in city councils is to provide assurance that the annual financial reports are fairly presented. It is found that the reliance of the external auditor on the work of internal auditors is governed by the accounting profession and traditional accounting conformism. The view in city councils is that the external audit function is to project assurance. It is said to involve more form than real substance. It merely issues an assurance opinion, not wider investigative or advisory functions.

Following the evidence, the external audit function for local governments is found to maintain strong independence from the city council's management and councillors. Unlike corporate entities the findings suggest that the external audit function is not integral to the day-to-day operations of local governments. Further, the external audit activity is external to the day-to-day operations of local governments.

6.2.8.3 Assumption Conclusion

Based on the evidence from Case One, the agency assumption which identifies the external audit function as being external yet simultaneously internal to the client is supported. In Case One, the interaction of the external auditor is found to be both external and internal to the client. Moreover, the external auditor seeks to build a trusted as opposed to an overly independent relationship. In contrast, the external audit function for local governments is found to be independent from the day-to-day operations and is monitoring focused. This is believed to be due to the nature of the external audit function of local governments which is determined at a higher-tier government level to be governed by VAGO, and Councils must comply. In contrast, with corporate firms the external audit function is an interactive communication between auditors, audit committee chair and the CFO which allows for a clearer expectation in terms of external audit responsibilities.

6.2.9 Actor interactions and processes are bureaucratic

Beattie et al. (2011) note that recent governance models show governance actors interacting in a more dynamic and interdependent way than a hierarchical or bureaucratic way. This agency assumption seeks to identify the way in which governance actors interact, in particular it seeks to highlight the bureaucratic functioning of governance mechanisms. Consequently, the evidence used may mirrors some of the previous agency assumptions.

6.2.9.1 Case One

It is found that the meeting agenda of the board is prepared by the company secretary in conjunction with the board chair, CEO and the CFO with periodic input of the full board. Members of the executive team may be invited to attend all or part of board meetings whenever the board requires their involvement or assistance in consideration of issues before the board. In the board chair's absence of another director is to chair all or part of the Board meeting.

External communication to directors from regulators particularly ASIC, is sent via the company secretary, i.e., the secretary passes the information down to directors. It is found that direct communication does not normally take place between directors and regulators. Accordingly, no director has direct communication with external regulators or other external parties, except for the board chair who may directly communicate to and with major shareholders. Moreover, the external audit partner stated in interview statements that regulatory practice updates or changes are commonly passed through by the audit firm to executive management (i.e., CFO). In turn, executive management is expected to debrief the board in relation to these changes as executive management is better positioned to tailor the information to company operations. However, at times the external auditor may directly pass this information to directors. As previously explained, each director at the expense of Case One may seek independent professional advice following a formal request issued by the board or its chair.

As previously noted, the board delegates the day-to-day management of Case One resources to the executive management team under the leadership of the CEO, but the board holds responsibility for

the establishment and monitoring of management goals. Accordingly, the board is found to remain accountable to shareholders over the overall performance of Case One. A further bureaucratic aspect of Board governance in Case One is the establishment of sub-committees and their obligation to adopt a formal charter which sets out matters regarding their composition, responsibilities, functions and administration.

Bureaucratic features are again evident for the audit committee. It has a specific responsibility to assist the board in the discharge of responsibilities and functions as delegated by the board. However, it is not to make decisions on behalf of the board, its sole accountability is to the board. To fulfil its work of supporting the board, the audit committee is required to meet with the external and internal auditors in the absence of executive management whenever it is deemed appropriate but not less than twice a year. The audit committee chair is expected to report to the board following each audit committee meeting. As previously explained the chair is also to facilitate the work of and act as a bridge for the audit committee. This involves a relatively dynamic and interdependent working relationship between the audit committee chair and executive management.

Other bureaucratic features are found to be present in the governance structures, designated roles and modes of operation of the external auditor and internal audit function in Case One, as previously explained. Similarly to the engagement of the external auditor, the engagement of the internal auditor is to be approved by the audit committee. However the internal audit program is regarded as being more of a tool of executive management than directors. Although, when the scope of the audit programs overlap, the external auditor is able to rely on the working papers of the internal auditor as agreed upon in the initial external audit engagement. As stated earlier, the external auditor is to provide feedback to the board and executive management team on financial reports. In fulfilling this responsibility the external auditor seeks to build trusted relationships with both the board and executive management. It was found that a successful audit is dependent on open communication.

In light of the evidence, the interactions and processes of Case One governance actors appears to be bureaucratic. However, at times these interactions and processes also appear to be dynamic and interdependent. In particular the evidence suggests that actor interactions are more or less dynamic and interdependent, while processes and procedures are bureaucratic.

6.2.9.2 Local Governments

A Council is composed of elected councillors meeting as a whole. Individual members are found to lack the authority to make unilateral decisions. Typically one to two meetings are held per month to discharge general city council business. Bureaucratic structures are evident in Council audit committees they are to be composed of five members; three independent experts and two Council members. Five audit committee meetings are to be held annually. A majority presence shall form a quorum, unless no Councillor members are present. In its chair's absence, the audit committee will appoint a chair from its independent members. At each meeting the audit committee has the opportunity to meet with both the internal and external auditors in the absence of city management.

In terms of processes, the audit committee acts as a communication means between the external auditor, internal auditor, city management and Council. Independent members are found to hold a coaching role to both Council and city management. According, the audit committee aims to build a constructive rather than an overly independent relationship with city management. Interestingly, its independent members may seek information and expert advice subject to the CEO's approval. Consequently, the effective execution of audit committee responsibilities is heavily dependent on building trusted relationships and open communication with city management and Council.

As previously stated, the primarily focus of the external auditor (i.e., VAGO) is to merely issue an assurance opinion as to whether local governments are complying with accounting standards. This suggests that that external audit function of city council is bureaucratic in terms of its interaction and processes.

In light of the evidence, the interactions and processes of local government governance actors appears to be largely bureaucratic. However, the evidence concerning the activities of the audit committee indicates that at times the interactions and processes of governance actors are also dynamic and interdependent in local governments. Similarly to Case One the local government evidence suggests that some actor interactions are more or less dynamic and interdependent, while processes and procedures are bureaucratic. The external audit function determined by VAGO in practice is viewed as being purely bureaucratic.

6.2.9.3 Assumption Conclusion

Following the discussed evidence the agency assumption which states that actor interactions are bureaucratic is largely supported. The evidence identifies that structures and in some situations actor interactions and processes are in fact bureaucratic. However, for some actors (especially the audit committee chair) part of their role is to pursue base-line dynamic and interdependent interactions. Therefore, it is suggested that governance actor interactions and processes are bureaucratic at times. This provides support for Turley and Zaman's (2007) finding which suggests that the main role of governance actors is to deal with change and adaptability.

6.2.10 Overall Agency Conclusion

Following the conclusions reached about the expanded models' agency assumptions, it is concluded that the governance phenomena can be explained by adopting an agency-based theoretical framework. However, singularly adopting the agency perspective does not holistically address the governance phenomena. Therefore, it is suggested that agency theory is useful mainly for addressing the purpose and function of governance. Adopting a broader behavioural perspective on the 'self-interest' core of agency theory can more pluralistically explain the underlying motivations for observed governance policy disclosures and governance actor relationships.

6.3 INSTITUTIONAL ASSUMPTIONS

As previously mentioned, the initial framework for a governance model given in Figure 2.3 in Chapter 2 is used to guide the examination of the governance phenomena centred upon the audit

committee. In doing so, the institutional assumptions underlying this framework, as drawn from the institutional literature, can be empirically tested through the gathering and interpreting of evidence about the governance policies, practices and interfaces as presented in the case unit chapters (i.e., Chapters 4 and 5).

The interpretation of this evidence from Chapters 4 and 5 is now undertaken in the next subsections for each institutional assumption in turn. Similar to the agency section, reference is frequently made to ‘the evidence’ or ‘the findings’ as a recap on relevant paraphrases from the analysis in the previous chapters. Reference to ‘the evidence’ or ‘the findings’ indicates that a paraphrased statement has been derived from the source interview text, case unit document content or both. Attributing these recapped paraphrases to specific interviewees or specific organisation documents is only sparingly undertaken in this chapter because several paraphrases are drawn from an amalgam of text from the interviews and case unit documents. To make these specific attributions would be distracting to the discussion. Moreover, as some of the behavioural institutional assumptions are on a continuum with the agency assumptions, some repetition in the selection of evidence is unavoidable. That is, some of the behavioural assumptions rely on the same evidence.

6.3.1 Legitimacy is a resource

This assumption does not seek to address the degree in which legitimacy is a resource. It seeks to identify whether legitimacy is viewed and is regarded as a resource by governance actors.

6.3.1.1 Case One

As previously identified the board has the ultimate responsibility over setting and ensuring policies regarding the business and affairs of Case One are to the benefit of shareholders and stakeholders. Further, the board is committed to ensuring that its constitutional powers and responsibilities are exercised and discharged, adopting best practice governance principles and applicable laws to ensure shareholder value. The evidence suggests that through poor environmental and social

compliance, brand damage is inevitable. This can potentially cost Case One its ability to supply retailers and ultimately the end consumer.

The policies and review processes concerning the board and its sub-committees convey apparent perceptions of legitimacy to the board's environment of institutions. For example, a policy is for the board to be composed of directors with an appropriate range and mix of qualifications, expertise, and experience which will enable the effective functional discharge of board responsibilities. It is to be composed of a majority of independent and non-executive directors. And its chair is to be an independent and non-executive director. In a process that conveys a reinforcement of its effectiveness, the board meets bi-annually to review the performance, membership and charters of the board and its sub-committees to determine their adequacy in the then current circumstances.

For each standing sub-committee of the board, a formal charter is adopted. These charters set out matters regarding the sub-committee's composition, responsibilities, functions and administration. Each sub-committee is to be composed of a minimum of three non-executive directors, a majority of which are independent. Other disclosures of policies that represent investments in the establishment and maintenance of Case One's legitimacy include a policy on maintaining ethical standards, a risk oversight and management policy and a fraud and corruption policy.

In terms of the building of a working culture that maintains perceived legitimacy, the audit committee is identified as working diligently to assist the board by seeking to ensure that potential or simmering issues are identified and acknowledged. This is achieved by constructing a culture which allows the executive management team to raise issues early. In doing so, the audit committee chair is found to facilitate the work of the audit committee and to act as a *bridge* between audit committee and non-audit committee directors and the external auditor, internal auditor, and executive management.

While the audit committee is to oversee auditor independence, it is an external and internal auditor's fundamental responsibility and duty to maintain independence; the main reason being professional integrity and reputation. This perception of independence of the external audit function in particular, is said by interviewees to be paramount to Case One's legitimacy in its superordinate system. The evidence suggests the external auditor firm will always remain cognisant of protecting its perceived independence while building open trusted communications with executive management.

In summary, the evidence suggests that legitimacy is a resource because Case One highlights through its charters and policy documents, its sound governance structures and processes. A determination is evident in Case One that its governance policies and practices must be exemplary in meeting ASX good governance benchmarks and professional auditing ethics.

6.3.1.2 Local Government

Councils are found to adopt guidelines and disclose policies that emphasise the establishment of governance and business functions necessary for an effective and publicly accountable body. These guidelines and policies are identified as adaptations from the corporate sector. But they are more politically driven in the sense that they are treated as *best practice* and therefore should be *conformed to*, to ensure the Council's legitimacy in its superordinate system.

In respect of the composition of audit committees, the requirement of a majority of independent members (i.e., three outside appointees and two councillors) gives strength to the perception of legitimacy in the monitoring of matters concerning accounting and financial reporting, risk management and reliability of internal controls. While Council is under no formal obligation to act on audit committee advice, it would be perceived as negligent to disregard such advice.

Like the audit committee in Case One, the building of a working culture that maintains perceived legitimacy in governance processes is found to be pursued by audit committees of Councils. Thus, the audit committee is aiming to build a constructive relationship with Council and city management

rather than an overly independent relationship. At each meeting the audit committee is provided with the opportunity to meet with both the internal and external auditors in the absence of city management. This evidence implies that the audit committee seeks to legitimatise interactions between executive management and auditors by independently assessing the effectiveness of monitoring policies and procedures.

As previously stated, VAGO governs the external audit program of city councils. The external audit program is found to be limited to providing an opinion that the annual financial reports comply with accounting standards. This suggests that the external audit is a somewhat symbolic practice to gain legitimacy. Interestingly, the evidence identifies that the reliance of the external auditor on the work of internal auditors is justified by the accounting profession and traditional accounting conformism. This is particularly interesting because it suggests that the external auditor is able to almost fully rely on the work of the internal auditor to the extent that this reliance can be professionally legitimated to stakeholders within local government's superordinate system.

6.3.1.3 Assumption Conclusion

Based on the discussed evidence the institutional assumption which suggests that firms and councils consider legitimacy as a resource is supported. The evidence shows that board (and Councils) and their audit committee, and internal and external auditors treat their perceived legitimacy within the wider superordinate system as a valuable resource to be established and maintained through governance policies and procedures that are, to a large extent, in conformity to best practices.

6.3.2.2 Actors interact in a dynamic and interdependent way

This institutional assumption seeks to identify the way in which governance actors interact. In particular it seeks to determine whether actors' interactions are more in line with behaviours expected under institutional theory as opposed to agency theory. The agency assumption that governance actor' interactions and processes are bureaucratic, as set out in section 6.2.9 (above), is at the other end of the behavioural continuum to this institutional assumption that actors interactions are dynamic and interdependent. This means that the evidence and conclusion as

presented in section 6.2.9 is equally relevant to this section. That is, the evidence in section 6.2.9 reveals that governance actors do, in several situations, interact in a dynamic and interdependent way although at times interactions are bureaucratic. Thus, it is suggested that governance actor interactions are both dynamic and interdependent and bureaucratic; i.e., this assumption is similarly largely supported. At times governance actors rely on their bureaucratic interactions and processes to legitimatise their activities, while at other times governance actors rely on more flexible and interdependent interactions and processes to effectively execute their overlapping monitoring and assurance responsibilities.

6.3.3 Firms (or city councils) operate and interact within a superordinate social system

6.3.3.1 Case One

At the centre of its endeavours the board of Case One is found to have a commitment to protecting its shareholders and other stakeholders by ensuring that its constitutional powers and responsibilities are exercised and discharged, adopting best practice governance principles and applicable laws. There is evidence of an underlying concern that a perception of sub-standard governance would damage the brand of Case One and the reputation of the key governance actors (i.e., the board, its committees and its auditors). Brand and reputation damage to Case One due to governance problems could negatively impact on its share price and its supply chain. This suggests that Case One is operating within a corporate eco-system.

In terms of direct interactions with external regulatory bodies, this is organised in a way that ensures the company receives formal information and responds to it through a single consistent channel. Hence, external communication from regulators (mainly ASX and ASIC) to Case One is channelled through the company secretary. No direct communication is found to take place between directors and regulators, unless on the rare occasion it is specifically demanded. Additionally, the external audit firm provides taxation and accounting standards updates directly to the CFO. In turn, the CFO debriefs executive management and directors regarding relevant changes. The company secretary and CFO, respectively, are in a position to tailor the incoming information and suggest its

implications for company governance policies, financial reporting and other compliance and operating practices. Occasionally, the external auditor may directly pass this update information to directors.

Looking into the way in which Case one operates and interacts, it is evident that it is operating and interacting within a superordinate social system. This is shown by emphasising its commitment to integrity and sound governance to ensure stakeholder protection. Further, as previously identified governance actors are seeking to build trusted relationships with one another, this suggests that that actors are interacting with one another as distinct institutions.

6.3.3.2 Local Government

Like corporate entities, city councils have governance guidelines to follow which are aimed at protecting the interests of stakeholders in the superordinate social system. The general consensus amongst city councils is that these guidelines are *best practice* and therefore should be *conformed* with. Hence, city councils clearly recognise that they operate in a superordinate social system.

In terms of interactions with this superordinate social system, it is found that the audit committee of Council has no authority to directly communicate with external stakeholders unless legally required. The independent members' of audit committee, however, engage with the wider business and professional communities in their capacity as professionals and not as city council audit committee members. Similarly to the Case One evidence local government governance actors are interacting within a superordinate social system as a whole entity (i.e., city council), governance mechanism (e.g., Council or audit committee) and as individual actors.

6.3.3.3 Assumption Conclusion

The evidence provided in this study about the nature and extent of operation and interaction by Case One and city councils within a superordinate social system is limited. Evidence has not been obtained on the various business, professional and regulator circles that may be regularly frequented by the chair of the board, the chair of audit committee, the CFO or other governance

actors in Case One. Likewise, the mayor, councillors and CEO are likely to have regular interactions with a wide range of stakeholders at the community level and high-tier government level.

However, the evidence does reveal that both the board of Case One and its committees are formally committed to the interests of shareholders and wider stakeholders, particularly regulators and the external auditor. This commitment is evidenced through disclosures in board and board sub-committee charters and policies, and adherence to these charters and policies in practice. This infers that governance actors in Case One place high importance on the need for their firm to operate within a superordinate social system. The same formal commitment to the interests of stakeholders and compliance to the governance expectations of regulators is found in city councils. Moreover, the official interactions with this superordinate social system on matters of corporate governance are closely managed. For Case One, direct interactions from and to external regulatory bodies and the external audit firm are tightly channelled through the company secretary and the CFO. For city councils, communications to and from external regulators is also carefully managed, with restrictions being placed on certain governance actors such as the audit committee. Overall, there is clear evidence to support the assumption that firms (and city councils) place high importance on their need to operate within a superordinate social system. There is also evidence of formally managed processes of interaction of governance actors in these entities with the governance actors in the superordinate social system. Following this evidence, it is suggested that superordinate social system interaction and operation is on three levels as a single entity, as a governance mechanism and as an individual governance actor.

6.3.4 Firms are closed yet simultaneously open to pressures of the superordinate social system and consequently, there exists some form of peer or institutional compliance pressures

This assumption seeks to identify whether Case One and city councils are closed yet open to the pressures of the superordinate social system. As stated in Chapter 2, firms may acquiesce; negotiate; avoid; defy; or control and manipulate the pressures of the superordinate social system to maintain

legitimacy (Oliver 1991). As this study is limited to one corporate case example, the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations presented in Chapter 3 provide an example of pressure from the superordinate social system. To further illustrate this concept of peer compliance pressure, appendices 3 and 4 present an example of a board charter and audit committee charter (respectively) of other ASX 300 listed entities. Key concepts from these appendices are quoted in this section to illustrate Case One's similarity to other firms (i.e., other ASX 300 listed entities) with respect to their superordinate social system. The similarity would imply that Case One is open to the pressures of the superordinate social system.

6.3.4.1 Case One

The evidence identifies that the board is committed to ensuring that its constitutional powers and responsibilities are exercised and discharged, adopting best practice governance principles and applicable laws. Additionally, the board is committed to maximising operational performance creating shareholder value by adopting and maintaining best practice governance standards. Further, the company secretary explained that should there be poor environmental and social compliance, brand damage would be inevitable. Such brand damage could result in problems to Case One's core activity of supplying its products to retailers and, in turn, could impact on perceptions of the end consumer. Accordingly, responsibility for conformity with best practice governance principles and compliance with applicable laws is found to emanate from the board of Case One. The Board's charter requires it to ensure that directors, officers, and employees operate in a sound governance environment. It parallels the board charter of a comparable ASX company which states:

"The Board ... has adopted this Charter to outline the manner in which its constitutional powers and responsibilities will be exercised and discharged, adopting principles of good corporate governance and practice that accord with applicable laws" (Ansell 2010, p.1).

“The Board ... is ultimately responsible for the oversight and review of the management, administration and overall governance ... the protection of shareholders' interests ... authorising policies and overseeing the strategic direction ... establishing goals for management and monitoring the achievement ... [and] engaging, reviewing and replacing the Chief Executive Officer” (Ansell 2010, p.1).

“... Board has retained ultimate responsibility for the strategic direction and control of the Company. The Board delegates management of the Company's resources to the executive team under the leadership of the Chief Executive Officer” (Ansell 2010, p.4).

The Case One board's charter requires that the board be composed of directors with an appropriate range and mix of qualifications, expertise, and experience which will enable the effective functional discharge of Board responsibilities. Further, it is to be composed of a majority of independent and non-executive directors. And the board chair is to be an independent and non-executive director. In ensuring its effectiveness, the board will bi-annually, with the assistance of the NC and an external advisor, review the performance, membership and charters of the board and its sub-committees to determine their adequacy in the then current circumstances and to determine whether their processes are adequate. Convergence with board composition and self-review processes found in the superordinate system is evident in the statements from a comparable ASX company as follows:

“The composition of the Board is reviewed on an annual basis [by the NC] ... to ensure that the Board has the appropriate mix of skills, expertise and experience necessary to fulfil its function effectively” (Ansell 2010, p.2).

“... the Board comprise a majority of non-executive directors. It is intended that at least half of the Board from time to time be independent non-executive directors” (Ansell 2010, p.2).

“The Board ... [will] review the membership and charter of the Board to determine their adequacy in the then current circumstances and to determine that the Board's processes are adequate” (Ansell 2010, p.6).

Peer or institutional compliance pressures are also evident in the way Case One’s board has established sub-committees. Similar to other larger ASX companies, Case One’s standing sub-committees are each to adopt a formal charter which sets out matters regarding its composition, responsibilities, functions and administration. Additionally, each sub-committee is to be composed of a minimum of three non-executive directors, a majority of which are independent; while their chair is to be both an independent and non-executive director and shall not be the board chair. For example:

“The Board from time to time establishes Committees to streamline the discharge of its responsibilities and, for each standing Committee, adopts a formal charter setting out the matters relevant to the composition, responsibilities and administration ... also delegates specific functions to ad hoc Committees on an "as needs" basis” (Ansell 2010, p.4).

The audit committee is viewed as a board sub-committee which is to assist the Board in the discharge of its responsibilities. The audit committee’s key responsibilities and functions are to review, oversee and report to the board on the following: financial processes and reporting; audit programmes; and internal controls and risk management. Therefore, all persons appointed to the audit committee must have the ability to comprehend and interpret financial statements and have sufficient financial knowledge and understanding. The evidence shows that that CEO and CFO are to provide compliance certificates to the audit committee in relation to the integrity and accounting standards compliance of financial papers. As such, the audit committee chair is regarded as having an informal accountability to executive management in assisting them in improving the quality of

such papers. The purpose, functions and membership of Case One's audit committee, parallel's that of other ASX companies. For example:

"The primary purpose of the Audit Committee is to assist the Board discharge its responsibility in ... ensuring the Company adopts, maintains and applies appropriate accounting and financial reporting processes and procedures ... facilitating the independence of the external audit process and addressing issues arising from the audit process ... ensuring the Company maintains effective risk management and internal control systems" (Cochlear n.d, p.1).

"All members shall be independent Non-Executive Directors who possess the requisite qualifications and financial literacy" (Cochlear n.d, p.1).

In using an outsourced-internal audit function, the executive management team and the board are able to gain access to relevant experts as opposed to outsourcing for specific expertise. However, the internal audit program is regarded as a tool for executive management rather than the audit committee or the board, though it aids and supports the audit committee's assessment of the internal control framework. Similarly to the engagement of the external auditor, the engagement of the outsourced-internal auditor is to be approved by the audit committee. When the scope of the audit programs overlap, the external auditor is able to rely on the working papers of the internal auditor as agreed upon in the initial external audit engagement.

As Case One is an ASX listed company and it is required to comply with the ASX's best practices (these were presented in Table 3.3 of Chapter 3), this creates compliance pressure. In light of the above evidence in consideration with appendices 3 and 4, the operations and practices of Case One largely suggest that it is closed yet simultaneously open to the pressures of the superordinate system. However, the evidence provides stronger support for Case One being open rather than closed. While the governance policies and structures of Case One are clearly shaped by an openness

to the pressures of the superordinate system, there are also procedures in place that keep the governance system closed to these pressures. For example, open communications between directors and external regulators is limited and controlled in Case One. An established process in Case One is that notifications to directors by regulators such as ASIC and ASX are received by the company secretary who filters this information. Unless directors are referred to in-person in communications from and to regulators, then the company secretary deals with pressures from regulators and involves management as deemed necessary.

6.3.4.2 Local Government

The four city councils reviewed in this study have broad commonalities. They are composed of an elected policy-making arm and an appointed management arm. For each city council, evidence indicates that city councils are open to pressures from the superordinate system in the way they have developed the CEO's contract of employment. The CEO is found to hold responsibility for the implementation of Council decisions, for ensuring Council achieves its Council Plan objectives, and for managing the day-to-day operations, resources and staff of a city council. Additionally, the Local Government Act requires a Council to delegate authority to the CEO. The CEO is to be appointed for no more than five years, on a performance based contract; the incumbent CEO may be reappointed for a further term.

Further indication of openness of city councils to pressures to converge their governance practices is evident in their establishment of audit committees. Similar to corporate entities, city councils have governance guidelines to follow in relation to the formation and composition of audit committees. The general consensus about these guidelines is that they are *best practice* and therefore should be *conformed* with. However the voluntary adoption of audit committees in city councils dates back to 1998.

Each of the four city councils has an audit committee with a state primary role of assisting Council in the effective discharge of its corporate governance responsibilities over accounting and financial

reporting, risk management, governance and reliable internal controls. The audit committee assists Council by providing an independent review of its municipality's financial management and reporting systems. However, Council is under no formal obligation to act on audit committee advice. In each case, however, it holds strong persuasiveness as ignoring such advice is viewed as negligent. Moreover, the audit committee acts as an effective means of communication between the external auditor, internal auditor, city management and Council. In each city council case, the audit committee is found to work constructively with city management and Council. Further, as independent advisers, the audit committee has no direct communication with external stakeholders unless legally required. The independent members' engagement with the wider business community is with their capacity as professionals and not as city council audit committee members.

The external audit program of city councils is governed by the VAGO. The primary focus of the external audit program is to provide assurance that the annual financial reports are fairly presented. However, the external audit is viewed as being more form than real substance; "it merely issues an assurance opinion as to whether firms are complying with accounting standards". Interestingly, the evidence identifies that the reliance of the external auditor on the work of internal auditors is governed by the accounting profession and traditional accounting conformism. This is particularly interesting because it suggests that the external auditor is able to rely on the work of the internal auditor to the extent that the superordinate social system deems it to be legitimate.

The amalgamated evidence as summarised in Chapter 5, suggests that governance structures and practices in local government are convergent because they are open to the pressures of the superordinate social system. Illustrations of convergence of city councils are provided in this subsection in the CEO's employment contract and the extent of the audit committee's roles and influences. The evidence identifies that in terms of the external audit local governments have to comply with VAGO's decision in terms of actual performance.

6.3.4.3 Assumption Conclusion

Following the evidence, support is given to the institutional assumption which identifies Case One and local governments as being open to the pressures of the superordinate social system in terms of accepting and, in fact, leading peer or institutional compliance pressures. The evidence shows that there exists a form of institutional compliance through the adoption of similar governance structures, policies and processes. However, there is also evidence of Case One adopting processes that seek to shield directors from pressures of regulators and shareholders in the superordinate system. This suggests an element of seeking to be simultaneously closed to the superordinate system. Similarly, evidence from the selected city councils indicates that their practices are of a confirmative nature as illustrated in Chapter 5. This suggests that both firms and city councils tend to conform to the pressures placed on them by the superordinate social system. Further, Case One and city council governance actors appear to be the driving force behind these organisations being open yet simultaneously closed to the pressures of the superordinate system.

6.3.5 There exists some institutional homogeneity

The institutional theory literature contends or assumes that there exists institutional homogeneity. This has been found in terms of audit committee characteristics (i.e., independence and expertise) and in the external auditors' provision for non-audit services (Abbott et al. 2003b; 2004; Ashbaugh et al. 2003; Beasley 1996; Frankel et al. 2002; Kinney et al. 2004; Lary and Taylor 2012; Raghunandan et al. 2003; Xie et al. 2003).

This assumption seeks to identify the existence of institutional homogeneity within its superordinate social system (i.e., both the wider eco-system and the contract nexus). It is closely related to the institutional assumption presented in section 6.3.4 above, which sought to identify whether an entity is closed yet simultaneously open the pressures of the superordinate social system and consequently, there existed some form of peer or institutional compliance pressure. Therefore, in light of the evidence presented in section 6.3.4 the institutional assumption which identifies that there exists institutional homogeneity is supported. Homogeneity is implicit in the evidence that

governance structures and actors appear to be following a similar pattern in terms of their basic form, structure, roles and responsibilities. However, the evidence suggests that while there exists some degree of non-homogeneity in terms of actual composition, this is due to the individual needs of the firm or city council. For illustrative purposes some of this evidence is linked back to the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (ACGPR).

Principle 1 from ACGPR identifies that a listed entity should establish the functions of the governing body and those delegated to management (ASX 2010a). The Case One evidence finds the board has the ultimate responsibility for the strategic direction and control of Case One. Further, the board will delegate the day-to-day management of Case One's resources to the executive management team under the leadership of the CEO. City councils have a different structure but similar strategy-setting and delegated management functions. The elected Council (headed by the mayor) holds the responsibility for establishing policies and making strategic decisions of the city council, whereas the city management (headed by the CEO) holds the responsibility for implementing Council decisions.

Principle 2 from ACGPR states that the governing body should be composed of an independent majority, independent chair and should establish a NC (ASX 2010a). In Case One, the board is to be composed of directors with an appropriate range and mix of qualifications, expertise, and experience to enable the effective discharge of board responsibilities. Further, it is to be composed of a majority of independent and non-executive directors. And the Board chair is to be an independent and non-executive director. In city councils, Council is to be composed of councillors elected by the residents of the municipality. The mayor is either independently elected or is appointed from and by the municipality's councillors.

Principle 4 from ACGPR states that the governing body should establish an audit committee; the audit committee should have a charter, consist of only non-executive directors, have a majority of independent directors, have at least three members, and have an independent chair that is not the board chair (ASX 2010a). The Case One audit committee is to assist the board in the discharge of its

responsibilities. The audit committee's key responsibilities and functions are to review, oversee and report to the board on the following: financial processes and reporting; audit programmes; and internal controls and risk management. Similarly, the primary role of city council audit committees is to assist Council in the effective discharge of its corporate governance responsibilities over accounting and financial reporting, risk management, governance and reliable internal controls.

Principle 8 from ACGPR states that the governing body should establish a RC that is to consist of a majority of independent directors, have at least three members, and have an independent chair that is not the board chair (ASX 2010a). The Case One board may establish sub-committees to streamline the discharge of its responsibilities and functions. Each standing sub-committee is to adopt a formal charter which sets out matters regarding its composition, responsibilities, functions and administration. Additionally, each sub-committee is to be composed of a minimum of three non-executive directors, a majority of which are independent. Each sub-committee chair is to be both an independent and non-executive director.

Institutional homogeneity through conformity of structures and practices is also seen in the engagement of the external auditor. In relation to the external auditor reliance, the Case One findings show that when the scope of the audit programs overlap, the external auditor is able to rely on the working papers of the internal auditor as agreed upon in the initial external audit engagement. Interestingly, the city council evidence identifies that the heavy reliance of the external auditor on the work of internal auditors is justified by citing auditing principles of the accounting profession and traditional accounting conformism. This infers that the external auditor is able to rely on the work of the internal auditor to the extent that the professional bodies in the superordinate social system deem it to be legitimate.

6.3.6 Governance mechanisms are adaptive

Following the evidence, as presented in section 6.2.7 the agency assumption that governance mechanisms evolve to better address agency concerns was partially supported. It was found that

governance mechanisms have the authority and capability of evolving to better address agency problems; i.e., they are adaptive. Further, governance mechanisms, processes and structures require a built-in annually review. This periodic review process will result in modifications, if necessary, to the performance targets, charters or composition of governance mechanisms. Therefore, governance mechanisms are able to adapt and modify their basic form, structure, purpose and responsibilities. Consequently, following this evidence the institutional assumption which identifies governance mechanisms as being adaptive is supported.

6.3.7 Change innovations are driven by performance enhancement and legitimacy

This institutional behavioural assumption is closely related to the agency behavioural assumption of section 6.2.7 which suggested that governance mechanisms evolve to better address agency concerns. This improvement through evolution was illustrated when addressing the agency assumption of section 6.2.7. The evidence presented in section 6.2.7 partially supported the assumption as governance mechanisms were found to have the authority and capability of evolving to better address agency problems. However, this authority and capability may also be used to better adapt governance structures towards achieving business efficiency, conformity and political needs. This ability to evolve did not concede that evolutions are exclusively agency driven. As earlier explained governance mechanisms are found to entail the building and forming of trusted relationships with open communication systems as opposed to purely independent monitoring focused relationships. This suggests that governance mechanisms may be evolving in an effort to improve their productivity and legitimacy. Therefore, using this evidence, the institutional assumption that change innovations are driven by performance enhancement and legitimacy is similarly partially supported.

6.3.8 Governance mechanisms are merely symbolic displays for conformity and legitimacy

Gendro and Bedard's (2006) findings suggest that the effectiveness of audit committees is dependent on symbolic processes and outcomes. Likewise, Collier and Zaman (2005) suggest that

the adoption of governance models and mechanisms may be a symbolic concept used to signal the addressing of monitoring and control concerns. In contrast, Cohen et al. (2010) find that governance mechanisms are regarded as effective monitors as opposed to mere symbols of legitimacy based on external auditor experiences. Similarly, Spira (1998) finds that the audit committee will evolve into an effective monitoring body over time; the reason for its establishment affects the speed in which it becomes effective. However, the literature has also suggested that the governance characteristics of audit committees will critically impact their ability to effectively execute their duties (Abbott et al. 2003b; Lary and Taylor 2012).

This assumption seeks to identify whether governance mechanisms are symbolic displays for conformity and legitimacy. However, given its nature the evidence used will closely mirror the evidences used in sections 6.3.4, which sought to identify the existence of compliance pressure. Moreover, the evidence is also closely related to the agency assumption of section 6.2.6, which sought to identify whether governance mechanisms are monitors.

6.3.8.1 Case One

The evidence points to the Case One board taking a genuine monitoring role, although within the bounds of conformity with perceived best governance practice. There is little evidence that its endeavours to conformity with best practice are currently pursued as a symbolic display for legitimacy. The independent director and chair of audit committee of Case One emphasised in interview that the board is committed to ensuring that its constitutional powers and responsibilities are exercised and discharged, adopting best practice governance principles and applicable laws. The board, through its public disclosures, does signal its commitment to effective monitoring using best monitoring practices. While such public disclosures may be construed as symbolic displays aimed at maintaining legitimacy, the supporting evidence suggests the effective monitoring is their main priority. For example, to ensure effective monitoring each director has the right to access Case One information and Case One's executive management, external advisors and auditors.

Moreover, as previously mentioned, the board will bi-annually with the assistance of the NC and an external advisor, review the performance, membership and charters of the board and its sub-committees to determine their adequacy in the then current circumstances. This is to determine whether their processes are adequate to ensure they are able to carry out their functions in the most effective manner. This ensures that the board is composed of directors with an appropriate range and mix of qualifications, expertise, and experience.

The board delegates the day-to-day management of Case One's resources to the executive management team. Accordingly, a key function of the Board is to monitor the executive management team's performance. Further, the board has retained the ultimate responsibility for the strategic direction and control of Case One. This evidence further identifies that the board is acting as a monitor.

Conflict between the board and executive management is found to occur regarding when issues should be disclosed rather than what or how. And in such situations the board is prepared to take a different view from executive management. Further, the board is also prepared to take a different view following a recommendation from its audit committee or other sub-committee. Directors are found to draw upon their knowledge and experience in executing their judgement.

As stated earlier, the board establishes sub-committees to *streamline* the discharge of its responsibilities and functions. Following a board responsibility delegation to one of its sub-committees, the executive management team is required to deal with that sub-committee and not the board regarding the issues of that responsibility. The evidence shows that each standing sub-committee is to adopt a formal charter which sets out matters regarding its composition, responsibilities, functions and administration.

In terms of the audit committee, the evidence reveals that the audit committee seeks to construct a culture which allows the executive management team to raise issues early. This has enabled more

proactive monitoring by the audit committee. Further, the audit committee is found to meet more often than the minimum requirement of four times per year. The meeting frequency is dependent on the complexity of issues and the structure of both board and audit committee meetings. At the end of the meeting agenda the audit committee will commence a closed private session between the non-executive directors and the lead internal auditor and external audit partner. The closed private session is a formal process for the audit committee to eye-ball the auditors in the absence of the executive management team. The evidence shows that the audit committee is expected to meet with the external and internal auditors in the absence of executive management whenever it is deemed appropriate but not less than twice a year.

The chair of the audit committee strongly refutes the suggestion that the work of the chair or that of the audit committee represents a symbolic display of conformity or legitimacy. The chair perceives the purpose of the role as facilitating the effectiveness of the work of the audit committee and acting as a *bridge* between audit committee and non-audit committee directors and the external auditor, internal auditor, and executive management. As this bridge the chair will meet with key presenters prior to audit committee meetings, to go through information papers, request additional papers, identify issues, raise questions, and make a judgement to facilitate information sessions. The audit committee chair is found to hold an informal coaching role in aiding executive management. Acting as a coach is not considered to threaten the chair's independence but rather an opportunity to probe the rigour of management proposals. This suggests that the audit committee is monitoring through actively engaging governance actors. This active engagement is viewed as a signal of the audit committee's commitment towards sound governance, not a symbolic display.

In respect of the external auditor, the importance of ensuring a perception of independence from the executive management of their client, Case One, could be construed as a symbolic display of legitimacy. In conducting the external audit, the auditor uses Best Practice Templates which are developed by the audit firm. Further, the external auditor is prohibited from providing any non-audit

service which would create a perceived or real threat to their independence. Moreover, the external auditor is identified as having a formal relationship and front-line accountability to an audit committee. However, the external audit partner will also engage with executive management in a way that is not a display of perceived independence. The main purpose of the external audit is to form and provide an objective view on financial reports; and to provide feedback to the board and executive management team on financial reports. In fulfilling its purpose of providing an objective view on financial reports and feedback to the board, the external auditor takes the initiative to build a trusted relationship with executive management of Case One. The argument of the external audit partner is that too much independence will lead to ineffective monitoring as the purpose of the external audit is to form and provide an objective view on the published financial reports, where that view is dependent on trusted communication.

The evidence discussed provides little indication that governance mechanisms are merely symbolic displays for conformity and legitimacy. The evidence suggests that governance mechanisms are committed to sound governance practices through active monitoring. However, while the evidence implies that governance mechanisms are monitoring mechanisms, it also suggests that mechanisms can be monitoring mechanisms while simultaneously acting as signals for conformity and legitimacy.

6.3.8.2 Local Government

Similar to large corporate entities, city councils have governance guidelines to follow in relation to the formation and composition of audit committees, although the voluntary adoption of audit committees has applied in city councils. The composition for city council audit committees is modelled after best practice guidelines for local government which, in turn, have been modelled after private sector corporations.

Since an audit committee of the Council is deemed to be established as an independent advisory committee, does it become a mere symbolic display of conformity and legitimacy? Its stated role is to provide an independent review of its municipality's financial management and reporting systems.

But, as an advisory committee, the audit committee holds no executive powers or formal authority. However, in situations of material disputes, the audit committee may rely on the formal powers of the mayor and Council (dispute with city management) or the auditor general (dispute with Council). Nevertheless, its lack of authority is evident in the fact that Council retains the authority to appoint and remove audit committee members. Further, Council is under no formal obligation to act on audit committee advice; however it holds strong persuasiveness as ignoring such advice is viewed as negligent.

Interestingly, the audit committee acts as an effective means of communication between the external auditor, internal auditor, city management and Council. The independent members hold a coaching role to both Council and city management, this coaching role involves providing advice based on previous corporate knowledge and experience. The interviewees contend that audit committees work constructively with city management and Council. Generally, the audit committee is aiming to build a constructive relationship with city management rather than an overly independent relationship. The evidence identifies that the effective execution of audit committee responsibilities is dependent on building trusted relationships, open communication and cooperation with city management. This behaviour cannot be construed as a symbolic display of conformism by the audit committee.

The primary focus of the external audit program is to provide assurance that the annual financial reports are fairly presented. However, the external audit (who is the State government audit office or sub-contracted auditor by this government office) is viewed as being concerned with meeting the form of the audit, rather than providing real audit substance. To quote an interviewee: "it merely issues an assurance opinion as to whether firms are complying with accounting standards". This is significantly different to Case One where the focus of external audit program is to provide an objective view and feedback by building trusted relationships. This is interesting because it suggests

that the external audit function for local governments is more akin to a symbolic display of conformity.

In summary, the local government evidence suggests that governance mechanisms, especially the activities of the audit committee, are substantially committed to sound governance practices through active and constructive monitoring. However, there is other evidence that the external audit function is substantially concerned with providing a display of conformity and legitimacy.

6.3.8.3 Assumption Conclusion

According to the evidence presented in the case chapters and the discussed evidence the institutional assumption which identifies governance mechanisms as merely symbolic displays for conformity and legitimacy is largely rejected. While some evidence identifies that governance mechanisms can at times be symbolic displays of conformity and legitimacy, there is not enough support for the assumption that these mechanisms are *merely* symbolic displays for conformity and legitimacy. As explained earlier, the evidence identifies governance actors as fulfilling their monitoring roles and responsibilities, while simultaneously signalling the achievement and commitment to sound governance outcomes and processes through actively engaging with governance actors. Although both boards and Councils delegate some of their monitoring decision, control functions remain accountable to main stakeholders. In light of the evidence it is suggested that governance mechanisms are monitoring mechanisms while simultaneously acting as signals for conformity and legitimacy.

6.3.9 Governance mechanisms use symbolic gestures to legitimise interactions

Collier and Zaman (2005) suggested that governance mechanisms and practices may be a symbolic concept used to signal the addressing of monitoring and control concerns. This assumption seeks to address whether governance actors adopt symbolic practices to ensure their legitimacy to the wider corporate eco-system and within their contract system.

6.3.9.1 Case One

As earlier stated, the board is responsible for the review and oversight of Case One administration, management and governance. The board is ultimately responsible for setting policies regarding the business and affairs of Case One, and monitoring the performance of the executive management team so as to ensure these policies are to the benefit of shareholders and stakeholders. Evidence was not apparent to indicate that the board used its independent directors or its sub-committees as symbolic gestures to legitimise its interactions.

In terms of the audit committee as a governance mechanism, the use symbolic gestures to legitimise its interactions is not evident. As previously explained, the behaviours of the audit committee include: (a) being proactive in monitoring emerging issues by constructing a culture which allows the executive management team to raise issues early; (b) conducting a closed private session between the non-executive directors and the lead internal auditor and external audit partner; (c) using the audit committee's chair as a *bridge* between the audit committee and non-audit committee directors and the external auditor, internal auditor, and executive management.

Similarly, the external auditor, as a governance mechanism, does not appear to use symbolic gestures to legitimise its interactions. It has been found that the external audit partner seeks to build a trusted relationship with executive management in order to achieve trust in communications that can be effective in forming an objective view on the published financial reports. This nurturing of trusted communications is pursued by the external auditor subject to the fundamental caveat that the external auditor team's professional integrity and reputation is upheld.

The evidence discussed suggests that governance actors in Case One are more concerned with building trusted relationships to ensure effective monitoring than maintaining symbolic gestures to legitimise their interactions.

6.3.8.2 Local Government

The audit committee is formed as a mechanism to assist Council by providing an independent review of its municipality's financial management and reporting systems. As an advisory committee Council is under no formal obligation to act on audit committee advice, although the advice of the audit committee is found to hold strong persuasiveness. In practice, the audit committee is found to act as an effective means of communication between the external auditor, internal auditor, city management and Council. This is especially evident in the advice provided by the independent members of the audit committee who are appointed for their professional expertise and external experience. The evidence identifies that the effective execution of audit committee responsibilities is dependent on building trusted relationships, open communication and cooperation with city management. In summary, the audit committee in local government is found to be engaged in building trusted relationships and effective monitoring among governance actors, rather than being engaged in symbolic gestures to legitimise the interactions among governance actors.

6.3.9.3 Assumption Conclusion

Based on the evidence the institutional assumption which suggests that governance mechanisms use symbolic gestures to legitimise interactions is largely rejected. While the evidence suggests that governance actors are more concerned with ensuring effective monitoring through building and maintaining trusted relationships.

6.3.10 Overall Institutional Conclusion

The conclusion drawn is that some traces of institutional assumptions will underpin the governance model. In Chapter 2, the proposed expanded governance model suggested that the governance phenomena may be explained by singularly adopting an institutional framework. However such an adoption would fail to sufficiently address the governance phenomena. The institutional framework is found to be relatively weak in explaining the shaping of the audit committee and external audit function as governance mechanisms, as well as the behaviours of actors within those mechanisms.

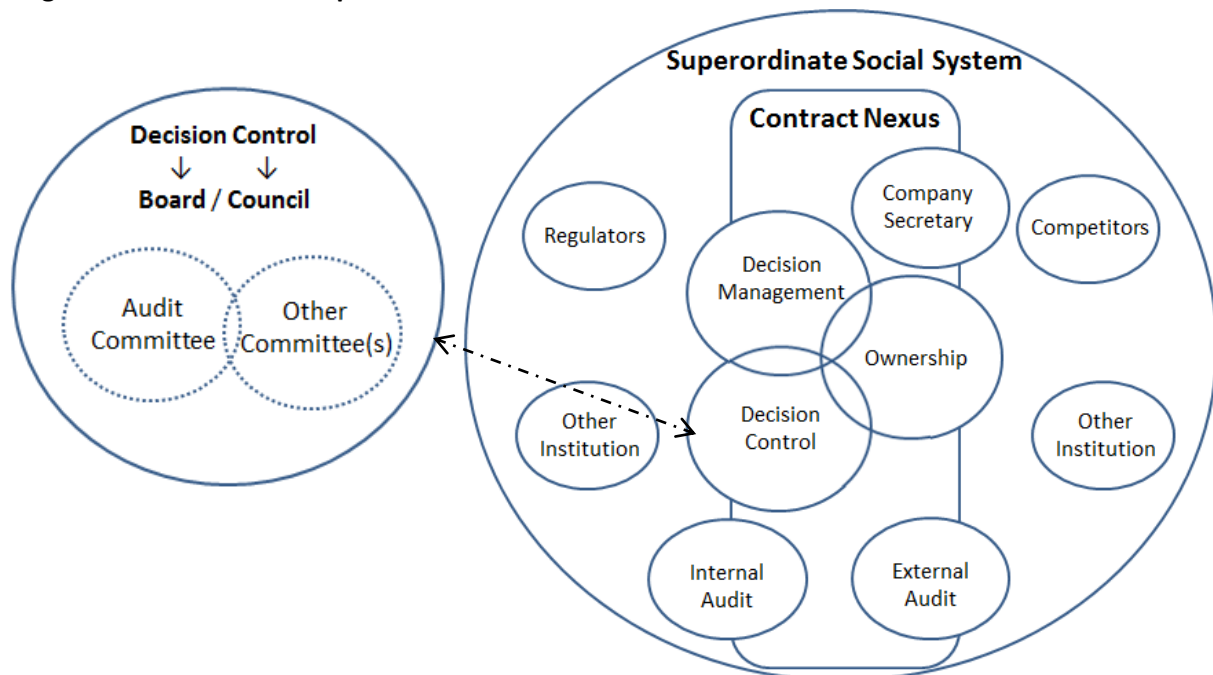
The institutional assumptions may be better suited for addressing a broader range of aspects of the governance model where the net is cast to include the legal, social, political and strategic factors.

6.4 THE REVISED EXPANDED GOVERNANCE MODEL AND ITS ASSUMPTIONS

Following the evidence it is contended that corporate governance phenomenon can be more holistically depicted adopting a mixed theoretical framework consisting of both agency theory and institutional theory. As such, Figure 6.1 presents two related aspects of the revised model: the graphical depiction of the model itself and the set of assumptions underpinning the model.

First, in terms of graphical depiction, the previously proposed expanded governance model depicted in Figure 2.3 is revised to more pluralistically depict governance phenomena in Figure 6.1. This revised model in Figure 6.1 has been designed after reflecting on the evidence presented in Chapters 4 and 5.

Figure 6.1: The Revised Expanded Governance Model



The Revised Assumptions of the Expanded Governance Model

1. The contract nexus operates and interacts within a superordinate social system;
2. Both mechanisms and actors of the contract nexus are external yet simultaneously internal to the contract nexus;

3. The contract nexus is closed yet simultaneously open to the pressures of the superordinate social system and consequently, there exists some form of peer pressure and institutional compliance pressures;
4. There exists some institutional homogeneity;
5. Legitimacy is a resource;
6. Actors of the contract nexus are self-interested;
7. There exists a separation between decision control and decision management;
8. The decision controller is to delegate decision management and some decision control functions to internal (or external) agents;
9. Actor interactions are bureaucratic yet simultaneously dynamic and interdependent;
10. Governance mechanisms act as monitors and signalling mechanisms for legitimacy;
11. Governance mechanisms are adaptive; and
12. Governance mechanism innovations are driven by agency conflicts, social legitimacy and performance enhancement.

The model in Figure 6.1 renames the external institutional environment as the superordinate social system. This is because the literature identifies firms (or Councils) to exist within a superordinate social system (Dillard et al. 2004; Dowling and Pfeffer 1975; Oliver 1997; Scott 1987; Zucker 1987). The model further renames the internal institutional environment to become the contract nexus. Fama and Jensen (1983) identify a firm (or Council) as a contract nexus.

Further, the revised model in Figure 6.1 narrows the contract nexus, in order to better depict the scope of the contract nexus reflected by the evidence gathered in this study. This narrowing identifies that governance mechanisms and their actors are internal yet simultaneously external to the contract nexus. In this sense, all of the circles drawn as internal to the contract nexus in Figure 6.1 are also depicted as interfacing into the superordinate social system. In relation to 'decision

control', this model depicts in a telescoped circle the composition of the institutional group encapsulated by the agency theory notion of decision control. This institutional group centres on the board and its sub-committees. The players in this institutional group can comprise non-executive directors who are both internal and external agents. In relation to the executive management team, they represent players in the institutional group encapsulated by agency theory notion of 'decision management'. They will be linked to the superordinate social system through their professional affiliations and dealings with industry competitors and regulators. Likewise, the external auditor, the outsourced-internal auditor and the company secretary are also depicted as being internal to the contract nexus, but also part of the superordinate social system. Each has strong ethical and professional affiliations with their respective professional and regulatory bodies. For example, the company secretary is found to be a key tool of communication between internal contract players (i.e., directors, executives and auditors) and external corporate governance regulators. Further, the outsourced internal auditor, like the external auditor, enters an internal contract with the board and performs services for management, but is an entity external to the firm. Consequently, each of the types of internal and external agents depicted in Figure 6.1 is positioned to generate both internal and external isomorphic pressure on the organisation's governance system.

Furthermore, this narrowing of the scope of the contract nexus better depicts the notion of agency separation. Thus, internal to the contract nexus, ownership (the principal) is shown in Figure 6.1 as not fully separated from the players (the agents) responsible for decision control or decision management. Importantly, it also shows an overlap between decision control and decision management. This overlap is found in this study in the constructive interactions between audit committee (especially the chair) and executive management (especially the CFO). On the other hand, the external auditor, the outsourced-internal auditor and the company secretary are found to have more independence from players in the organisation's decision control and decision management.

While the model only indicatively identifies the external mechanisms of the superordinate social system, it may be revised to specifically capture some phenomenon of interest to other researchers. Taking the group, 'regulators', as a single institution, such a grouping may be split into separate institutions (e.g., firm regulators, audit regulators, director regulators). Similarly, the broad competitors' institution may be split into distinct institutions (e.g., hostile competitors, colluding competitors). Also the model may be expanded to include other types of institutions or stakeholders (e.g., customers, suppliers, lenders) who could exert isomorphic pressure on the governance system.

In summary, Figure 6.1, which is the expanded model that has been revised in light of the evidence, is believed to better reflect the integrating and influencing nature of the key components of a corporate governance system. This revised expanded model may be regarded as a theoretical Frankenstein as it borrows elements from both agency theory and institutional theory to help explain the corporate governance phenomena.

The second part of Figure 6.1 depicts the set of assumptions underpinning the graphical model. These assumptions have been amalgamated from the conclusions arising in discussion of the evidence in relation to the separate sets of agency and institutional theory assumptions given in this chapter.

In the list of 12 assumptions put forward in Figure 6.1, the following categorisations are noted:

- Three agency theory assumptions are retained unchanged. There are assumptions 6, 7 and 8. However, assumption 8 is slightly qualified to indicate that the decision controller delegates to decision managers who are contracted as internal agents within the contract nexus, but can be external to the firm (i.e., the external auditor and outsourced-internal auditor).
- Three legitimacy assumptions are retained unchanged. These are assumptions 5, 11 and 12.

- Three assumptions are slightly refocused. Assumptions 1 and 3 are changed by replacing the word 'firm' or 'organisation' with the words 'contract nexus'. This better reflects the positioning of governance mechanisms and actors as part of the contract nexus which operates and interacts within, and can be influenced by, the superordinate social system. Assumption 2 is changed in a similar way. The words 'external auditor' and 'client' (in reference to the client firm of the external auditor) are replaced with the words 'mechanisms and actors' and 'contract nexus' to reflect a broader-base for this agency assumption.
- Three assumptions are created as hybrids of agency and institutional theories. These are assumptions 9, 10 and 12. First, assumption 9 becomes a hybrid of actor interactions and processes which have been identified as having both 'bureaucratic' and 'dynamic and interdependent' features. Second, assumption 10 becomes a hybrid of governance mechanisms which have been identified as serving the purposes of both strong monitoring mechanisms and potent signals of legitimacy. Third, assumption 12 becomes a hybrid of innovative change and evolution of governance mechanisms that has been identified as both a response to an agency conflict problem and an isomorphic development driven by legitimacy considerations.

6.5 CHAPTER SUMMARY

This chapter presented the findings of the illustrative-narrative analysis based on theory-driven selective coding of the narrative-network analysis as presented in chapters 4 and 5. The chapter examined the agency assumptions and suggested that while an agency theoretical framework may explain the governance phenomena, it fails to holistically address the governance phenomena. The agency framework is found to be useful in addressing the purpose and function of the governance mechanisms. Further, the behaviours of governance actors within governance mechanisms are more pluralistically captured by adopting a broader perspective on the 'self-interest' core of agency

theory. The chapter then proceeded to examine institutional theory's assumptions. It was similarly suggested that while the governance phenomena could be solely explained by adopting an institutional theory perspective, this perspective also fails to holistically address the governance phenomena.

In light of the findings it is concluded that adopting a selection of both agency theory and institutional theory assumptions can more holistically explain the corporate governance phenomenon. As such, the expanded governance model presented in Chapter 2 of this thesis was revised. Further, as the model was revised to incorporate aspects of both agency theory and institutional theory perspectives, the original assumptions from these theories were also revised to better integrate the two theoretical assumptions into a single theoretical Frankenstein – i.e., creating a new living entity. This theoretical Frankenstein presents the revised expanded governance model which, it is contended, more holistically captures and explains the corporate governance phenomena.

"I had worked hard for nearly two years, for the sole purpose of infusing life into an inanimate body ... I had desired it with an ardour that far exceeded moderation; but now that I had finished ..." (Shelley 1818, p. 45).

“The astonishment which I had at first experienced on this discovery soon gave place to delight and rapture. After so much time spent in painful labour, to arrive at once the summit of my desires, was the most gratifying consummation of my toils. But this discovery was so great and overwhelming, that all the steps by which I had been progressively led to it were obliterated, and I beheld only the result” (Shelley 1818, p. 41).

CHAPTER SEVEN

CONCLUSIONS

7.1 INTRODUCTION

This chapter begins by providing an overview for the thesis and presents the main findings and conclusions. It then revisits the research objectives and questions. It continues by addressing the limitations of this thesis. A discussion of the implications of the findings is then provided. The thesis finishes with suggestions for future research.

7.2 RESEARCH SUMMARY AND CONCLUSIONS

The central proposition of this thesis is that agency theory is an empirically valid perspective to apply to corporate governance phenomena only when it is coupled with another grand-theory’s perspective that is founded on different, yet complementary, underlying behavioural assumptions. The conceptual thinking underlying corporate governance regulations and best practice guidelines has been dominated by the agency theory perspective alone. This limits the understanding of interactions between governance actors and mechanisms within a wider corporate eco-system.

Corporate governance is defined as a process set which forms part of the principal’s assurance process where corporate ownership is separated from control. It is claimed that good corporate governance practices serve to enhance the credibility of financial reports, safeguard against earnings manipulation, and ensure a fair return for investors (Bhagat et al. 2010, Dechow et al. 1996). This assurance process is important for firms as they are dependent on external economic resources to expand and grow (Davis et al. 1997). Reforms to governance models and mechanisms have largely been driven by corporate collapses and financial scandals, while being motivated by investor desire

for increased transparency, accountability and market confidence (Collier and Zaman 2005; Mallin 2010a). Consequently, as stated earlier, the agency paradigm has dominated the rationalisation and policy outcomes of corporate governance (Anderson et al. 2007; Cohen et al. 2008). However, the agency-theory-driven governance research has revealed inconsistent findings; therefore some researchers have subsequently addressed corporate governance through alternative theoretical paradigms (Cohen et al. 2008; Mallin 2010a; Todd 2010). These researchers have suggested that adopting a pluralistic theoretical framework to better address the corporate governance phenomenon (Cohen et al. 2008; Young and Thyl 2008).

Accordingly, this thesis has sought to examine the interactions of corporate governance mechanisms and actors as part of a holistic corporate eco-system. To this end, both agency theory and institutional theory are invoked in order to develop a more comprehensive conceptual understanding of corporate governance phenomena. The notion of agency separation is identified as the driving force behind the governance phenomena. However, its form, integration and evolution into a firm as a set of institutions is determined by both agency contracts and their larger social system. This set of institutions is more likely to be driven by the notion of legitimacy.

To examine these interactions, this thesis has used a qualitative research methodology in order to provide an enhanced means of exploring and understanding the interactions of governance structures within a corporate eco-system. The interpretivist ontological philosophical assumption is adopted, to embrace the notion of multiple realities. The post-positivism, constructivism and pragmatism inquiry paradigms were adopted to address the research problem. As such, the governance phenomenon is assumed to be bounded by causality and shaped by prior events and theories, yet it simultaneously remains evolutionary.

The case study research strategy was adopted, as it enables an in-depth holistic focus on the governance relationships and interactions within a particular firm by exploring its corporate eco-system. The 'key case' method was adopted for the sampling frame, based on an exemplar case that

can demonstrate high compliance with governance guidelines. The type of case study approach taken in this thesis entails a combination of instrumental, explanatory and exploratory purposes. Further, the 'key case' from the private sector is supplemented with a nested case unit from the public sector. This lends greater completeness to the findings from qualitative analysis that seeks evidence within governance phenomena on the presence or otherwise of behavioural assumptions underlying the agency and institutional perspectives.

The evidence obtained for the main case unit is sourced from semi-structured taped interviews conducted with the company secretary, audit committee chair and external audit partner. Additionally, data is collected from multiple documents available online. The evidence for the complementary case unit is similarly collected from semi-structured taped interviews conducted with two local government audit committee chairs. In coding and analysing the data the thesis adopts a three stage coding scheme and a two-step analysis approach.

The first step is the narrative-network data analysis which is broken into two sections; the corporate case (i.e., Case One) and the local government case. The Case One findings show that actor and mechanism processes and interactions within the superordinate social system are bureaucratic. However actor and mechanism processes and interactions within the contract nexus are both bureaucratic and interdependent. Further, actors appear to have a strong sense of professional integrity and reputation. The establishment of governance processes, it is suggested, are the result of the need for active monitoring and compliance. Overall the findings suggest Case One has in place a comprehensively documented and professionally managed governance system.

The local government case findings show that actor and mechanism processes and interactions within the contract nexus are both are similarly bureaucratic and interdependent. Further, the findings suggest that actors also have a strong sense of professional integrity and reputation. The findings in local government suggest that governance possesses high compliance emphasis. These processes in local government are more exclusively concerned with monitoring, compared to the

listed company's emphasis on monitoring and company performance, especially efficiency. Interestingly, the external audit for local governments is viewed as a compliance symbol rather than providing real audit substance.

The second step is the illustrative-narrative data analysis which involves an assessment of each of the sets of assumptions underlying agency theory and institutional theory in turn. The findings regarding agency assumptions of the study are summarised as follows:

Governance actors are self-interested

- The assumption is supported. The evidence suggests that actor behaviour is that of self-preservation; i.e., maintenance of their integrity, reputation and minimisation of personal liability.

Governance actors are solely economic utility maximisers

- The assumption is not supported. No evidence is found to suggest that actor behaviour is purely based on economic self-interest.

The firm (or city council) is a nexus of contracts, i.e. a series of contractual relationships

- The assumption is supported. The evidence identifies many formal and informal contractual relationships between governance actors and mechanisms.

There exists a separation between decision control and decision management

- The assumption is supported. The evidence identifies that there is a separation between the ratification and monitoring functions, and initiation and implementation functions.

The board is the decision controller, and it then delegates the decision management and some decision control functions to internal agents

- The assumption is supported. The evidence suggests that the board and Council delegate the day-to-day management of resources to management. However, the

board delegates some its decision control functions to internal agents, while Council delegates to both internal and external agents.

Governance mechanisms act as monitors

- The assumption is only partially supported. The evidence identifies governance mechanisms (particularly the audit committee) as actively monitoring and simultaneously signalling their achievement and commitment towards sound governance.

Governance mechanisms evolve to better address agency problems

- The assumption is only partially supported. The evidence suggests that governance mechanisms are evolving to address both agency and legitimacy problems.

The external audit function is external (independent) yet simultaneously internal to the client

- The assumption is supported. Particularly for Case One as the evidence finds that the external auditor seeks to build trusted relationships with governance actors rather than an overly independent relationship. However, with city councils the external audit appears to be more external and independent.

Actor interactions and processes are bureaucratic

- The assumption is only partially supported. The evidence identifies that actor interactions and processes are bureaucratic yet at times dynamic and interdependent.

The findings regarding the institutional assumptions of the study are as follows:

Legitimacy is a resource

- The assumption is supported. The evidence identifies legitimacy as a resource.

Actors interact in a dynamic and interdependent way

- The assumption is partially supported. As stated earlier the evidence identifies that actor interactions and processes are dynamic and interdependent yet at times bureaucratic.

Firms (or city councils) operate and interact within a superordinate social system

- The assumption is supported. The evidence reveals that Case One and city councils intentionally, and unavoidably, operate within a superordinate social system.

Firms (or city councils) are closed yet simultaneously open to the pressures of the superordinate social system and consequently, there exists some form of peer or institutional compliance pressures.

- The assumption is supported. The evidence shows that there exists some form of institutional compliance pressure.

There exists some institutional homogeneity

- The assumption is supported. Governance mechanisms are found to following a similar pattern in terms of their basic form, structure, roles and responsibilities.

Governance mechanisms are adaptive

- The assumption is supported. The evidence identifies that governance mechanisms are adaptive.

Change innovations are driven by performance enhancement and legitimacy

- The assumption is partially supported. The evidence suggests that innovations are aimed at achieving improve performance and legitimacy.

Governance mechanisms are merely symbolic displays for conformity and legitimacy

- The assumption is rejected. No evidence is found to suggest that governance mechanisms are solely symbolic displays of conformity and legitimacy.

Governance mechanisms use symbolic gestures to legitimise interactions

- The assumption is largely rejected. Governance actors are found to be more concerned with ensuring adequate monitoring through building trusted relationships.

Following the main theoretical findings, the conclusions drawn from the study are as follows:

- To attain a more empirically valid perspective on the practices of corporate governance actors and mechanisms, the assumptions underlying and informing the agency theory perspective need to be coupled with those underlying and informing the institutional theory perspective.
- The complementary nature of these two theoretical perspectives is highlighted in interpretations from findings. The interpretations are that agency theory primarily explains the formally espoused policies and procedures concerning the purposes, functions and roles of corporate governance actors and mechanisms. On the other hand, institutional theory primarily explains the homogeneity of governance structures and interfaces between internal mechanisms as well as their evolving and converging nature through behavioural relationships between governance actors.

Further, as a final part to the findings, the expanded governance model as presented in chapter 2 was revised, in light of the main conclusions drawn from the qualitative findings. The revised expanded governance model could be regarded as a theoretical Frankenstein. Shelley's Frankenstein is the story of the piecing together of the vital elements of a human body to bring it to life. This thesis has sought to integrate the empirically-supported assumptions of agency theory and institutional theory in order to more realistically perceive and explain corporate governance phenomena.

7.3 ADDRESSING RESEARCH OBJECTIVES AND QUESTIONS

This section summarises the research findings in response to the research objectives and questions, as stated in Chapter 1.

Objective 1: Identify a firm's internal and external actors who function within the formal governance structures and the corporate eco-system

Following the reviewed literature presented in Chapter 2, seven broad governance mechanisms were identified. First, decision management, decision control, ownership, and internal audit were the mechanisms considered operating within the contract nexus. Second, regulators and other institutions (including competitors) were considered to operate external to the contract nexus and, therefore, they operated within the superordinate social system. Third, the external audit was regarded as operating both internally and externally to the contract nexus. In terms of the mechanism of decision control, the board was considered to be the decision controller and the audit committee and other committees were considered to exist as distinct institutions within the mechanism of decision control.

In keeping within the scope of the thesis, five key governance actors were identified as revealed by the literature: the CFO from the institution of decision management; the board chair and audit committee chair within the institution of decision control; the external audit partner from the external audit institution; and the internal audit partner from the internal audit institution. As such these governance actors were targeted at the interview stage. The company secretary was also sought to initially gain access, however the interview with the company secretary determined that he was another key governance actor.

Consequently, in light of the evidence the seven broad governance actors and mechanisms were expanded into eight. The first six became the company secretary, decision management, decision control, ownership, external audit, and internal audit, who were now considered to operate both internal and external to the contract nexus. The last two were the regulators and other institutions such as competitors who were still considered to operate external to the contract nexus.

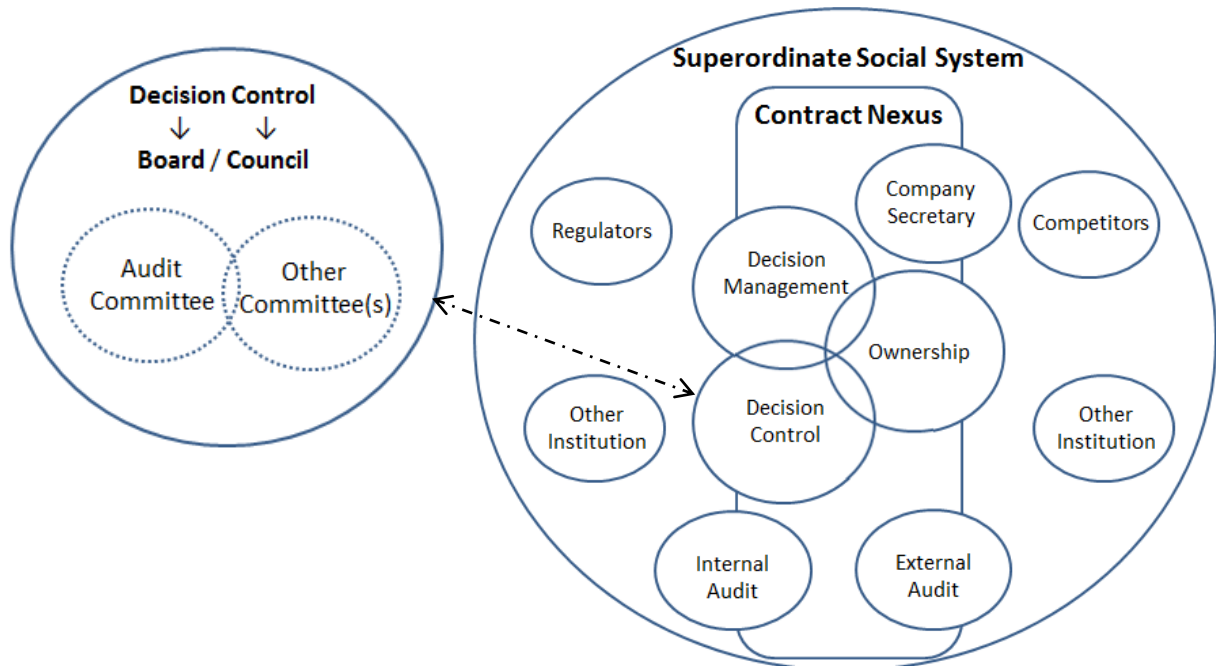
Objective 2: Examine the impact of these actors on the shaping of outcomes within the corporate eco-system

In examining the impact of these actors interviews were conducted. However, due to unavailability of all required participants for interviewing, additional documents were sought which provided further insights into the way in which governance actors shape the outcomes of the contract nexus and the superordinate social system. These findings were presented in Chapter 4 for the company case and Chapter 5 for the local government case.

Objective 3: Develop an integrated model of internal and external mechanisms which co-exist within a corporate eco-system

A model was developed based on the literature reviewed in Chapter 2. This integrated model shown in Figure 2.3 is the expanded governance model which borrowed elements from agency theory and institutional theory. This expanded model developed in Chapter 2 could be explained by adopting an agency framework, institutional framework or both. Following the interpretive analysis undertaken in Chapter 6, the expanded governance model was revised to integrate the interpretations from the findings about assumptions into the model. The revised expanded governance model was given in Figure 6.1. It is again presented, including the list of its revised empirically-supported underlying assumptions, in Figure 7.1.

Figure 7.1: The Revised Expanded Governance Model



The Revised Assumptions of the Expanded Governance Model

1. The contract nexus operates and interacts within a superordinate social system;
2. Both mechanisms and actors of the contract nexus are external yet simultaneously internal to the contract nexus;
3. The contract nexus is closed yet simultaneously open to the pressures of the superordinate social system and consequently, there exists some form of peer pressure and institutional compliance pressures;
4. There exists some institutional homogeneity;
5. Legitimacy is a resource;
6. Actors of the contract nexus are self-interested;
7. There exists a separation between decision control and decision management;
8. The decision controller is to delegate decision management and some decision control functions to internal (or external) agents;
9. Actor interactions are bureaucratic yet simultaneously dynamic and interdependent;
10. Governance mechanisms act as monitors and signalling mechanisms for legitimacy;
11. Governance mechanisms are adaptive; and

12. Governance mechanism innovations are driven by agency conflicts, social legitimacy and performance enhancement.

RQ1: To what extent do governance mechanisms and actors interact as part of a holistic corporate eco-system?

Oliver (1997, p.699) notes that “firms operate within a social framework of norms, values, and taken-for-granted assumptions about what constitutes appropriate or acceptable economic behaviour”. Therefore, the literature identifies firms as existing and operating within a superordinate social system, i.e., a holistic corporate eco-system (Dowling and Pfeffer 1975). Within such a holistic system, continued growth is dependent on the legitimate utilisation of resources (Dowling and Pfeffer 1975; Mallin 2010a).

The evidence discussed in Chapter 6, determines that governance actors and mechanisms interact as part of a superordinate social system. The evidence reveals that both Case One and city councils are concerned with maintaining their legitimacy within the superordinate social system where they operate. Further, findings suggest that governance actors are concerned with maintaining their legitimacy with the other actors within the contract nexus and the superordinate social system. As such, the findings identify governance actors and mechanisms as interacting within superordinate social system on three levels: as a single entity or contract nexus; as a governance mechanism; and as an individual governance actor.

RQ2: Does agency or institutional theory more pluralistically define the governance phenomena?

Following the discussion of the evidence in Chapter 6, a combination of agency theory and institutional theory perspectives is required to more realistically understand governance practices. This is consistent with the literature which suggests that combining agency theory with institutional

theory may better explain governance phenomena (Beattie et al. 2011; Cohen et al. 2008; 2010 Kalbers and Fogarty 1998; Turley and Zaman 2007). As such, this thesis contributes a more holistic, framework for perceiving governance phenomena based on a combination of empirically-supported underlying assumptions. It is labelled the Frankenstein framework because it seeks to integrate elements from different paradigms (i.e., agency and institutional perspectives) to create a more 'alive' system.

7.4 RESEARCH LIMITATIONS

This study has relied on the case study method. The features of case study research that provide the rationale for its selection, also present certain limitations in its usage. Case study research can describe phenomena in richer detail than other methods because it is situated and embedded in local contexts and it can provide an understanding and description of people's personal experiences with that phenomenon (Denscombe 2007; Thomas 2011). However, the stages of both designing the case study research and collecting and interpreting case data will be influenced by the researcher's personal biases (Thomas 2011). Further, the case study researcher is to determine the degree of description, analysis, and summary material for the report (Stake 2005). As explained by Stake (2005), the researcher must make a lot of personal judgements. These include

"a. How much to make the report a story ... b. How much to compare with other cases ... c. How much to formalize generalizations or leave such generalizing to readers ... [and] d. How much description of the researcher to include in the report" (Stake 2005, p. 460).

An overriding issue faced in case study research is that denial of access to some of the key players and documents by the host case organisation can result in the data collection being insufficiently exhaustive. Whether the interviews and document analysis undertaken in this study has been sufficiently exhaustive to establish support or reject for each one of the pre-specified theoretical assumptions is a matter of subjective judgement. This judgement is typically based on whether

qualitative data analysis eventually reaches a point of saturation when there is deemed to be diminishing returns and little need for more sampling (Mason 2010; O'Reilly and Parker 2012). This is the point where new data and their sorting only confirm the categories, themes, and conclusions already reached (O'Reilly and Parker 2012). This point of saturation, according to Strauss and Corbin (cited in Mason 2010) is a *matter of degree*. The limitation remains, however, that the case study researcher must make a subjective judgement about the sufficiency of saturation in the data collection.

At a broader level, limitations of the case study method are commonly associated with issues of reliability, validity, and generalisability. Hamel et al. (1993, p. 23) observe, that

"... the case study [approach] has basically been faulted for its lack of representativeness ... and its lack of rigor in the collection, construction, and analysis of the empirical materials that give rise to the case study. This lack of rigor is linked to the problem of bias ... introduced by the subjectivity of the researcher and others involved in the case".

Nevertheless, supporters of qualitative case study research claim that this argument misses the point of doing this type of research. For example, Myers (2000) argues that compared to deductive quantitative research design the strength of a qualitative case study is that it accounts for and includes differences in ideologically, epistemologically and humanity. The Case study design does not attempt to eliminate what cannot be counted nor does it attempt to simplify what cannot be simplified (Myers 2000).

However, the generalisability of findings from this study must be acknowledged as an important limitation. The study relies on evidence which is situated in a local context. It is based on the knowledge, experiences and qualifications of interviewees concerning a specific corporate entity and Victorian local governments. Hence, this evidence is largely non-generalisable to a wider population

of private and public sector organisations. However, while the study cannot be generalised to wider settings, its findings do have 'naturalistic generalisability' to theory (Mysers 2000). In this study, the proposed expanded governance model in which key assumptions underlying agency and institutional theories are combined, has been tested through this case study approach. This type of testing can provide results that are in conceptual accord with the reader's professional experience and subsequently provide a natural basis for generalisation (Mysers; Stake 2005).

In addition to concerns about generalisability, qualitative methodology is rebuked because studies are often difficult to replicate. Future researchers may not have access to the same participants or subjects, and if other participants are used, results may differ. Participants may openly communicate with one researcher and remain distant with others. The aim, therefore, is on producing research that can inform and enhance reader's understandings.

The researcher can use the primarily qualitative method of grounded theory to inductively generate a tentative but explanatory theory about a phenomenon. In this study, a grounded theory approach has not been adhered to. Rather a deductive logic is first employed to generate a list of assumptions underlying agency and institutional theories. These pre-specified assumptions become the set of propositions to be assessed. The study then moves to inductive logic in qualitatively analysing the case-based data so as to assess the veracity and integration of the assumptions.

The study is also limited by its scope of selection amongst recognised theories. Other theoretical perspectives, such as stakeholder theory (that could include the specific impacts of a wider range of stakeholders) and actor network theory (that could perceive the more dynamic nature of relationships between actors) have not been addressed. Other research methods, such as a structured questionnaire to a wide sample of firms and public sector entities, could have corroborated some of the evidence from the case-study approach.

The study is limited in terms of the number of interview participants in both case studies (i.e., private vs. public sector governance). This is a significant limitation, especially as the type of interviewees are not consistent across the cases; hence comparability and validity is severely limited in the public sector especially as there is no additional interviewees to help confirm the statements made by the two audit committee chairs. Further, the case studies relate to the interpretation of issues relating to governance. Both case studies operate under different sets of rules (i.e., private vs. public sector governance). These differences could have an impact on the way audit committee chairs in both of these sectors respond to issues of governance.

7.5 IMPLICATIONS

The study provides a fresh perspective on traditional agency theory's use in 'mainstream' corporate governance research. By diverging from traditional economic self-interest to a broader self-interest (i.e., economic, social or political), it seeks to more closely resemble the reality of governance relationships and actor behaviours. This can provide new understanding and insight to the reader with a professional interest in the workings of audit committees. The reader will need to adopt a partially intuitive process in order to recognise the similarities of objects and issues in and out of the context of this study.

The expanded governance model proposed in this study, and the argument and evidence given to support this expanded model, have implications for corporate and public sector regulators external to the organisation, and the independent directors internal to the organisation. The conceptualisation and empirical findings in this study suggest that these regulators and directors should re-think any myopic agency theory perspective. They should diverge from developing solely agency-based policies for governance mechanisms. For example, this study's findings suggest that governance actors should not be pre-conceived as solely economic utility maximisers or that governance mechanisms act purely as monitors. Further, the implication for the relevant regulators and directors is that they need to design mechanisms that are structured to accommodate multi-

layers of homogeneous institutional groups. Also regulations and policies should be oriented to achieving the desired effect on the legitimacy standards of the superordinate social system within which institutional groups interact under the expanded governance model.

In terms of theory development, this study contributes to the call for a more pluralistic theoretical approach to understand the complexities of corporate governance practices as open systems (Roberts et al. 2005). The expanded corporate governance model and the evidence that this model is underpinned by the presence of a combination of assumptions drawn from both agency theory and institutional theory, points to the need for corporate governance researchers to increasingly adopt pluralistic theoretic perspectives if they seek to investigate any forms of governance systems.

7.6 DIRECTIONS FOR FURTHER RESEARCH

As stated earlier the qualitative case study methodology has been criticised because studies are often difficult to replicate (Stake 2005). In replicating this study, future researchers may not have access to the same participants, and if other participants are used, results may differ. The aim, then, is for further case studies on the corporate governance model presented in this study to produce research that can further inform and enhance reader's understandings using different contexts. These contexts for further case study research could involve a listed company that has weak governance mechanisms, particularly an ineffective audit committee, as benchmarked against ASX guidelines. Or it could involve local government(s) from different State jurisdictions. Additionally, future case study research could embrace more ethnographic types of methods. That is, not only one-to-one interviews, but also focus groups and unobtrusive observations of practices could be applied.

Alternatively, the theoretical framework developed in this study can be tested by a deductive hypothesis-driven quantitative approach. The method of gathering data about the concepts considered in this study could be extended to the quantification of those concepts as variables through a structured questionnaire. That is, this study provides a framework for a future survey of a

sample of key corporate governance actors (particularly Audit Committee Chairs, Internal Audit Executives and External Auditors) that would seek to measure the extent to which certain agency and institutional theory assumptions explain different corporate governance structures and modes of behaviour.

“Nothing is so painful to the human mind as a great and sudden change” (Shelley 1818, p. 178)

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APPENDIX ONE



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17 October 2011

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INVITATION TO PARTICIPATE IN A RESEARCH PROJECT PARTICIPANT INFORMATION STATEMENT

Project Title:

AUDIT COMMITTEE ROLE FULFILMENT: OPERATIONS, ACTIONS, AND STRUCTURE

Investigators:

- Mr Akeel M. Lary
 - PhD Candidate, School of Accounting, RMIT University,
 - akeel.lary@rmit.edu.au, (03) 9925 5765
- Prof Dennis W. Taylor
 - Project Supervisor, School of Accounting, RMIT University,
 - dennis.taylor@rmit.edu.au, (03) 9925 5765

Dear,

You are invited to participate in a research project being conducted by RMIT University and the Institute of Internal Auditors Australia. Please read this sheet carefully and be confident that you understand its contents before deciding whether to participate. If you have any questions about the project, please ask one of the investigators.

Who is involved in this research project? Why is it being conducted?

- Mr Akeel M. Lary is a PhD candidate and the principal researcher for the project and Prof Dennis W. Taylor is the project supervisor.
- The research project is being conducted in the in fulfilment of the requirements of the degree of Doctor of Philosophy (Accountancy).
- The project has been approved by the RMIT Human Research Ethics Committee and supported by the Institute of Internal Auditors Australia.

Why have you been approached?

As a (Audit Committee member, Board or Board Sub-committee member, senior executive, chief internal auditor, and external audit partner) you have been approached to participate in the project. Your background and experience will provide project researchers with greater insights into the inter-compositional dynamics of various corporate governance mechanisms. Contact details have been obtained from information available on your organisations website or directly contacting your organisation.



What is the project about? What are the questions being addressed?

- The project investigates the operations and actions, role fulfilment, and organisational structure of Audit Committees.
- It aims to:
 1. Identify the extent to which the operations and actions of Audit Committees' is shaped by their focus and orientation;
 2. Examine the effects of Audit Committee operations and actions on its corporate governance role fulfilment;
 3. Provide insights into the organisational structure of Audit Committees to better align academic theory with professional practice.
- We are seeking 9 to 12 participants to take part in an audio-taped interview for 1 to 2 hours, to be used in case study research.

If I agree to participate, what will I be required to do?

As a participant, you will be expected to participate in an audio-taped interview for a duration of 1 to 2 hours. Interview date, time, and location will be negotiated at your convenience, it is expected that interviews will commence in May 2012 and conclude in November 2012. Interview questions are attached see Appendix I.

What are the possible risks or disadvantages?

- A time commitment of 1 to 2 hours is required; this may serve as an inconvenience.
- Neither you nor your organisation will be identifiable in any way without express written permission in any publication, as a result of your role, background, and company profile, your participation and statements may be considered identifiable in published works. Pseudonyms will be used this may or may not reflect gender.
- Questioning will be centred on the Audit Committee, its role, your interaction with the Audit Committee, Board, Board sub-committees and your role.
- If you are unduly concerned about your responses to any of the interview questions or if you find participation in the project distressing, you should contact Prof Dennis W. Taylor as soon as convenient. Prof Dennis W. Taylor will discuss your concerns with you confidentially and suggest appropriate follow-up, if necessary.

What are the benefits associated with participation?

Results may provide insights into the inter-compositional dynamics of corporate governance mechanisms, this may allow for a better understanding of how corporate governance mechanisms work collectively in fulfilling their governance role(s). This information may be used improve communication channels and reduce role conflicts.

What will happen to the information I provide?

- All information collected from the interview(s) will only be viewed by Mr Akeel M. Lary the principal researcher, and Prof Dennis W. Taylor the project supervisor if requested, and remain strictly confidential.
- An interview manuscript will be drafted and returned to you, so you may modify or extend your responses, if necessary. Direct quoting may be presented in published works. Neither you nor your organisation will be identifiable in any way without express written permission and will be kept confidential, however information provided may be published.



- Results and information provided may be disseminated in the form of a student thesis, research paper, conference proceeding(s), and published text. Pseudonyms will be used which may or may not reflect gender.
- All research data will be kept securely at RMIT for a period of 5 years after thesis publication, before being destroyed.
- Any information that you provide can be disclosed only if (1) it is to protect you or others from harm, (2) a court order is produced, or (3) you provide the researchers with written permission.

What are my rights as a participant?

- The right to withdraw from participation at any time.
- The right to have any unprocessed data withdrawn and destroyed, provided it can be reliably identified, and provided that so doing does not increase the risk for the participant.
- The right to have any questions answered at any time.
- The right to request the audio recording to be terminated at any stage during the interview.

Whom should I contact if I have any questions?

- Any queries about the project or your participation in this project may be directed to the principle researcher, Mr Akeel M Lary (akeel.lary@rmit.edu.au) or the project supervisor, Prof Dennis W Taylor (dennis.taylor@rmit.edu.au, (03) 9925 5765).

What other issues should I be aware of before deciding whether to participate?

- As a result of your role, background, and company profile, your participation and statements may be considered identifiable in published works. Even if pseudonyms are used, this may or may not reflect gender.
- Any complaints about your participation in this project may be directed to the Chair, Business College Human Ethics Advisory Network, College of Business, RMIT, GPO Box 2476V, Melbourne, 3001. The telephone number is (03) 9925 5596 or email address bchean@rmit.edu.au. Details of the complaints procedure are available from <http://www.rmit.edu.au/browse:ID=2jqrn7hnpyo>.

Yours sincerely

Mr Akeel M Lary
PhD Candidate;
BBus(Mgt), BBus(Hons)
School of Accounting,
RMIT University,
Level 15, 239 Bourke St,
Melbourne, VIC 3000

Prof Dennis W Taylor
Project Supervisor;
BEcon(Hons), MBA, PhD, FCPA, CA
School of Accounting,
RMIT University,
Level 15, 239 Bourke St,



Melbourne, VIC 3000

RMIT BUSINESS COLLEGE HUMAN ETHICS ADVISORY NETWORK

Prescribed Consent Form for Persons Participating In Research Projects Involving Interviews, Questionnaires, Focus Groups or Disclosure of Personal Information

COLLEGE OF Business
SCHOOL/CENTRE OF Accounting

Name of Participant: _____

Project Title: Audit Committee Role Fulfilment: Operations, Actions, and Structure

Name(s) of Investigators: (1) Mr Akeel M Lary Phone: _____
(2) Prof Dennis W Taylor Phone: (03) 9925 5765

1. I have received a statement explaining the interview/questionnaire involved in this project.
2. I consent to participate in the above project, the particulars of which - including details of the interviews or questionnaires - have been explained to me.
3. I authorise the investigator or his or her assistant to interview me or administer a questionnaire.
4. I give my permission to be audio taped: Yes No
5. I give my permission for my name or identity to be used: Yes No
6. I give my permission for my name, identity and image to be modified: Yes No
7. I acknowledge that:
 - (a) Having read the Plain Language Statement, I agree to the general purpose, methods and demands of the study.
 - (b) I understand that my participation is voluntary and that I am free to withdraw from the project at any time and to withdraw any unprocessed data previously supplied.
 - (c) The project is for the purpose of research and/or teaching. It may not be of direct benefit to me.
 - (d) The privacy of the information I provide will be safeguarded. However should information of a private nature need to be disclosed for moral, clinical or legal reasons, I will be given an opportunity to negotiate the terms of this disclosure.
If I participate in a focus group I understand that whilst all participants will be asked to keep the conversation confidential, the researcher cannot guarantee that other participants will do this.
 - (e) The security of the research data is assured during and after completion of the study. The data collected during the study may be published, and a report of the project outcomes will be provided to _____ (researcher to specify). Any information which may be used to identify me will not be used unless I have given my permission (see point 5).

Participant's Consent

Name: _____ Date: _____
(Participant)

Name: _____ Date: _____
(Witness to signature)

Participants should be given a photocopy of this consent form after it has been signed.

Any complaints about your participation in this project may be directed to the Chair, Business College Human Ethics Advisory Network, College of Business, RMIT, GPO Box 2476V, Melbourne, 3001. The telephone number is (03) 9925 5596 or email address bchean@rmit.edu.au. Details of the complaints procedure are available from <http://www.rmit.edu.au/browse;ID=2jqrn7hnpyo>



Appendix I: DRAFT Question Schedule for Semi-Structured Interviews

1. Research Title:

Audit Committee Role Fulfilment: Operations, Actions, and Structure

2. Researchers:

Mr Akeel M. Lary

Prof Dennis W. Taylor

3. Anticipated Interview Duration

1 – 2 hours

4. Questions

4.1. To Audit Committee (AC)

1. How would you define your roles and responsibilities?
 - i. As a AC
 - ii. As a member of the AC
2. In relation to the lines of accountability
 - i. Who or what structures/ practices are you accountable to? (BOD, chair of BOD, CEO (company management), ASIC)
 - ii. Who is accountable to the AC?
3. Moving to the operations of the AC, please comment on the following matters:
 - Reliance on the internal auditor
 - Nature decision making
 - Nature of informal meetings
 - Monitoring of internal controls
 - Maintaining of external auditor independence
 - Vetting the integrity of financial statements
4. (If not already covered) Of the structures accountable to you, how do they impact on your operations?
5. How do other structures impact your operations?
 - i. (If not already covered) How do regulators, financial lenders and competitors' impact your operations?
6. Does the BOD have any conflicting roles – e.g. monitor and partner to management?
 - i. If applicable, what effect does this have on your composition?

4.2. To Other Board Sub-committees/ BOD/ CEO (Executive MGT)/ Chief Internal Auditor / External Audit Partner

1. What are your formal roles and responsibilities?
2. How would you define the roles and responsibilities of the AC?
3. Who or what structures/ practices are you accountable to? (BOD, chair of BOD, CEO (Executive MGT), ASIC)
 - i. Who is accountable to you?
4. In what way do your operations assist, inform, advise and investigate the AC in fulfilling its roles and responsibilities?
5. In carrying out you roles and responsibilities what if any conflicts do you have with the AC?
 - i. Other structures/ practices



APPENDIX TWO



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www.iia.org.au
Level 7, 133 Castlereagh Street
Sydney NSW 2000

7 July 2011

Professor Dennis Taylor, BEcon(Hons), MBA, PhD, FCPA, CA
RMIT University
School of Accounting
Level 15, 239 Bourke St
Melbourne Vic 3000

Dear Dennis

Thank you for your proposal suggesting a research project on *Corporate Audit Committees and Internal Auditors*.

We recognise that there is limited research on the Audit Committee's role in terms of the internal audit function. This is what makes your research proposal so attractive to us.

We are happy to provide the support of the type outlined in your proposal.

To move this forward, please contact Stephanie Koehn our Manager, Technical (02 8268 5808 or stephanie.koehn@iia.org.au) who will be the IIA-Australia's co-ordinator for the project.

It will be exciting to see the results and I look forward to the interest and response from our members and the wider community.

Yours sincerely

Christopher McRostie
Chief Executive Officer



www.sopac.org.au

voice of the profession

APPENDIX THREE



ANSELL LIMITED

BOARD CHARTER

The Board of Ansell Limited (the Company) has adopted this Charter to outline the manner in which its constitutional powers and responsibilities will be exercised and discharged, adopting principles of good corporate governance and practice that accord with applicable laws in the jurisdictions within which the Company operates, including, as a result of the Company's listing on Australian Stock Exchange (ASX) and its status as an Australian public company, the requirements of the Corporations Act and the ASX Listing Rules.

The Board has also adopted a protocol pursuant to this Charter that sets out the practices and procedures of the Board to ensure that its functions and duties are adequately discharged.

1 Background

The Board of the Company is ultimately responsible for the oversight and review of the management, administration and overall governance of the Company, including:

- the protection of shareholders' interests;
- authorising policies and overseeing the strategic direction of the Company;
- establishing goals for management and monitoring the achievement of these goals; and
- engaging, reviewing and replacing the Chief Executive Officer.

2 Board Guarantee

In carrying out its responsibilities and powers as set out in this Charter the Board will at all times recognise its overriding responsibility:

- to act honestly, fairly and diligently;
- to act in accordance with laws and regulations;
- to avoid or manage conflicts of interests;
- to support and be consistent with the Company's objective to be a good corporate citizen; and
- to achieve and maintain community respect.

3 Composition and term of office

3.1 Composition

It is intended that the composition of the Board of the Company, be determined using the following principles:

- the Constitution provides for a minimum of four directors, which may be increased by the Board to a maximum of eight directors where the Board considers additional expertise is required or when an outstanding candidate is identified;
- the appointed chair of the Board should be an independent non-executive director. Of course, this does not stop another director chairing all or a part of a meeting in the absence of the chair;
- the appointed chair of the Board is the only official spokesperson for the Board, unless the Board determines otherwise; and
- the Constitution requires that the Board comprise a majority of non-executive directors. It is intended that at least half of the Board from time to time be independent non-executive directors.

The composition of the Board is reviewed on an annual basis by the Nomination, Remuneration & Evaluation Committee, to ensure that the Board has the appropriate mix of skills, expertise and experience necessary to fulfil its function effectively. The criteria for considering new candidates for the Board are set out in the Charter of the Nomination, Remuneration & Evaluation Committee.

3.2 Independence

The Board recognises that various principles and factors are relevant in determining independence, but considers that independence is a matter of judgment in the particular circumstances. The guidelines used by the Board in determining independence are outlined in the Board Protocol, which mirror the definition of independence set out in the Investment & Financial Services Association Limited (IFSA) Blue Book (October 2004). The Board regularly reviews the independence of each director in light of interests disclosed to the Board.

Whether the Board considers a non-executive director to be independent or not, and the reasons for the Board's opinion, are described in the corporate governance statement set out in the Company's annual report.

3.3 Commitment

Non-executive directors are expected to devote the necessary time to discharge their duties. It is Board policy that prior to their appointment, non-executive directors must provide the Chairman with details of other commitments and an indication of time involved and to acknowledge that they will have adequate time to meet what is expected of them. Further, they should consult with the Chairman, or the Board, and should inform the Nomination, Remuneration & Evaluation Committee prior to accepting any non-Ansell non-executive director appointment.

3.4 Term

All directors (except the Chief Executive Officer) are required to submit themselves for re-election at least once every three years. The Board undertakes an annual review process which includes a review of the performance of individual directors. The Board will endorse a retiring director for re-election only where his or her performance over the preceding year meets or exceeds the Board's expectations.

In order to ensure that composition of the Board will change over time, it is a general policy that:

- non-executive directors should not serve for a consecutive period exceeding 12 years; and
- the Chairman should not serve in that role for more than 10 years.

4 Role of the Board

The Board has ultimate responsibility to set policy regarding the business and affairs of the Company and its subsidiaries for the benefit of the shareholders and other stakeholders of the Company. The Board is accountable to shareholders for the performance of the Group.

The Board has the following responsibilities and functions:

- (a) Strategy, planning and monitoring
- reviewing and approving corporate strategies, budgets, plans and policies developed by management and evaluating performance of the Group against those strategies and business plans in order to:
 - monitor the performance of functions delegated to the executive team, including the progress of major capital expenditure, capital management, acquisitions, divestitures and strategic commitments; and
 - assess the suitability of the Company's overall strategies, business plans and resource allocation;
 - monitoring financial and business results (including the audit process) to understand the financial position of the Group;
 - appointing and, where appropriate, removing the Chief Executive Officer;
 - appointing and, where appropriate, removing the Company Secretary;
 - regularly evaluating the performance of the Chief Executive Officer and senior management;
 - reviewing and approving the remuneration package for the Chief Executive Officer and the remuneration policy for other senior executives of the Company; and
 - ensuring appropriate resources are available to senior management to enable them to carry out their duties.
- (b) Shareholder communication and compliance
- monitoring communications to shareholders and the ASX (including disclosures made under the ASX continuous disclosure requirements) to ensure that the Company's shareholders and the market in general is kept well informed of all major developments affecting the state of affairs of the Company;
 - approving and reviewing from time to time, the Company's internal compliance procedures; and

- implementing appropriate procedures to ensure compliance with all applicable laws, regulations, accounting standards, ethical standards and business practices.
- (c) Risk management and internal controls
- approving the Company's risk management framework and internal compliance and controls systems relevant to both financial and non-financial risk;
 - overseeing management's implementation of systems to monitor and address the financial, operational and business risk management policies; and
 - reviewing the Company's wider risk profile, including issues of corporate social responsibility that may impact upon the Company's reputation with its customers, suppliers, employees or the communities in which it operates.

5 Delegation of authority

5.1 Delegation to management

As indicated above, the Board has retained ultimate responsibility for the strategic direction and control of the Company. The Board delegates management of the Company's resources to the executive team under the leadership of the Chief Executive Officer, to deliver the strategic direction and goals determined by the Board. A key function of the Board, which is conducted at Board meetings, is to monitor the performance of senior management in this function. In addition to the Board's oversight role, the Chief Executive Officer conducts a formal review at least once each year to assess the performance of senior management and reports back to the Board.

5.2 Delegation to committees

The Board from time to time establishes Committees to streamline the discharge of its responsibilities and, for each standing Committee, adopts a formal charter setting out the matters relevant to the composition, responsibilities and administration of such Committees. The Board has, at the date of this Charter, established the:

- (a) Audit and Risk Committee; and
- (b) Nomination, Remuneration and Evaluation Committee.

The Board also delegates specific functions to ad hoc Committees on an "as needs" basis. The powers delegated to these Committees are set out in Board resolutions. The composition, role and performance of each Committee will be reviewed on an annual basis as part of the Board's performance assessment process.

6 Governance

6.1 Code of Conduct

All directors are expected to comply with the Company's Code of Conduct and maintain the highest standard of ethical behaviour in discharging their duties with respect to the business of the Company.

6.2 Conflicts of interest

Directors are required to take all reasonable steps to avoid actual, potential or perceived conflict of interests with the Company.

In order to ensure that any 'interests' of a director in a particular matter to be considered by the Board are brought to the attention of each director, the Company has developed protocols to require each director to disclose any contracts, offices held, interests in transactions and other directorships which may involve any potential conflict. Appropriate procedures have been adopted to ensure that, where the possibility of a material conflict arises, relevant information is not provided to the director, and the director does not participate in discussion on the particular issue or vote in respect of the matter at the meeting where the matter is considered.

6.3 Confidentiality

Each director has a duty to maintain the confidentiality of information he or she learns by virtue of his or her position as director.

6.4 Trading in Company's securities

Each director must comply with the Company's policy for trading in the Company's securities, as varied from time to time.

7 Administrative matters

The Board determines a schedule of meetings at the beginning of each year. It is the Company's practice that one or more of these meetings coincide with site visits, in order to continue the education and information provided to directors regarding the Company's various businesses.

Additional meetings are held as required to address specific issues.

The Company Secretary attends meetings of the Board or a Committee as minute secretary. Senior executives will be invited to attend Board or Committee meetings (or parts of meetings) from time to time where the Board or Committee considers their involvement of assistance to the consideration of items of business before the meeting.

All minutes of the Board or a Committee are required to be signed by the Chairman as a true and correct record.

All directors and other attendees at Board or Committee meetings are, as officers and/or fiduciaries, required to keep all information presented to (whether written or oral) or discussed at Board meetings confidential.

8 Review

The Board of the Company will, at least once in each year, review the membership and charters of the Board to determine their adequacy in the then current circumstances and to determine that the Board's processes are adequate to ensure it is able to carry out its functions in the most effective manner.

Reviewed and approved by the Ansell Limited Board – June 2010

APPENDIX FOUR

AUDIT COMMITTEE TERMS OF REFERENCE

Purpose

The primary purpose of the Audit Committee is to assist the Board discharge its responsibility in the following areas:

- ensuring the Company adopts, maintains and applies appropriate accounting and financial reporting processes and procedures;
- facilitating the independence of the external audit process and addressing issues arising from the audit process; and
- ensuring the Company maintains effective risk management and internal control systems.

Membership

- The Audit Committee shall comprise not less than three members.
- All members shall be independent Non-Executive Directors who possess the requisite qualifications and financial literacy.
- The Chief Executive Officer/President, Chief Financial Officer and other Executives shall be invited to attend meetings at the Committee's discretion.
- The external auditors and other external experts shall be invited to attend meetings at the Committee's discretion.

Chairperson

- The Chairperson of the Audit Committee shall be an independent Non-Executive Director. The Chairperson of the Board shall not be the Chairperson of the Audit Committee.
- The Chairperson of the Audit Committee is responsible for planning and conducting meetings.
- The Chairperson of the Audit Committee shall report significant findings and recommendations of the Committee to the Board after each Committee meeting.

Secretary

- The Company Secretary shall be appointed Secretary of the Committee.
- The Secretary, in conjunction with the Chairperson, shall draw up an agenda, which shall be circulated, to the members of the Committee and the external auditors.



Meetings

- Meetings shall be held at least four times a year.
- The quorum of the meeting shall be a minimum of two.
- The minutes of all Committee meetings shall be circulated to members of the Board.
- The Chairperson will call a meeting of the Audit Committee if so requested by any Committee member, the Chief Financial Officer or the external auditors.
- The Chief Financial Officer and the external auditors shall be given notice of all meetings and have the right to attend and speak if it is the desire of the Committee.

Authority

- The Audit Committee shall have the authority to seek any information it requires from any officer or employee of the Company or its controlled entities and such officers or employees shall be instructed by the Board to respond to such enquiries.
- The Audit Committee shall have the authority to seek any information it requires from the internal and external auditors without the presence of management.
- The Audit Committee is authorised to take such independent professional advice as it considers necessary.
- The Audit Committee has no executive powers with regards to its findings and recommendations.

Responsibilities

The responsibilities of the Audit Committee shall include, but are not limited to the following:

1. Financial Reporting

- Reviewing financial statements and other financial information distributed externally;
- Monitoring the procedures in place to ensure the Company is in compliance with the Corporations Act, ASX Listing Rules and other legislative and reporting requirements;
- Reviewing related party transactions and considering the adequacy of disclosure of those transactions in the financial statements; and
- Reviewing reports on the Company's superannuation plan and compliance with relevant laws and regulations.

2. Risk Management and Internal Control

- Monitoring risk assessment and the internal controls instituted;
- Reviewing risk management practices, including the use of and the extent of derivatives and foreign exchange cover;
- Monitoring the establishment of an appropriate internal control framework, including information systems and considering enhancements;
- Reviewing external audit reports and, where major deficiencies or breakdowns in controls or procedures have been identified, monitoring remedial action taken by management to ensure such action is appropriate and prompt;



- Reviewing reports on any major defalcations, frauds and thefts from the Company;
- Initiating and supervising special investigations;
- Reviewing reports on the adequacy of insurance coverage; and
- Reviewing transfer pricing arrangements.

3. External Auditors

- Overseeing the selection and appointment of the external auditors including reviewing the nominations for external auditors and assessing the performance of the incumbent external auditors;
- Liaising with the external auditors and ensuring the annual and half-year statutory audits and reviews are conducted in an effective manner;
- Approving audit fees;
- Reviewing matters relating to auditor independence; and
- Ensuring the rotation of the audit partner every 5 years.

4. Internal Audit

- Reviewing the internal audit plan for adequacy; and
- Reviewing internal audit reports.

5. Corporate Governance Compliance

- Ensuring that a corporate Code of Business Conduct is established and periodically reviewed;
- Reviewing policies on sensitive issues or practices such as environmental issues;
- Reviewing policies to avoid conflicts of interest and reviewing past or proposed transactions between the Company and members of management and Company Directors; and
- Reviewing the Audit Committee Terms of Reference.

6. Reporting to the Board

- Ensuring that all matters relevant to the Audit Committee's roles and responsibilities are reported to the Board.



APPENDIX FIVE

The table below sets out the array of documents analysed under each case and the theme(s) derived, in whole or part, from content in the related document.

Table A5: Array of Documents Analysed Under Each Case Theme	
Broad Theme	Sources of Evidence
The board/ Council (e.g., role, responsibilities, composition and processes)	<p>Case One:</p> <ul style="list-style-type: none"> Audit committee chair transcript Company secretary transcript 2011 annual report Board charter <p>Local Government:</p> <ul style="list-style-type: none"> CouncilA and CouncilC audit committee chair transcript CouncilB and CouncilD audit committee chair transcript CouncilA, annual report 2011-2012 CouncilB, annual report 2011-12 CouncilC, annual report 2011-12 Department of Planning and Community Development, how councils work Department of Planning and Community Development, how councils operate Department of Planning and Community Development, council administration and staff Department of Planning and Community Development, council meetings
Audit committee (e.g., role, responsibilities, composition, meetings, reporting, processes and governance policies)	<p>Case One:</p> <ul style="list-style-type: none"> Audit committee chair transcript Company secretary transcript External audit partner transcript 2011 annual report Audit committee charter Audit committee meeting agenda's Audit committee policy on non-audit services and auditor rotation Risk oversight and management policy

	<p>Local Government:</p> <p>CouncilA and CouncilC audit committee chair transcript CouncilB and CouncilD audit committee chair transcript CouncilA, annual report 2011-2012 CouncilB, annual report 2011-12 CouncilC, annual report 2011-12 CouncilA, audit committee charter CouncilB, audit committee charter CouncilC, draft audit committee charter CouncilD, audit committee charter CouncilA, Audit Committee Work Plan CouncilA, Draft Audit Committee Work Plan CouncilC, Audit Committee Agenda Plan CouncilB, Information Package: appointment of an independent audit committee member</p>
Nomination committee (e.g., role, responsibilities, composition and functions)	<p>Case One:</p> <p>2011 annual report Nomination committee charter</p> <p>Local Government:</p> <p>Beyond research scope</p>
Remuneration committee (e.g., role, responsibilities, composition and functions)	<p>Case One:</p> <p>2011 annual report Remuneration committee charter</p> <p>Local Government:</p> <p>Beyond research scope</p>
Internal audit (e.g., purpose, function and scope)	<p>Case One:</p> <p>Audit committee chair transcript Company secretary transcript External audit partner transcript 2011 annual report Audit committee charter</p> <p>Local Government:</p> <p>CouncilA and CouncilC audit committee chair transcript CouncilB and CouncilD audit committee chair transcript CouncilA, annual report 2011-2012 CouncilB, annual report 2011-12 CouncilC, annual report 2011-12</p>

	<p>CouncilA, audit committee charter</p> <p>CouncilB, audit committee charter</p> <p>CouncilC, draft audit committee charter</p> <p>CouncilD, audit committee charter</p>
External audit (e.g., purpose, function, fee and scope)	<p>Case One:</p> <p>Audit committee chair transcript</p> <p>Company secretary transcript</p> <p>External audit partner transcript</p> <p>2011 annual report</p> <p>Audit committee charter</p> <p>Audit committee policy on non-audit services and auditor rotation</p> <p>Local Government:</p> <p>CouncilA and CouncilC audit committee chair transcript</p> <p>CouncilB and CouncilD audit committee chair transcript</p> <p>CouncilA, annual report 2011-2012</p> <p>CouncilB, annual report 2011-12</p> <p>CouncilC, annual report 2011-12</p> <p>CouncilA, audit committee charter</p> <p>CouncilB, audit committee charter</p> <p>CouncilC, draft audit committee charter</p> <p>CouncilD, audit committee charter</p>