Audit Committee and Auditor Independence: The Bankers’ Perception

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ABSTRACT

This paper examines the perception of bankers on contribution of audit committees towards external auditor independence in public listed companies. All Malaysian public listed companies are required to establish an audit committee as a measure to improve on the internal control mechanism that can help improve the corporate governance practices of firms. Postal questionnaires and interview surveys were used to solicit the perception and views of loan officers. The majority of the respondents believe that auditor independence is preserved with the presence of an actively functioning audit committee. This implies favourably on the corporate governance reforms initiated by the government after the 1998 financial crisis.

Keywords: Loan Officers, Meeting, Report, Audit Fees, Composition

INTRODUCTION

Over the last decade, various regulatory agencies and interest groups had been actively promoting the idea of an effective audit committee in all public listed companies, in the interest strengthen the corporate governance practices. The establishment of audit committee is perceived to improve the financial aspects of corporate governance. Indeed, the Malaysian Code on Corporate Governance (MCCG) postulates that “an independent audit committee serves to implement and support the oversight function of the board in several ways” (MCCG 2001, p. 38). Audit committee is expected to undertake the board of director roles in providing

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1 In Malaysia, the MCCG defined independent of directors as “broadly to two crucial aspects - independence from management and independence from a significant shareholder” (MCCG 2001, p. 25).
Any remaining errors or omissions rest solely with the author(s) of this paper.
“focused review and detailed discussion of the company’s processes for producing financial data, its internal controls, and independence of its external auditor”, which it “might be too time-consuming for the full board” (MCCG 2001, p. 36).

However, prior studies on audit committees in the listed firms indicate that these committees are ineffective in their expected roles. Zulkarnain and Shamsher (2007) reported that many Malaysian audit committees only act as a ‘rubber stamp’ and committees are formed to comply by the new requirement, and the requirement do not detail on the various pertinent issues that could justify the establishment of such a committee. Menon and Williams (1994) pointed out that audit committees ‘are often created for the purposes of appearances rather than to enhance stockholders’ control of management’. Sommer (1991) argues that the formation of audit committee is not a guarantee that they will perform effective oversight duties or improve the ineffective financial reporting and auditing practices. They construed with the following statement, ‘there is considerable anecdotal evidence that many, if not most, audit committees fall short of doing what are generally perceived as being their duties’.

The objective of this paper is to examine the bankers’ perception or more specifically the loan officers perceptions on the impact of audit committee (i.e. meeting, report, role to approve audit fees, role to review audit fees, composition) on auditor independence. It may be that the presence of audit committee could reduce the impending management threat to auditor independence because the majority of the audit committee members are independent and non-executive that cannot be easily influenced by management.

The remainder of the paper is structured as follows. The next section outlines the relevant literature and the third section describes the research methodology. The results of the study are reported in the fourth section, while the final section concludes the paper.

**LITERATURE REVIEW**

Consistent with global trends, the Bursa Malaysia (previously known as the Kuala Lumpur Stock Exchange) has made it mandatory for all Malaysian public listed companies to have audit committee with effect from 1994. Seven years after the call to establish audit committee, the Malaysian government established the Malaysian Code of Corporate governance to ensure high quality of corporate governance practices, consistent with the efforts to globalize its financial markets. Among others, the Code emphasise the important role of audit committees in improving the good corporate governance practices.

The effort to improve corporate governance practices in Malaysian capital market has been undertaken by the Securities Commission (SC) as early as 1996 in a three-phased shift towards disclosure-based regulation (DBR). During Phase 1 (1996-1999: Flexible/Hybrid MBR), the emphasis was to regulate on disclosure,
due diligence and corporate governance. Phase 2 (January 2000: Partial DBR) still focused on corporate disclosure, due diligence and corporate governance, but included focus on promotion of accountability and self-regulation. In Phase 3 (2001 onwards: Full DBR) the SC enforced high standards of disclosure, due diligence and corporate governance as well as exercise of self regulation and responsible conduct.

In developed countries, the evolution of audit committee in mid-twentieth century, where the committees were established voluntarily indicated it provide more effective communication between the external auditors and management (Rezaee, 2002). Indeed, the committee is expected to oversee corporate governance, financial reporting, internal control structure, internal audit functions, and external audit services (Rezaee et al., 2003).

It is well documented that audit committee could enhance the communication network between auditor and management (Fearnley and Beattie, 2004; Goodwin-Stewart and Kent, 2006; Stewart and Munro, 2007). In a study participated by audit partners, finance directors and financial journalists, Beattie et al. (1999) discovered that audit committee that comprise of independent directors could strengthen auditor independence.

However, Shamsher et al. (2001) found that a large majority of companies listed on the Malaysian stock exchange (Bursa Malaysia) to practice ‘box ticking’ culture, where the formation of audit committee is a procedural compliance. These companies established audit committee as a result of rules imposed on them by regulator.

Relevant disclosures about a company’s audit committee, its activities and its interaction with the company’s auditors and management could improve investor confidence in the process and the overall quality of financial reporting. For example, the requirement to submit audit committee reports with financial statements will provide investors with a better understanding of the committee’s oversight role in the financial reporting process (Shamsher et al., 2001). The contents of the committee report should include details such as plans and discussions with management and external auditors. However, Shamsher et al. (2001) discovered that large majorities of Malaysian audit committees only report their terms of reference (i.e. only what they are expected to do) in the audit committee report (ACR) and nothing is reported on what they have actually done.

An independent audit committee is crucial to the good governance practices. Beasley et al. (2000) discovers the association between companies committing financial statement fraud with the incidence of lack of independent audit committee members. Abbott et al. (2003) found that companies that did not commit fraud tend to have more independent audit committees than companies committing fraud. Indeed, independent directors did not have personal or economic interest in the company, and thus are able to put their argument without fear and favour (Beasley et al., 2000). Klein (2002) discovers the extent of annual discretionary accruals is
negatively associated with audit committee independence only when an independent committee is defined as one with more than a majority of independent directors.

DeZoort et al. (2003) pointed out that audit committees should be active and diligent to discharge their oversight responsibilities. Literature views the audit committee diligence through the frequency of the committee meetings throughout the financial year (Song & Windram, 2004; Xie et al., 2003).

Bedard et al. (2004) discovered audit committees that meet more than twice a year, have member(s) with financial knowledge (i.e. financial expertise) and consist solely of independent directors are associated with less income-increasing earnings management (or are more independent). Xie et al. (2003) discovered the negative relationship between audit committee meetings with earnings management. The documented evidence indicates that an active and diligent audit committee adds value and help maintain the integrity of the financial reporting process (DeFond and Jiambalvo, 1991; Dechow et al., 1996).

METHODOLOGY

The required information in this study was sourced from questionnaire survey and personal interviews of loan officers of selected top banks and financial institutions. The level of officers interviewed were those users of financial statements and had a good understanding of the importance of auditor independence. The aim of the interview survey was to further elaborate the issues raised in the postal survey and to investigate the underlying reasons behind the answers given. Indeed, face-to-face interviews provide rich data, offer the opportunity to establish rapport with the interviewees, and help to explore and understand complex issues like the relationship between audit committee and auditor independence.

The questionnaires were pilot-tested to ensure that the relevant questions on the research issue of interest were asked in the context of the current level of practices to generate a maximum response rate. The total response rate for this study was 44%, which is consistent with the average response rate in similar studies in the developed markets. For example, Wallace and Mellor (1998) pointed out that the common phenomenon of responses is as low as between 30 to 50%.

<table>
<thead>
<tr>
<th>Category</th>
<th>Total Questionnaires Issued</th>
<th>Usable Responses Received Pre-reminder</th>
<th>Usable Responses Received Post-reminder 1</th>
<th>Usable Responses Received Post-reminder 2</th>
<th>Total Usable Response</th>
<th>Total Usable Response Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Institutions</td>
<td>200</td>
<td>32</td>
<td>28</td>
<td>27</td>
<td>87</td>
<td>44</td>
</tr>
</tbody>
</table>
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Majority of the respondents had a working experience of at least 5 years and were responsible for the decision making that involve reading and evaluating financial statements for loan approval. The seniority of the respondents provides better validity for their responses since it is assumed that they were well-informed with the changes in the rules and regulations, well versed with their job functions and subsequently keep informed with the changes in the accounting and auditing profession.

Table 2 Profile of loan officers analysed by category of employment

<table>
<thead>
<tr>
<th>Status</th>
<th>Number</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Officer</td>
<td>34</td>
<td>39</td>
</tr>
<tr>
<td>Senior Manager</td>
<td>41</td>
<td>47</td>
</tr>
<tr>
<td>Chief Executive</td>
<td>12</td>
<td>14</td>
</tr>
<tr>
<td>Total</td>
<td>87</td>
<td>100</td>
</tr>
</tbody>
</table>

For the purposes of better understanding of perceptions given by respondents from different size of banks, the respondents were classified based on size of deposits from customer. Responses from loan officers of banks with deposits from customers above RM50 million were grouped as Top Tier, those with deposits from customers between RM33 million and 50 million were classified as Medium Tier and those with deposits from customers below 33 million were treated as Low Tier. The frequencies of responses to the questionnaire distributed are reported in Table 3.

Table 3 Analysis showing frequency and criteria of sample partitioned

<table>
<thead>
<tr>
<th>Banks</th>
<th>Criterion Deposits from Customers</th>
<th>Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top Tier</td>
<td>≥ 50 Million</td>
<td>25</td>
</tr>
<tr>
<td>Medium Tier</td>
<td>&gt;33 Million, &lt; 50 Million</td>
<td>25</td>
</tr>
<tr>
<td>Low Tier</td>
<td>≤ RM33 Million</td>
<td>37</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>87</td>
</tr>
</tbody>
</table>

To ensure the reliability and validity of the information gathered, a test was done to diagnose the presence of non-response bias. This procedure was made possible by differentiating the colour of questionnaires cover. Prior to distributing the questionnaire, respective banks’ deposits from customers were gathered and they were grouped into the appropriate size classification.

The possibility of occurrence of non-response bias arises when some of the survey sample failed to return the questionnaire and the data may consequently turn out to be invalid. It is well recognised in the literature that responses to mail questionnaires are generally poor, and it is a common phenomenon to see return percentages as low as between 30 to 50% (Wallace and Mellor, 1988, p. 132).

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non-response bias, the first 20 questionnaires received were compared with the last 20 questionnaires using the Mann-Whitney test. It was found that there was no significant difference between the 20 early and 20 late responses, implying the absence of any significant non-response bias.

<table>
<thead>
<tr>
<th>Bank</th>
<th>Number of Loan Officers Interviewed</th>
<th>Job Description of Interviewee</th>
<th>Size of Bank</th>
<th>Experience in Function</th>
</tr>
</thead>
<tbody>
<tr>
<td>B1</td>
<td>1</td>
<td>Chief Executive Officer</td>
<td>Top Tier</td>
<td>20</td>
</tr>
<tr>
<td>B2</td>
<td>1</td>
<td>Manager</td>
<td>Low Tier</td>
<td>13</td>
</tr>
<tr>
<td>B3</td>
<td>1</td>
<td>Manager</td>
<td>Top Tier</td>
<td>8</td>
</tr>
<tr>
<td>B4</td>
<td>1</td>
<td>Manager</td>
<td>Top Tier</td>
<td>12</td>
</tr>
<tr>
<td>B5</td>
<td>2</td>
<td>Director</td>
<td>Low Tier</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Senior Manager</td>
<td>Low Tier</td>
<td>16</td>
</tr>
<tr>
<td>B6</td>
<td>1</td>
<td>Manager</td>
<td>Top Tier</td>
<td>13</td>
</tr>
<tr>
<td>B7</td>
<td>1</td>
<td>Chief Executive Officer</td>
<td>Low Tier</td>
<td>25</td>
</tr>
<tr>
<td>B8</td>
<td>1</td>
<td>Assistant Manager</td>
<td>Medium Tier</td>
<td>10</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Director</td>
<td>Medium Tier</td>
<td>20</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Executive</td>
<td>Medium Tier</td>
<td>5</td>
</tr>
<tr>
<td>B10</td>
<td>1</td>
<td>Manager</td>
<td>Top Tier</td>
<td>18</td>
</tr>
<tr>
<td>B11</td>
<td>1</td>
<td>Manager</td>
<td>Low Tier</td>
<td>12</td>
</tr>
<tr>
<td>B12</td>
<td>1</td>
<td>Assistant General Manager</td>
<td>Low Tier</td>
<td>18</td>
</tr>
<tr>
<td>B13</td>
<td>1</td>
<td>Vice President</td>
<td>Top Tier</td>
<td>28</td>
</tr>
<tr>
<td>B14</td>
<td>2</td>
<td>Chief Executive Officer</td>
<td>Low Tier</td>
<td>22</td>
</tr>
<tr>
<td></td>
<td></td>
<td>General Manager</td>
<td>Low Tier</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>15.29</td>
</tr>
</tbody>
</table>

The long period of experience of the respondents in Table 4 indicate that their opinions as authoritative, and consequently can be generalised to the whole population.

**RESULTS**

Public and regulatory bodies demand for accountability and reform has lead to the requirement for establishment of audit committees as the important component of corporate governance practices in Malaysian public listed companies. The Bursa

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4 Another source of bias in survey-type studies is self-selection bias (Eysenbach and Wyatt, 2002; Oppenheim, 1992; Whitehead, 1991). Oppenheim (1992, p.30) termed this phenomenon as ‘volunteer bias’. The bias might arise from the fact that “people are more likely to respond to a questionnaire if they see items which interest them” (Eysenbach and Wyatt, 2002) and “they may try to ‘respond’ extra-well” (Oppenheim, 1992, p.30) to the questions. In this study, it was found that self-selection bias did not exist.
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Malaysia has taken steps by amending its listing requirements in 2001. The new requirement necessitates audit committee members to be independent, vigilant, able to manage their enhanced liability and are able to perform their delegated responsibilities in an effective manner. The respondents were asked to indicate their views on the five relevant issues or required characteristics of a well functioning audit committee. The results are tabulated in Panel A and B of Table 5 below and reported in the following sections.

**Activeness Audit Committee**

The frequency of audit committee meetings would be a sign of the amount of effort by members of audit committee in delivering their responsibilities. Menon and Williams (1994) pointed out that the common perceptions that audit committees will not be effective unless they meet regularly to discuss issues arise (i.e. active). The UK’s Smith Report (2003) suggested that the audit committee chairman, in discussion with the company secretary, should determine the frequency and timing of its meetings.

The information in Table 5 indicates that the majority of the loan officers in Top (40%), Medium (28%) and Low (70%) Tier banks agreed with the view that an active audit committee would better support auditor independence. The responses shown by the majority of the respondents might be a sign of agreement with the general perceptions that active audit committees that spend more time through having frequent meetings to discuss issues on internal control, risk, corporate reporting and any matters arising from business operations would enhance auditor independence. This would be expected to serve as a safeguard for good financial reporting. However, the meetings frequency during a financial year has not always been clearly specified in codes and principles. For example, the amended Bursa Malaysia Listing Requirements did not suggest a minimum number of meetings or guideline on the appropriate meetings frequency.

Based on size classification, the loan officers of Low Tier banks seem to exhibit higher agreement that active audit committee could support auditor independence. The perception stem from the fact that the Top and Medium Tier banks might be already dealing with larger and establish corporate client that are practising good corporate governance and produce better quality financial statements. On the other hand, Low-Tier banks might deals with higher risks corporate customer, who might not be able to secured loans from bigger banks. Thus, the loan officers have to investigate or acquire more information and would value active audit committee as a sign of low risk. Statistical test documented a significant differences of perceptions (at 1% level), between the three groups of respondents (see Panel A and B of Table 5). This indicate the strength of their perceptions in the need for an active audit committee to safeguard auditor independence.
The findings from the interviews were consistent with that of the questionnaire survey, that is the majority (53%) of the loan officers interviewed agreed with the statement that active audit committees would safeguard auditor independence. However, there was concern expressed not on the frequency but the quality of the meetings that can help improve good governance practices. The interviews disclosed that audit committee should meet at least three times during a financial year, which conducted to correspond with important dates during a financial reporting such as reviewing quarterly financial statements. The person to present during the meeting includes audit committee’s chairman and members of the committee. In this context, the Bursa Malaysia has clearly specified in the Part C of Chapter 15 of the Listing requirement that “A listed issuer must ensure that other directors and employees attend any particular audit committee meeting only at the audit committee’s invitation, specific to the relevant meeting.” It was indicated that the meeting as an avenue for discussion about business transactions, debates among members and management on business issues and other matters arise. The following are some extract of the interviews undertaken with the loan officers:

“The meeting frequency depends on the issues faced by the organisation where different organisations are facing different set of issues. If there are many issues needed attention, they have to conduct more frequent meetings, otherwise they don’t need frequent meeting. I think the meeting frequency doesn’t have relationship with audit committee effectiveness…Also, the regulatory agencies have to come out with a standard agenda and meeting guide that outline possible issues that need attention and clarification and the issue should be a common issues across the board.”

(Vice President, Top Tier Bank)

“...when audit committee meet; they meet for a reason, they meet to review the quarterly audit report or annual report. So, what is important is not the frequency of meeting, it is the quality of the meeting. You can even meet once a year, but if there is thorough and quality meeting, it is good enough.”

(Assistant General Manager, Low Tier Bank)

“...its boils down to the individual director that comes from various backgrounds. Frequency of meeting does not ensure that they are effective; the most important is the content of the meeting.”

(Manager, Low Tier Bank)

“You have to look at how independent is the independent director; I think it is more important than the meeting frequency. If they meet
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“...if we don’t tell audit committee members on certain issues, they wouldn’t know...whatever information that I give them is what I want them to see. If I want to hide certain figures, I wouldn’t say they never find out, they can, they got to look at very detail. ...to me, audit committee quality depend on their members quality...depends on how detail is their work. I have seen some audit committee very superficial.”

(Chief Executive Officers, Top Tier Bank)

Compulsory Audit Committee Reports

In an effort to highlight the existence of audit committee and their monitoring duties, the amended Bursa Malaysia listing requirements requires Malaysian public listed companies to prepare and disclose their report in the annual report. Audit committee report presents information about the committee efforts during the financial year such as meetings and oversight role. A clear majority of the respondents in the Top (52%), Medium (52%) and Low (65%) Tier banks agreed with the view that auditor independence would be better safeguarded if audit committee reports were to be made compulsory in the annual report (refer Panel A of Table 5). The responses might reflect their belief that the information presented in the reports could provide additional information to shareholders and the other stakeholders on activities undertaken by the committee during the financial year. Further analysis on the different perceptions between loan officers of different size of banks indicated no significant differences.

Majority (72%) of the loan officers interviewed believed that audit committees should present their reports as part of the company’s financial statement, which is consistent with the findings from the questionnaire survey. The interviewees pointed out that audit committee report is an important document for stakeholders as they have very limited access to information on the committee activities and oversight efforts. The general views are the existing requirements on audit committee report are too general and there is no review on such report by the regulators, which encourage the culture of ‘box ticking’ among Malaysian public listed companies. It was suggested that the respective regulator to come out with toolkit on possible content of audit committee report. The toolkit should include open-ended questions relating to important issues that the members should discuss in their meetings such as risk areas, exceptional items, business risks, and threats arising from technology changes. From the discussion, the committee should prepare their report accordingly. The following are some extract of the interviews:
“...Audit committee report represents as communication tool between the committee and the stakeholders. Outsiders don’t have idea on our role to safeguard their interests.”

(Director, Medium Tier Bank)

“...currently, the content of the report is quite similar across companies and years...we don’t have idea on what should and should not be disclosed. There is no clear guideline or sample of report. We used the same style of reporting from year to year. I believe regulators should come out with a guide for audit committee discussion, frequently asked questions and reporting guideline.”

(Director, Low Tier Bank)

Approval and Review of Audit Fees by Audit Committees

Generally, audit committee is perceived to present a strong corporate governance mechanism and could reduce the pressure faced by auditors in their communication with management. Auditor might be influenced and pressured when management perform the role to approve and review audit fees. Thus, the dilemma might be reduced if audit committees were to undertake the role of approving audit fees. Panel A of Table 5 shows that 72%, 60% and 65% of the loan officers of Top, Medium and Low Tier banks respectively agreed with the view that auditor independence would be safeguarded if audit committees were to assume the role of approving audit fees. The result indicates the loan officers’ confidence that an independent committee should have a hand in this important decision. It is not the question of audit committee could be able minimising audit fees, but, the more important issue is that audit committee could encourage the ‘value for money’ audit fees. When auditor is well paid, the job quality is expected to rise.

On the other hand, the majority of the loan officers (i.e. 72%, 68% and 68% of the Top, Medium and Low Tier banks respectively) as reported in Panel A of Table 5 agreed with the view that auditor independence would be better safeguarded if audit committees were to assume the role of reviewing audit fees. The respondents are of the view that a strong independent audit committee will provide better review of audit fees without any vested interest in financial reporting and auditing services.

Management influence over auditors would diminish if audit committees were to take on responsibility to review and approve audit fees. It was found that more than half of the interviewees agreed that auditor independence would be strengthened if auditors were given the responsibility to approve audit fees. The interviews disclosed that audit committees could play a critical role in the financial reporting process by acting as intermediaries, having the power to review and approve audit fees, and as a result, helping auditors to maintain their independence.
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In delivering their duties appropriately, audit committees should ensure that audit hours are not discounted at the expense of audit quality. The following are some extract of the interviews that reflects the above stated views:

“…the effectiveness of the audit committee in performing their role to review and approve audit fees very much depends on who are the directors, their ability to grasp a lot of technical issues…”

(Director, Medium Tier Bank)

“…some of this audit committee are just there for show, to comply with the requirement.”

(Senior Manager, Low Tier Bank)

“…when audit committee review and approve audit fees, the auditor should no longer fear of the possible threat from company’s management; fear of termination, fear of fees reduction, fear not be appointed in the following financial year.”

(Executive, Top Tier Bank)

Audit Committee Members

Among important factors that determine audit committee effectiveness is its composition (e.g. the independence). The Bursa Malaysia Listing Requirements necessitate that the majority of audit committee members and its chairman composed of independent directors. Audit committee is perceived by business community to monitor the integrity of financial statements and internal controls system. Audit committees that comprise of solely independent (or outside) directors is perceived to be more effective to deliver their duties that possibly ask for greater depth and scope of internal audit activities and procedures. The majority of the loan officers of Top (96%), Medium (92%) and Low (95%) Tier banks agreed with the view that auditor independence would be safeguarded if audit committees were mostly comprised of independent and non-executive directors (refer to Panel A of Table 5). The result indicates the expectation that an independent director should be independent of management interests and thus can deliver their duties as a director; (i) minimize agency costs or moral hazards through effectively and efficiently monitor the management, and (ii) enhance financial transparency. In this context, Bursa Malaysia listing requirements defines an independent director “as a director who is independent of management and free from any business or other relationship which could interfere with the exercise of independent judgment or the ability to act in the best interests of an applicant or a listed issuer.”
Consistent with the findings from the questionnaire survey, the majority of the interviewees (i.e. 94%) agreed that auditor independence would be better safeguarded if audit committees were mostly comprised of independent and non-executive directors. However, many of the interviewees have raised concern on the independence quality of members of audit committee as reflected in the following extracts of the interviews:

“How independent are they? To me it all boils down to individual… but I have seen the so-called independent directors not independent.”

(Chief Executive Officers, Top Tier Bank)

“…we have to look who nominate the independent director, which is normally the director. I think this kind of appointment more or less will have an impact to the committee independence.”

(Vice President, Top Tier Bank)

“I’m a bit concerned, we talk about independent directors, how can they be independent? Say I’m appointed as independent director by Mr CEO, do you think I’m going to say something which is going to make him unhappy? I wouldn’t!”

(General Manager, Low Tier Bank)

Some of the interviewees come out with recommendations on selecting members of audit committee. The following are an extract of the interviews relating to the suggestion:

“…To me if we need the real independent, audit committee members should be appointed by a body and that body have a list of persons that eligible to be an independent director and the body will appoint them.”

(Chief Executive Officer, Low Tier Bank)

“...the authority should be the selecting body...organisation can submit the various names, an independent selection body should pick this people...Once they have selected, if the organisation wants to terminate their services, they have to give various reasons to the authority... Whatever the perks, whatever the benefits are totally decided by this independent body, so there are no compromise.

(Assistant General Manager, Low Tier Bank)
The views expressed during the interviews on the importance of an independent audit committee to perform their duties objectively to evaluate company’s financial disclosure and internal control adequacy is consistent with findings of prior studies in developed markets. For example, Beasley et al. (2000) and Abbott et al. (2003) show that companies that have majority independent audit committee members exhibit low fraud incidence, implying better quality financial reporting.

**CONCLUSION**

Issues on audit committee have been well researched and documented in the literature. The issue of interest has direct impact on the quality of corporate governance practices. Generally, investors perceive that strong market discipline protects their interest. This market discipline creates incentives for companies to conduct their businesses in a sound and efficient manner. In this study, the questionnaire and interview surveys of a category of stakeholders, the loan officers of major banks and financial institutions in Malaysia, agree that auditor independence would be better safeguarded by the presence of an active audit committee, the audit committee report detailing their activities should be mandatory in the annual report, the audit committee be made responsible for approving and reviewing audit fees, and audit committee members comprise of independent and non-executive directors.

Audit committee could significantly safeguard auditor independence if members are truly independent, knowledgeable and are committed to improve good governance without fear and favour. The culture of ‘box ticking’ or ‘mere compliance’ as reflected by the responses in the interviews are a matter of great concern and requires immediate response from regulators. There is an urgent need for the committee to go beyond procedural compliance, which address issues on good governance, internal control structure over financial reporting, internal audit issues and the role of the head of accounting and finance division with internal audit (monitoring) division. In an effort to support and encourage audit committee to deliver their duties effectively, regulatory bodies need to develop a tool kit to guide the committee. The tool kit should identify and, which among others, include explanation on internal control mechanisms, the relevant guiding information.

The result indicate the confidence of the respondents on the potential benefits from having well functioning and independent audit committees in facilitating communication network between auditors, management and related parties in preparing quality financial reports. Majority of loan officers participated in the study appreciate the potential benefits from having a well functioning audit committee and its role in enhancing good corporate governance practices. This implies positively on the efforts towards improving efficiency and transparency of financial reporting process, which is important consideration in attracting more foreign capital in our financial markets.


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