

*“The development of Audit Committees internationally and an analysis of their effectiveness in the Irish educational sector”*



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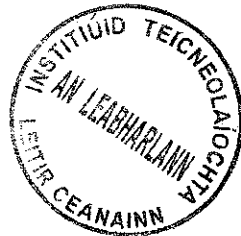
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## ABSTRACT

Corporate Governance has come under intense scrutiny in the past. The Audit Committee (AC) is a corporate governance tool. The development of ACs has been that of an active process. ACs were once seen as “*best practice*”, where now it can be seen that in some cases they are a requirement. ACs are established in both profit making and non-profit making organisations. The effectiveness of ACs has been and can be questioned in some cases.

The main stages in the development of ACs are discussed, in both the international context and in the Irish Third Level Educational Sector. The development stages include the codes of best practice, reports and acts dealing with AC establishment. The issues in relation to ACs, which are examined include, its role, effectiveness, perceived benefits and AC future.

The research project aims to examine the development of ACs and to assess AC effectiveness, specifically within the Third Level Educational Sector. The researcher attempts to satisfy these aims by conducting analyse of the literature that exists and also by interpreting the opinions expressed by the individuals who took part in the research. The primary research involved sending questionnaires to Chief Financial Officers (CFOs) at the Third Level institutions and conducting three semi- structured interviewees with individuals with relevant experience in the area.

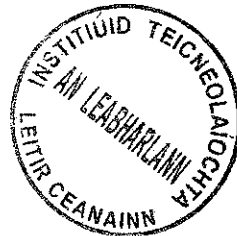
The research findings show that AC development has a long history and has progressed greatly in a number of countries internationally and also within the Irish Third Level Educational Sector. It was found that in the majority of Third Level institutions, ACs are determined to be effective and contribute positively to the organisations as a whole. However, there is still scope for improvements and the research participants express suggestions for such in certain areas.



## ACKNOWLEDGEMENTS

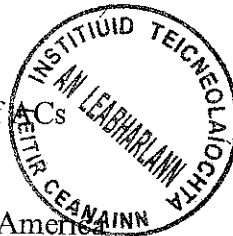
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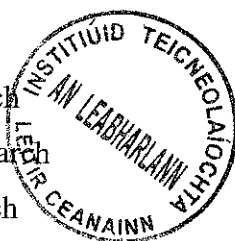


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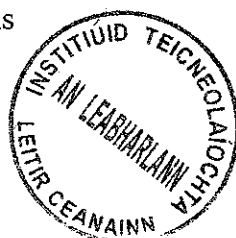
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## Chapter 1

### INTRODUCTION

#### 1.1 Overview of the research topic

An Audit Committee (AC) can be viewed as a way of improving the corporate governance of an organisation. Numerous reports, codes and acts mention Audit Committees (ACs), these are outlined in the literature review chapter.

The Sarbanes Oxley (SOX) Act, (2002) poses a definition of an AC:

*“A Committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer; and audits of the financial statements of the issuer.”*

An AC can be described as a committee set up internally but independent from the organisation. The duties and responsibilities of the committee have been outlined numerous times but all seem to include the same basic duties.

AC duties can be summarised as follows:

- To make recommendations to directors which relate to the approval of the company’s annual accounts, as well as the directors’ compliance statement;
- Establish whether or not proper books and records have been kept;
- Assist on the external auditor’s appointment;
- Monitor the auditor’s performance and work;
- Assess the independence of the auditor and give advice on the distribution of non-audit work;
- Provide for an adequately resourced internal audit function;
- Make an annual report to the directors on their work completed.

(Amended from the Companies Act, 2003)

As evident from numerous reports and acts, it is true to say that ACs have come through a lengthy development process. The first evidence of ACs was as far back as the 1800’s and they still remain in public discussion today, for example, their inclusion in the Companies (Auditing & Accounting) Act (CA), 2003.



## **1.2 Aims & Objectives of the research**

The research aims are as follows:

1. To follow the development of ACs internationally, and
2. To analyse how effective ACs are as a corporate governance tool in the Irish Third Level Educational Sector.

The research objectives are as follows:

- To follow the development of ACs in the international context;
- To examine the development of ACs in Ireland;
- To investigate the role of ACs in general i.e. the main duties and responsibilities of the AC;
- To investigate the role of ACs specifically in the Irish Third Level Educational Sector,
- To obtain expert opinions on these duties;
- To determine how effective ACs are in Irish Third Level institutions based on views of the institutions themselves;
- To ascertain any improvements required to make ACs more effective in the Irish Third Level Educational Sector.

## **1.3 Research Methodology**

It was decided that the research methodology to be used, would be that of interpretivism, also known as Phenomenology. As the research aim has a number of possible truths i.e. the AC could be of advantage to the overall organisation or it could be effective to some of the members of the organisation, or in a worse case scenario it could be of absolutely no effect to the organisation.

The research methods will be conducted mainly in an exploratory manner. There is no evidence that AC effectiveness has been examined in the Irish Third Level Educational Sector. This thesis involves determining if ACs are effective in this context. The research is therefore adding to the body of knowledge in this field.

#### **1.4 Literature Overview**

When conducting the literature review chapter, the researcher investigated and analysed the relevant code of good practice with regards to corporate governance, the relevant acts and academic and professional journals that discuss ACs, in both the private and public sectors and specifically in the Third Level Educational Sector. Codes exist worldwide, for example, in the UK the Cadbury Report (1992). There are a number of acts that also include ACs, for example The CA, 2003.

Critics commonly referred to throughout AC literature include Abbott, Collier, Lambe and Rezaee. The opinions and perceptions of these commentators are examined. The researcher gives personal analysis on the literature throughout the chapter.

#### **1.5 Rationale for the research**

The first element of the research entails the development of ACs. It can be said that the reason for so much written reference in this area of the AC, is that such development was a major part of the action taken in an attempt to improve corporate governance and attempt to reduce the risk of organisation failure. The collapse of Enron and Worldcom are examples of such corporate failures. The issue of corporate failure is of extreme and critical consequence to not only those directly involved with the organisation but also indirectly associated with the failure, for example, the government of the country in which the company operates. It was interesting and very relevant to trace AC development and analyse opinions raised worldwide, mainly the US, the UK and Ireland on the term "*Audit Committee*" and to analyse recommendations and guidance published in relation to AC operation.

The AC's role and responsibility has come under extreme misunderstanding from the public's perception. As a result each individual organisation should determine the role and responsibility for the AC and set these out in writing. The role and responsibility of each AC is unique to each organisation.

The limits outlined by The CA (2003) for determining AC existence are relatively low in comparison to the level of some companies' turnover activities and asset valuations. This implies that there are a relatively high number of companies with a requirement to have an AC in place.

For the Third Level Educational Sector, the rationale behind the study is based on the recent report published by the Higher Education Authority (HEA), which stresses and highlights the need within the sector for measures to be taken, to improve or sustain adequate controls, to control the institutions effectively.

Although it can be argued that the Third Level Educational Sector might not be relevant for such a study as it is not profit orientated. Cadbury's comments to the contrary, strengthen the rationale for the study.

In 1992, Cadbury wrote in his foreword to Davies work on corporate governance:

*“The issues which arise in the governance of voluntary, public sector bodies and professional organisations are broadly similar to those which arise in the governance of companies. In some ways, governance structures are even more important outside the public sector than within it. Clear statements of purpose and clear processes for the turning purpose into action are simpler to draft and put in place for a company than they are for a voluntary agency, or for any organisation which has a balance of aims, rather than a single overriding goal. Yet, the disciplines of governance are at least as necessary in a not-for-profit organisation as they are in a publicly quoted company”*

Also comments raised by Deloitte Partner, Gerry Fitzpatrick, where he stated that;

*“Audit committees can make a valuable contribution to all types of organisations across a broad range of governance and legal structures in the private, public and voluntary sectors”*

In relation to the Third level Educational Sector in Ireland, which is the focus of the majority of the research, the existence of ACs is common. The HEA and the Conference of Heads of Irish Universities (C.H.I.U.) recommends ACs in “The Report on the Financial Governance of Irish Universities- Balancing Autonomy and Accountability” published in December 2001. The Report outlines an AC as a channel to review the effectiveness of internal control, as well as being committed to its ultimate responsibility, which is to be outlined in the organisation’s terms of reference.

The more recently amended “Code of Practice for the Governance of Third Level Institutions” raises public interest in the Educational Sector, as it is only the I.Ts that have signed up to this document. The Universities are still in discussions on the issue. The Third Level Institutions involve both Institutes of Technologies (I.Ts) and Universities and these are included in Appendix 1.

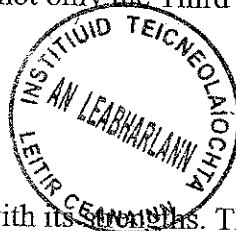
## **1.6 Potential Use & Limits of the Research**

### **➤ Usefulness**

This study could possibly be of use to a number of individuals and groups for both present and future reference. It can be used by, for example, the government to the extent that they are involved with the education of Third Level students and therefore help them in making decisions in relation to the financial governance and autonomy of Third Level Institutions for the future, the institutions themselves for the manner in which they operate and involve AC members in running the institutions, the members of the ACs, in order to improve their contribution to the organisations, and for future research purposes in relation to ACs in not only the Third Level Educational Sector but also within the public sector.

### **➤ Limitations**

This research has its limitations along with its strengths. The limitations are known to the majority research projects carried out at this level of education. There limitations include the resources available; these include time, money and accessibility.



## Chapter 2

### LITERATURE REVIEW

#### 2.1 Introduction

Throughout the process of the research in relation to ACs, it was found that substantial literature exists in this area, from both a historic perspective and a more current perspective. The chapter is divided into sections dealing with the following areas; an introduction to ACs, AC history and need for ACs, and AC development in general in the international context. Other issues include the perceived benefits, roles and responsibilities of ACs. A section within the chapter deals with the effectiveness of ACs. The literature involves the AC in the private and public contexts in the chapter.

Corporate governance can be defined as essentially the way in which the directors and management set out to govern or control an organisation (known as the '*governing body*' in the Third Level Educational Sector). An AC is a corporate governance tool, which aims to improve the organisation's position in this area (Abbott and Parker, 2000).

The concept of corporate governance has come under intense scrutiny in the past decade. The majority of the corporate failures were the result of inappropriate financial reporting. This led to an increased need for oversight and independence within an organisation. President George W. Bush (2002) stressed the need for improved corporate governance in the business environment (cited by Rezaee *et al*, 2003). These concerns have also brought attention onto the AC. According to Abbott and Parker (2000) the AC has received increased attention in recent years not only from the regulatory authorities but also from academics in the area.

### **2.1.1 Definition of an AC**

Numerous definitions exist that define the concept of an AC, including SOX seen in Chapter 1. Porter (2003) also defines an AC as:

*“A committee of the board of directors (or its equivalent) which has delegated responsibility from the board for, inter alia, overseeing the external financial reporting process – including the external audit”*

### **2.1.2 The History of ACs**

A number of cases relate to the history of ACs. The Great Western Airways Report (1872) case provides the earliest evidence of the need for an independent oversight function to review the financial affairs of an organisation; this is essentially one of the main functions of an AC.

The McKesson Robbins case in the US (1939) was one of the first major detected fraud cases. In this case the directors of the corporation had included fictitious items on the balance sheet totalling \$19 million. Although appointment of auditors (Price Waterhouse & Co) was conducted in accordance with generally accepted practices, it was felt that this does not in itself ensure independence (Baker *et al*, 2006). This case encouraged action taken by the New York Stock Exchange Council (NYSE) in 1940 (Gray and Manson, 2000).

The Post-Watergate scandals of the 1970's play an active role in more recent AC history. Further developments in relation to ACs have been as a result of the occurrence of the more recent scandals in both the US and the UK. Famous cases include Enron and Worldcom both in the US and Maxwell and Polly Peck in the UK.

### **2.1.3 The need for ACs**

Academics have identified various reasons for the establishment of ACs. Rezaee and Lander (1993) see ACs as a means of improving the communication process between the board of directors and the company shareholders.

According to Gray and Manson (2000) the AC is seen as a means of improving auditor independence. Spira (1999) investigate the AC role in relation to independence in corporate governance. In researching the area the conclusion reached by Spira was “*a common thread of reference to ‘independence’ could be discerned*” with all interviewees of the study believing that independence was a fundamental characteristic of ACs in order to ensure AC effectiveness.

Petra (2005) states that he believes that the “*presence of outside independent directors serving on these audit committees did not increase the reliability of the firm’s financial statements*”. The firms that he is referring to in the article are Enron Corp., Worldcom Inc., and Global Crossing Ltd.

Various pieces of literature emphasise that the AC serves as a corporate governance tool in today’s world (Collier, 1993). The AC has been seen as a way of improving the corporate governance position of organisations (Abbott and Parker, 2000). Corporate governance is said to be the relationship between the stakeholders and those in charge of the organisation’s governance. The board of directors and the AC are in charge of an organisation’s governance.

Barker (2002) states that the AC was introduced in an attempt, to increase the trust that exists between the company and its shareholders. The AC essentially gives “*comfort*” to the board. However, in turn Barker personally suggested that the “*idea of an Audit Committee as a response to a crisis of trust in the profession and in corporate governance in general is defective*”.

Vanasco (1994) suggested that the company’s board of directors form an AC, for the purpose of overseeing the company’s financial reporting process. According to Fama and Jensen (1983) the main incentive for AC establishment is the fact that most firms are characterised by the “*separation of ownership and specialization of residual claimholders, decision control, and decision management*” (cited by Bardbury, 1990).

As pointed out by Spira (2003) the function and influence of the AC is much more difficult in the practical world than simply meeting the terms of the codes laid out in writing.

### **2.1.4 Perceived benefits of ACs**

According to the literature there are a number of benefits that can be derived from the formation of ACs. These have been outlined by numerous sources, not only by the Cadbury report itself but also by major accountancy firms and the professional accounting bodies.

The benefits stated by Collier (1997) include assistance to directors on meeting their needs in relation to the accounts, strengthen the independence position of the company with non-executive directors on the committee and also that the AC will assess the independence of the external auditor employed. The AC can also improve communication between the internal auditor and the directors. Collier (1993) argues that the AC increases the credibility and objectivity of the financial reports of the organisation.

However, some researchers suggest that these advantages are not actually achieved in practice. It was concluded by Kalbers and Fogarty (1993) that at this time there was very little proof to show that an AC is effective. Some commentators suggest that the AC is only set up as a symbol, for example, Kalbers and Fogarty (1998). DeZoort (1997) pointed out that he believed the benefits of the AC are more rhetorical than substantive in nature.

## **2.2 Development of ACs**

There is evidence of an active AC development process internationally. This is mostly seen through the introduction or revision of corporate governance codes in many countries worldwide.

### **2.2.1 The United States of America**

According to Vanasco (1994) a survey conducted, highlights the main influences on the formation of ACs in the US.



➤ **The NYSE, The SEC and The AICPA**

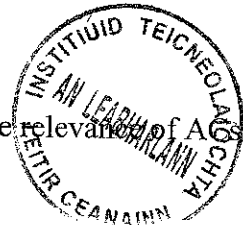
These were the NYSE, The Securities and Exchange Commission (SEC) and the American Institute of Certified Public Accountants (AICPA). There is evidence of the NYSE interaction as far back as 1940, when a report on Independent Audits and Audit Procedures was issued. In 1977, the NYSE issued a Policy Statement requiring the establishment of ACs in all companies listed on the Exchange. As far back as 1940, the SEC had already recognised the notion of the AC, which consisted of non-officers of the company. The AICPA recommended in 1967 that all plcs should establish ACs consisting of outside directors; with this they also published some general functions for ACs.

➤ **Other US influences**

The American Bar Association (1978) certified the idea of ACs and in relation to possible legal liabilities they made explicit recommendations as regards the responsibilities of ACs (Vanasco, 1994).

In 1987, The Report of the National Commission on Fraudulent Financial Reporting was issued. The report called for the SEC to make it a requirement to establish an AC (consisting of non-executive directors) for all listed companies (Rezaee and Farmer, 1994).

The Kirk Panel (1994) highlighted the relevance of ACs to the success of an organisation's corporate governance.



In the late 1990's a number of corporate collapses occurred in the US. These disasters encouraged the establishment of the Blue Ribbon Committee (BRC) (1999). One of the BRC's recommendations was the AC and specifically its role in relation to evaluating judgements made by management on financial issues (Business Lawyer, 1999).

According to some academics the role of the AC itself is questioned and criticised in the corporate failures of the early 2000's (Lavelle, 2002). One such case is that of the massive collapse of Enron. The SOX Act was introduced in 2002. This act established a number of guidelines and expectations for the AC. It requires the internal audit department to report directly to the AC, as well as the AC having a charter set that is approved by the board.

In accordance with Final NYSE corporate governance rules issued in 2003, plcs must establish an AC and operate in compliance with the requirements of Rule 10A-3 under the Exchange Act.

### **2.2.2 UK**

By 1976, ACs had been identified as a need for UK companies (Woolf, 1976). This reaction was encouraged by the corporate scandals that occurred in North America at this time.

According to Vanasco (1994), AC adoption began in the late 1980's, where as a result of increased fraud occurring internally in companies, the Bank of England, the Confederation of British Industry, and other financial institutions recommended the formation of ACs for public companies. The main steps throughout the development process of ACs were:

#### **➤ The Companies (Audit Committees) Bill, 1988**

The first formal recognition for the establishment of ACs in the UK was the Companies (Audit Committees) Bill (1988). The bill was introduced and intended to give the shareholders the authority to require the appointment of an AC (Collier, 1993). This bill was not enacted but if it had been, it would have required large plcs to establish an AC.

➤ **The Cadbury Report**

The need for ACs was not put into practice until Cadbury issued his report in 1992. This report became known as the Cadbury Report and was influenced by the corporate scandals of Maxwell and Polly Peck in the UK. The recommendations of the Cadbury report were taken on board by a great majority of listed companies in the UK according to Collier (1993). Collier suggests the reason for such compliance was due to the increased consensus on the view that ACs are best practice. The Cadbury report placed a major emphasis on the value of a correctly constituted AC and made the recommendation for all public listed companies to form an AC.

➤ **The Hampel Report**

The Hampel Committee Report (1998), suggests that ACs should take a more active role in relation to the objectivity and effectiveness of the external audit by reviewing the relationship that exists between the organisation and its auditors. The Combined Code 1998 was published following this report and included similar recommendations in relation to ACs. The London Stock Exchange adopted the AC recommendation issued by the Hampel Report for all companies listed on the Exchange.

➤ **The Turnbull Report**

This report sees ACs as a broader corporate governance tool in its role in relation to the internal control system of an organisation.

➤ **The Smith Report**

Smith (2003) published guidance on ACs. The report dealt with the following areas in relation to ACs; its establishment and role, membership, procedures, resources, the committee's relationship with the board, the role and responsibilities of the AC and communication between the AC and the company's shareholders.

➤ **The Combined Code on Corporate Governance**

The Smith Report encouraged the development of the Combined Code and the guidance provided in this code is closely based on that of the Smith Report. The recommendations in the Combined Code are appended to the Irish Stock Exchange Listing Rules, however do not form part of the rules (O'Shea, 2005).

### **2.2.3 Ireland**

It would be true to say that Ireland has followed the direction of the UK closely in relation to AC development.

➤ **The Irish Stock Exchange**

The Irish Stock Exchange Rules require the establishment of an AC for all companies listed on the exchange.

➤ **The Report of the Commission of the Inquiry into the Expectations of Users of Published Financial Statements**

In January 1992 the Institute of Chartered Accountants in Ireland (ICAI) published this report, which is also known as the Ryan Report. The report recommends an AC be established in order to ensure that the board of directors understand and are fulfilling their role and responsibility. The report also deals with independence, composition and meeting arrangements of the AC, it also addresses the AC role and responsibility.

➤ **Deposit Interest Retention Tax (DIRT) Inquiries**

Issues in relation to DIRT faced the Irish revenue at the end of the 20<sup>th</sup> Century and led to inquiries. A review group on external auditors recommends that large companies and financial institutions form an AC to act independently of the company board.

➤ **The Companies (Accounting & Auditing) Act**

This Act of 2003 enshrines the role of the AC members in law by listing their responsibility in the act. The act makes it a legal requirement for all plcs to form an AC. It also requires that large companies establish an AC or if they do not the company must disclose a reason for non-compliance in the annual report. The Act does this as an attempt to strengthen auditor regulation.

The main issues from the US, UK and Ireland are illustrated in appendix 4.

## **2.2.4 Other Countries**

The main development stages in relation to AC formation have been identified in a number of other countries.

### **2.2.4.1 Australia**

The Australian audit environment is one that believes the AC can improve auditor independence (Vanasco, 1994). Borsh (1990) headed a working group on corporate practices and conduct that encouraged the formation of an AC and issued a number of guidelines for companies in doing so. The report (1991) recommends that all plcs form an AC.

Horwath (2002) states that research took place as a result of the increased amount of company collapses that were happening in Australia at the time. HHH, Harris Scarfe and OneTel are examples of such collapses. The report stresses that at the very least an organisation have an AC in operation. The most advantageous position would be for it to consist of all independent members (including the chairperson) and for the committee to meet at least four times annually.

### **2.2.4.2 Canada**

The initial step in AC existence in Canada was due to the failure of Atlantic Acceptance Corporation Ltd as far back as the 1960's (Vinten, 1998). Vinten (1998) refers to the legal issues in Canada that deal with ACs. The Canadian Business Corporation in 1970 legally required companies dealing with public securities to establish ACs. ACs have been a legal requirement in Ontario since 1971 for plcs; this came about as a result of an investigation by the Royal Commission. Then in 1975, the Canadian Business Corporation Act strengthened the AC role by requiring members to review the accounts of the company prior to submission to the company directors.

The Canadian Institute of Chartered Accountants (CICA) issued the MacDonald Report (1988). The report suggests that all plcs establish ACs, which report to the shareholders on an annual basis and check both the interim and final financial statements of a company prior to publication.

## **2.3 Role and Effectiveness of ACs in an organisation**

### **2.3.1 The Role and Responsibility of ACs**

According to Smith (2003) the main roles of ACs is oversight, assessment and review within the organisation. Smith recommends the members of the AC do not involve themselves in the monitoring process within the organisation. Smith stresses "*it is not the duty of an audit committee to carry out functions that properly belong to others*".

According to recent publications the AC role has increased dramatically. According to Westfall (2005) directors are more inclined to refuse positions if it involves a duty on the AC. Westfall states that this is due to "*the huge time commitment for audit committee members, as well as the perception of increased liability risks*". Lee (2001) suggests that ACs formed within a corporation have the responsibility of reporting to the public any material issues that they find to cause them concern in relation to the quality of the financial statements.

With regards to the AC's role in fraud, the recent Sarbanes-Oxley Act (2002) raises concern. The act sets out specific roles in the area for ACs (Abbott and Parker, 2000). Abbott and Parker's (2000) investigation in the area of fraud discovers that "*audit committees which are composed of independent directors and which meet at least twice per year are less likely to be sanctioned for fraudulent or misleading reporting*".

Parker (1997) mentions the AC's role with regards to the external auditor. This is an activity in which a high number of ACs take part. They can be involved in the engagement, retention and the removal of the external auditors.

According to Morrow (2004) AC members are the least experienced compared to the other board committees; this was discovered by recent academic research conducted on the tenure and experience of AC members.

### 2.3.2 Effectiveness of ACs

As pointed out by Pomeranz (1997) the fact that an AC is established and is said to be in existence, does not in itself make a successful monitoring organisation. A number of areas with regard to AC effectiveness have been raised. Menon and William (1994) suggest that in order for an AC to be effective it will not be so by merely acting independently but it must also take an active role in its activities. This is also consistent with Abbott and Parker (2001), who suggest that ACs who are independent are more likely to appoint external auditors with higher quality in relation to actually identifying and then reporting material fraudulent findings.

Collier and Gregory (1996) raise the issue that the AC may possibly be required to exercise a two-way pressure on the audit fee. In one way the AC is encouraged to improve the quality of the audit conducted; increasing the audit fee of the organisation would ultimately do this. There is also the highlighted fact that the AC should be aiding in terms of the internal audit function in that one of its objectives is to reduce the audit fee to a minimum level.

According to Herdman of the US SEC (2002), there are three necessary qualities that have to be addressed when determining AC effectiveness. These are that the AC controls its agenda, have the ability to be diligent and to take the time necessary to acquire sufficient understanding of the financial aspects of the organisation. Jenkins (1989) mentions a report conducted by Coopers & Lybrand. The report determines that when examining the effectiveness of an AC it must be understood that "*its effectiveness depends to a large extent on the individuals who serve on it, the functions it fulfils, and its relationships with the board and the auditors*".



There are a number of checklists to aid an organisation and the AC members to self-assess their AC's effectiveness. These self-assessments are developed for general and also for specific sectors. Hicks (2004) considers what is essential for effective operation of an AC and she concludes that it was not something that can be enforced in regulation. She believes that it is "*the quality of engagement and attention that an audit committee member brings to his or her activities*". Hicks adds to this by saying that an organisation cannot substitute this by using checklists to determine effectiveness.

Wolnizer (1995) identifies that all those who promote the establishment of an AC should believe that it will enhance the quality of an organisation's financial reporting process. However as stated by Wolnizer (1995) a definition of what "*quality*" actually means and how it can be seen in the financial statements is absent from the literature on this area. Gray and Manson (2000) pose that when considering AC effectiveness, one must assess it under these two headings; the composition of the board and the authority and duty that the AC has.

### **2.3.3 Failures**

The effectiveness of ACs is seriously questioned in a number of corporate scandals including Enron, Global crossing, Adelphia and Worldcom. According to Lavelle (2002) the AC in Enron was "*chock full of talent*" yet failed to come to the aid of the shareholders. The AC followed all the rules. However Lavelle suggests the AC was out of date in terms of expertise and he concludes that the rules need to be re-thought in relation to the AC.

### **2.3.4 Gaps in AC guidelines**

Walker (2004) points out how the role of the AC evolved from that of a role which mainly involved "*negotiations with the auditors and reviewing financial statements*" to more recently where it has become more demanding. Walker indicates that there is increased pressure for a stronger AC role in light of the recent corporate scandals. However as Walker suggests lessons should have been learned following these scandals and that as a result we see that there is a lack or "*gaps in contemporary guidelines*" in relation to the AC and its role.



### **2.3.5 The future of ACs**

According to Lambe (2005) there is an increased risk that an expectation gap could emerge as a result of the increased demand now placed on AC members. In a KPMG survey (2003) of AC members it was found that 65% believe people will be discouraged from taking an AC position due to the increased expectations of members in terms of the role and responsibility that they undertake.

The survey finds that 57% believe that as a result of this the companies will come across difficulties in practice in finding suitable members with appropriate experience (cited by Dewing and Russell, 2003).

## **2.4 Public Sector**

ACs have had as much significance in the public sector as well as the private sector.

*“Corporate governance is every bit as important to bodies in the public sector as to those in the private sector”* (McCreevy T.D, 2001).

The Institute of Public Administration (IPA) and The Chartered Institute of Public Finance and Accountancy (CIPFA) published, *“On Board- A guide for Board members of State Bodies in Ireland”*. This code replaces the “State Bodies Guidelines” issued in 1992. The code contains updated and further clarified guidelines.

The National Economic and Social Council (NES) in Ireland published *“Achieving Quality Outcomes: the Management of Public Expenditure”* in 2001. This guide recommends selecting committees to deal with the management of the public expenditure within public bodies.

### **2.4.1 Development of ACs in the Third Level Educational Sector**

The Third Level Educational Sector can be divided in the Ireland. The I.Ts are state funded and controlled. The Universities have much more autonomy on financial issues. The researcher identified a number of developments within the Third Level Educational Sector in both the UK and Ireland

### 2.4.1.1 UK

A survey conducted by Dewing and Williams (1995) in UK institutions, shows that 86 out of 87 institutions had already established an AC at this time. This is a requirement of the individual funding councils. This requirement is laid out in the university funding council's "*Code of Practice for University Internal and External Audit*" (1992).

In 1996, The Chartered Institute of Public Finance and Accountancy (CIPFA) published "*A handbook for Audit Committee members in Further and Higher Education*". This publication addresses the role and responsibility of AC members. The handbook aids members in assessing AC effectiveness.

The Higher Education Funding Council for England (HEFCE) replaced the UFC. In June 2004 the HEFCE published a code of practice (Accountability and Audit) to the heads of HEFCE-funded institutions, their connected institutions and the related bodies. The code sets out the main requirements for the institutions in terms of "*accountability and audit arrangements and the broad framework in which they should operate*". The financial memorandums between the institutions and their own individual funding councils highlight the need for AC appointment. The HEFCE set out the duty of an AC in an appendix to the code. There are guidelines given in relation to the membership of ACs, independence issues, experience required and other issues for AC operation and reporting.

In November 2004, The Committee of University Chairmen (CUC) issued a "*Guide for Members of Higher Education Governing Bodies in the UK*". This guide was compiled with the help of the HEFCE. The guide outlines on page 31 the "*specific responsibilities*" of the institutions with regards to an audit. Within these responsibilities the appointment of the AC members and the need to act on the AC's annual report if necessary are referred to.

### **2.4.1.2 Ireland**

The HEA and the C.H.I.U published “*The Report on the Financial Governance of Irish Universities- Balancing Autonomy and Accountability*” in 2001. The C.H.I.U is now known as the Irish Universities Association (IUA).

In this report a number of recommendations are made, which are aimed at improving the accountability and transparency of the Irish Universities in relation to their financial governance. The report recommends that all HEA members establish an AC. According to an individual at the HEA, all universities have established an AC. The report outlines that the AC should monitor the existence and integrity of the financial control systems within the organisations. The publication gives model terms of reference for the AC in an appendix. This model is taken from the HEFCE recommendations.

The “Code of Practice for the Governance of State Bodies” was issued in 2001, however an amendment to this code is in draft at the moment, relating to third level institutions. The draft was first drawn up in September 2003. The 13 I.Ts are currently acting in accordance with this draft.

## **2.4.2 Issues in the Third Level Educational Sector**

### **2.4.2.1 The need for establishment of an AC**

As the Third Level Educational Sector cannot be seen as profit making, it can be argued that such corporate governance mechanisms are not required. However, the Cadbury Report (1992) addressed the issue of non- profit making organisations and concluded that corporate governance measures are just as important among non-profit as in profit orientated business structures.

Deloitte Partner, Gerry Fitzpatrick (2004), also stressed this;

*“Audit committees can make a valuable contribution to all types of organisations across a broad range of governance and legal structures in the private, public and voluntary sectors”.*

#### **2.4.2.2 The role of ACs in the Third Level Educational Sector in Ireland**

Dewing and Williams (1995) raised the issue of the AC role in the public sector versus their original role in the private sector. The AC role in an Third Level Educational institution is to be outlined in terms of references set by the board and the AC. The general role involves; risk assessment, internal control, internal audit activities, and determining whether “*value for money*” precautions are being taken.

Particular issues that could be of concern in the Irish Third Level Educational sector are in relation to appointment of members and the fact that the members do not receive remuneration packages for their duties. These concerns could ultimately have an influence on AC effectiveness within the institutions.

#### **2.5 Summary**

It is clear to see from the research conducted that the concept of ACs has come through a number of progressive stages in their development. The development has been from the first indication of their need within a company. This need has increased in the more recent years due to the many corporate scandals that have been mentioned. This increase has attracted attention to many areas in relation to the AC itself; the AC role and other issues throughout the AC operations in both profit making and non-profit making organisations both nationally and internationally.

## Chapter 3

### RESEARCH METHODOLOGY

#### 3.1 Introduction

The research area is discussed in this chapter. This includes the aims and objectives of the research and the methodology applied to achieve these. The criticisms of the research process are also discussed, as well as the strengths and limitations of the data collection process.

Numerous definitions of research exist. However, it can be agreed that research is a process of investigation and enquiry, which is systematic and has a methodology behind it. The knowledge will be increased as a result of research conducted.

According to Saunders *et al* (2003) research has a number of characteristics. These are that data is collected systematically, is interpreted systematically and there is an obvious purpose, which is to find answers.

#### 3.2 Research Aims and Objectives

The two main aims of this research are:

1. To follow the development of ACs, and
2. To analyse how effective ACs are as a corporate governance tool in the Irish Third Level Educational Sector.

These aims can be divided in the following research objectives:

- To follow the development of ACs in the international context;
- To examine the development of ACs in Ireland;
- To investigate the role of ACs in general i.e. the main duties and responsibilities of the AC;
- To examine the development of ACs in the Third Level Educational Sector in Ireland and the UK;
- To investigate the role and responsibility of ACs in the Irish Third Level Educational Sector;
- To obtain expert opinions on these duties;

- To determine how effective ACs are in Irish Third Level institutions based on views of the institutions themselves;
- To ascertain any improvements required to make ACs more effective in the Irish Third Level Educational Sector.

### **3.3 Research Philosophy**

#### **3.3.1 Research Theory**

Research theory involves identifying a suitable research approach, also referred to as research philosophy. This needed to be selected carefully, as it is extremely important to the research outcome. This is determined by the way that you think about the development of knowledge. There are three views on this that are common; positivism, interpretivism and realism.

##### **➤ Interpretative**

The view that is appropriate to this research is the interpretative approach. This approach was selected as the research aims are of an inductive nature, as the research answers add to the body of knowledge on the research topic. This differs to the deductive approach, which involves testing a theory that already exists.

The interpretative approach is concerned with understanding the patterns responsible for or behind the facts, rather than merely measuring the facts involved. The approach is suitable as it examines opinions and one of the main research aims is to establish the effectiveness based on opinions. This needs to be investigated by softer methods rather than testing it against a theory. No theory exists to examine AC effectiveness. The findings are based on the beliefs and perceptions of experts, who have essential knowledge and experience in the area.

There are both strengths and weaknesses to this approach. The approach adequately examines and understands how and why questions, that were asked. Another strength of the approach is that it enables the researcher to respond to changes that could occur throughout the research process. The interpretivism philosophy is also known for being good at understanding social processes.

There are a number of drawbacks to the approach. Data collection in such a nature can be difficult and time-consuming. Data analysis can be difficult as opinions and thoughts can be difficult to interpret. The researcher needs to be able to accept the probable uncertainty that the patterns, which emerge from the research, are always clear. There appears to be a much less credible public perception of this approach.

The philosophy decision was dependent on the research aims and objectives to be established. The interpretative approach is more involved with qualitative findings, as opposed to the positivism route that is more related to quantitative findings. A combination of both quantitative and qualitative research was desired in this study. Quantitative findings were achieved by questions such as the number of AC members, AC meetings and resources available. However these quantitative findings were not to be tested against a theory established on these issues. Qualitative findings were achieved by gathering the population members' feelings and opinions on issues.

### 3.3.2 Research Approach

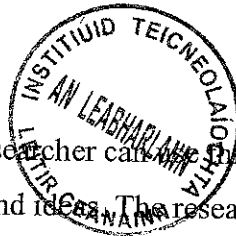
This decision must be made correctly in order to progress with the correct research design process. An understanding of the research theory is necessary to do so. The approach can either be of an inductive or deductive manner.

#### ➤ Deductive Approach

Saunders et al (2003) suggest that the researcher can use this approach, in an attempt to use the literature to identify theories and ideas. The researcher can then use these theories and ideas against their research findings.

#### ➤ Inductive Approach

The inductive approach on the other hand involves using the research findings to try and develop a theory from these findings (Saunders et al, 2003). This is more suitable to this study as this study involves trying to identify how effective ACs are and what determines AC effectiveness.



### **3.4 Research Methods**

The primary research carried out included both collecting quantitative and qualitative findings. This involved both exploratory and descriptive research methods.

#### **3.4.1 Exploratory Research**

The qualitative findings were established by trying to determine more exploratory type findings. These descriptive findings included trying to determine from the opinions and perceptions of the population members, for example, do they believe that ACs are effective or do they see any improvements that could be implemented.

#### **3.4.2 Descriptive Research**

The quantitative findings were established by seeking findings to more descriptive type details. These descriptive findings include, for example, the number of years the AC existed in the organisation or the number of meetings the AC holds annually.

### **3.5 Research Fieldwork**

#### **3.5.1 Data Collection**

It was decided that both questionnaires and semi-structured interviews would satisfy the research questions.

##### **3.5.1.1 Primary Research**

For primary research, the researcher decided that it would be sufficient to conduct three discussion type interviews in a semi-structured manner. The primary research also involved sending out questionnaires to the Chief Financial Officers (CFOs) of the Third Level Institutions.

##### **> Interviews**

An expert interview was conducted with an expert in the area of ACs in the Irish Third Level Educational Sector. This was conducted prior to the other two interviews and the questionnaires had been prepared. The expert interview helped establish both general and more critical areas that needed to be examined throughout the remainder of the primary research process.



Two other interviews were conducted discussing the area of ACs, with a number of relevant candidates who were well equipped to discuss AC issues. Issues that were discussed included; structured questions about the composition, meetings, members and duties of the AC. The interviews aimed at getting the interviewees to express their opinions and thoughts. The interviewer also left scope for the interviewees to make suggestions for future AC improvements. The interviewees are described as follows:

- Interviewee X: An expert within the I.Ts
- Interviewee Y: A CFO in an I.T
- Interviewee Z: An expert within the Universities.

### ➤ Questionnaires

Questionnaires were sent to 28 third level institutions, listed in appendix 1. This included both universities and I.Ts throughout Ireland. All organisations (members) in the population were selected. The questionnaires were sent to the CFOs at the Institutions. The CFOs were appropriate persons as they are involved and attend AC meetings. They were equipped with the proper knowledge and skills to complete the questionnaires. All institutions that responded had an AC established.

Both quantitative and qualitative questions were included in the questionnaires. There were a number of open-ended questions that required opinions and thoughts on certain issues. There were questions that involved one possible answer. These included yes/no answers or a quantity. Questions in relation to the role of the AC were also included to gather thoughts of the AC duty and responsibility.

A CFO performed a pilot test of the questionnaire. It was felt that this was necessary, as the questionnaire was sent to the CFOs of the Third Level Institutions.

Answers were recorded by a coding system. All the different question types had a unique coding system depending on the answer structure. Answer structures within the questionnaire included, yes/ no, rating, picking the most suitable answer from a selection of possible answers and finally open- ended discussion type answers.

An offer was made within the questionnaire for respondents to seek a summarised copy of the research including the research findings and conclusions. A copy of the cover letter and questionnaire used are included in Appendix 2 and 3.

### **3.5.1.2 Secondary Research**

The secondary research involved reviewing and analysing relevant academic journals and magazines. A number of reports, codes and acts were also investigated. These set out the recommendations and requirements of ACs in the general context and the Third Level Educational Sector.

### **3.5.2 Organisation of Research**

The research was organised in a logical sequence with an approved research strategy being followed. The strategy involved multi- methods of data collection. At the outset an expert interview was performed in order to give an effective understanding of the ACs existence in the Third Level Educational setting in Ireland.

The next stage was to get the perceptions from a number of individuals with adequate positions to give educated and knowledgeable opinions on the effectiveness of ACs. These individuals were asked about any improvements that they felt would increase AC effectiveness.

### **3.5.3 Ethical Considerations**

All primary research was concluded with professional integrity and strict confidentiality in all cases as research ethics were obeyed at all times.

### **3.5.4 Population**

A limitation of any research that involves responses from the participators, is concern of the research findings actually being representative of the entire population. To a certain extent this research reduced this risk as it involves surveying a census of the population. The members of the population are the CFOs at the Third Level institutions in Ireland. These are listed in Appendix 1. This is known as a census survey and therefore is less prone to the risks that are known to sample selection.

However, the risk of non-response must be noted. On response failure, reminders were given via telephone. Out of the 28 contacted, 15 responded. This is a 54% response rate which is over half of the respondents, which is considered adequate to validate the research findings.

### **3.5.5 Data Analysis**

Transcripts were produced of the interviews conducted. A numeric coding system was used to analyse the findings. This system helped identify patterns, trends and comparisons between what each individual contributed to the research findings. This was done by analysis of the CFOs' knowledge and perception and also by analysis of the organisational practices.

#### **➤ Financial Controllers' Knowledge and Perceptions**

This involved the interpretation of the knowledge and perceptions of the respondents of the questionnaires that is the CFOs of the institutions. These people had the necessary knowledge to make valid expressions on issues in relation to the operation and effectiveness of the ACs in performing their duties. It was felt that the CFOs' contributions were extremely valuable to the research findings.

#### **➤ Organisational Practices**

This involved analysis of what actually goes on within the institutions. The activities of the AC were summarised. The researcher then established averages and trends where appropriate. This analysis was completed with the number of meetings held annually and the number of years that AC members had held their position.

### **3.6 Limitations of Research**

As this research was conducted as part completion of a course, it was completed under both time and money restrictions. This could without a doubt affect the worthiness of the resource findings and must be expressed.

One might point out the fact that the research was conducted without the contribution of AC members. This might affect the research findings. This would not have been practical in such restricted time, as the AC members of each institution would be meeting at different times throughout the year. It would also have been extremely difficult to get contact details for AC members.

The fact that the majority of the research conclusions are drawn from the findings generated using postal questionnaires poses a threat to the validity and reliability of the conclusions and indeed the recommendations for improvements that were formed. Although a pilot test has performed, this does not eliminate all possible limitations of using questionnaires. The drawbacks of using questionnaires include; the fact that questions are open to interpretation, the fact that the researcher can not be 100% sure it was the CFOs who actually completed the questionnaires, the fact that some people can have a problem expressing their feelings on paper due to confidentiality reasons. A recommendation for future research would be to perform a re-test to ensure reliability of the findings formed in this study.

The researcher feels that another possible disadvantage of any research following the interpretivism route is the fact that it relies on human perceptions and opinions to a serious level. This is obviously prone to the possibility of personal biasness in the findings.

### 3.7 Summary

The aims of this dissertation were to follow the development of ACs internationally and within the Third Level Educational Sector in Ireland and to determine how effective ACs are within the Third Level Educational sector. The research also aimed to ascertain any recommendations for improvements in the area. The research theory involved was the interpretivism, which had to be conducted in a inductive manner. The research method was mainly that of an exploratory manner, which also involved a descriptive manner to an extent. The primary research included conducting three interviews with relevant experienced personnel in the area and questionnaires which were sent via post to each of the institutions listed in appendix 1.



## **Chapter 4**

### **ANALYSIS AND FINDINGS**

#### **4.1 Introduction**

This chapter includes the findings of the research, together with the researcher's analysis of the given situations under discussion. The research findings include both those gathered in the literature review and in conducting the primary research. The chapter is based on and achieves the aims and objectives that were set for the dissertation.

#### **4.2 The Development of ACs**

The primary research involved following the development of ACs within the general context in the US, the UK and other countries. Literature was also collected on the Irish context within both the private and public sectors. The public sector research focused mainly on the Third Level Educational Sector, which is where the majority of the primary research was conducted.

##### **4.2.1 Internationally**

From examining the history of ACs internationally it can see that their origin is based on the Great Western Airways case in 1872. This case highlighted the need for independent oversight. The development process of ACs internationally has come a long way from then, which was a best practice guideline approach, to now which can be seen to be much more stringent involving legal requirements, for example, the SOX Act (2001).

##### **4.2.2 Ireland**

In relation to AC development, Ireland can be seen to have followed closely their neighbours, the UK. The research finds evidence dating back to 1992 with mention of ACs in the Ryan Report.

#### **4.2.2.1 The Private Sector**

There exists a requirement for ACs, for companies listed on the Irish Stock Exchange. The Companies (Accounting & Auditing) Act enacted in 2003 also places great emphasis on ACs and contains certain requirements in relation to same.

#### **4.2.2.2 The Third Level Educational Sector**

A well-known publication unique to the Third Level Educational Sector in Ireland appeared in 2001 when the HEA and the then C.H.I.U together generated a report containing recommendations for the Third Level Educational Institutions. Because of such recommendations the establishment of ACs exist. The research finds that all institutions listed in appendix 1 have an AC currently in operation.

The main concern within the Third Level Educational Sector is the publication of “The Code of Practice for the Governance of State Bodies”, which was amended for Third Level Institutions. The issue here is that the I.Ts have already signed up to this document while the Universities are currently in discussions. The reason for the difference in agreement lies with the extent of autonomy given to each, as agreeing to such a document could possibly restrict this for universities.

### **4.3 The Main Role and Responsibility of ACs**

The role and responsibility should be outlined in the terms of reference for each AC in operation. The main issue with regards to the general role and responsibility can be seen in appendix 4.

#### **4.3.1 In General**

ACs in the private and general business context are involved in both quantitative and qualitative functions to a large extent. As the motive of any profit-making organisation is to maximise shareholders wealth, there is a major focus in the organisation’s culture to generate high profit volumes. This implies that the AC’s role will include great involvement with financial matters.

### **4.3.2 In the Third Level Educational Sector**

The main aim of any Educational Institution is to teach and operate effectively in a learning environment and to break even in financial terms. This will make a difference to the environment in which ACs operate. This will therefore require the focus of the AC's role and responsibility to reflect the more qualitative issues involved in the operation of a Third Level Educational Institution. The role of the ACs will therefore not be as focused on financial factors as in the private sector.

### **4.4 Effectiveness of ACs in the Third Level Educational Sector**

In order to determine if ACs are operating effectively in the Third Level Educational Sector in Ireland, the researcher aimed a number of questions in the questionnaires sent to the CFOs, relating to the operation of the ACs. These involved issues such as the length of time the ACs were in existence, the members of the ACs, AC meetings, performance of duties and self-assessment of AC effectiveness within the institutions.

#### **➤ Existence**

ACs were in existence in all institutions that responded to the questionnaire sent out. According to an individual at the HEA *“all HEA members have an AC presently in operation, some more recently set up than others due to numerous reasons”*. Another interviewee connected with I.Ts nationwide states that *“all 13 I.Ts have an AC that is operating in accordance with the code of practice for the governance of state bodies, that is amended for third level institutions”*.

According to the questionnaires 8 out of the 15 institutions have an AC that was established 5 or more years ago. Only 1 of the respondents has an AC established less than 1 year. This shows that in the majority of cases the AC should be familiar to the organisation and have reasonable experience to fulfil adequately its duty. However, there is the risk of familiarity as the AC members may have become complacent in their role.

Table A: How long ACs have been established

<b>Length of Time</b>	<b>No. of Institutions</b>
5 or more years	8
Over 3-5 years	4
2-3 years	2
Less than 1 year	1

➤ **Membership**

According to table B, from the research findings, 40% of respondents declared that there are 5 or more members on the AC, with 27% of institutions having just 3 or less members.

Table B: Number of members on ACs

<b>Number of members</b>	<b>No. of Institutions</b>
6 or more	3
5	3
4	5
3 or less	4

One difference between the I.Ts and Universities is the fact that the Governing Bodies of the I.Ts are required to declare their interests. From the findings of the completed questionnaires that were received by the researcher, it was found that in 12 out of the 15 ACs, members had declared their interests, in 2 out of the 15 institutions, members had not declared their interests and in 1 institution the CFO did not know the answer to this question. This is again one of the newly introduced recommendations of the “Code of Practice for the Governance of State Bodies”. It could ultimately show that all third level institutions are moving towards this even though formal agreement to such has not been achieved by the Irish Universities. It is important to remember that all AC members are also members of the GB.



According to interviewee X:

*“There is under the Code of Practice for State Bodies a statement which, says very clearly about conflict of interest under the Ethic and Public Office Act all governing body members have to complete a disclosure that and have to state what their interests are and it clearly states that if at any point during the year potential conflict of interest arises they have to bring it immediately to the attention of the governing body. Every member of the governing body has to fill this in”.*

Respondents were asked to rank a number of AC member characteristics. It can see from Table C below that independence stood out to be of critical importance. Ability to motivate and devote time to their meetings ranked least important with 40% selecting the least important option for this characteristic.

Table C: Characteristics of AC members

**Number of Rankings on Scale of Importance by Institutions**

<b>Characteristic</b>	<b>1 (Most Important)</b>	<b>2</b>	<b>3</b>	<b>4</b>
Accounting/ Financial knowledge and Experience	4	6	4	1
Knowledge of Legal and Regulatory Issues	0	5	6	4
Independence	9	2	1	3
Ability to Motivate and Devote Time To Meetings	2	3	4	6

The researcher finds the need to highlight the concern regarding the low perception of motivation and devotion of time to AC meetings. According to interviewee X:

*“The members need to be committed and they need to be of the highest integrity, ethics and they do in fair. They need to have a business acumen, to have pride, loyalty, they need to have because they don't get any money for this, this is done in their personal time so they have to be committed to it, to take it on and do it properly, its not just a matter of attending so many meetings”.*

In relation to whether or not members were external to the institutions, it was established that none of the 15 institutions were without an external member on the AC. In 60% of the cases it was found that all AC members were external to the organisations. This is a critical factor when establishing effectiveness, as it will have an affect on the independence of members when performing their duties.

Another important factor in relation to the members of the ACs is with regards to whether the members actually receive induction services prior to commencing their role on the committee. It was found that 11 out of the 15 institutions provided this service. This facility could ultimately determine the quality of the members' contribution on the ACs.

➤ **Selection of Members**

According to Interviewee Y:

*"The GB will nominate the members of the AC. The AC members are of course members of the governing body also".*



Interviewee Y, described the terms of membership duration within the I.Ts:

*"For the ordinary members of the GB the term is 5 years and the AC can be changed during that 5 years if the GB so decide. The members can be changed or if some of them want to get off it they can nominate somebody else on to it".*

This could have a positive effect on the operation of the ACs, as the GB has the discretion to decide whether or not members on the AC are performing their role adequately. This could also be an incentive for members to perform well for the organisations success, as they can feel like that the GB is in a way appraising their work.

Another concern that was established from the research findings is that of the selection process to the GB. The terms for appointment to such are set out in the RTC Act (1992). Interviewee X believes that *"the biggest problem is that these people are nominated on to it and they all have their own jobs and careers. The time commitment plus the facts that there are a few other things happening which are no help as well".*

When respondents were asked if they agreed with the current selection procedures in place for AC members, 11 out of the 15 agreed. This means that nearly 30% of the population did not which leads us to question its validity to a certain extent. One member of the population surveyed suggests, "*Selection of members is based on suitability not constituency*".

➤ **Meetings**

Average number of AC meetings per annum in the majority of cases is 4 or 5 as can be seen from Table D below.

Table D: Average number of meetings per annum

<b>Average number of meetings per annum</b>	<b>No. of Institutions</b>
Once	0
2 times	2
3 times	3
4 times	5
5 or more	5

According to the findings attendance at AC meetings is extremely positive with 14 out of the 15 CFOs agreeing that AC members attended meetings on a regular basis. In 14 out of the 15 institutions the CFOs believed that a quorum of members was reached at meetings. This shows that members are committed to their roles and are prepared to put the necessary time into the roles that they are to fulfil.

Preparation for meetings was also examined in the research. This was investigated, generating findings on the notice that the members receive and agendas being prepared for meetings. When asked did AC members receive materials in advance of meetings, 100% of the CFOs indicated that the members did so. Table E shows the length of time in advance of the meetings that the members received this material. As we can see in the majority of cases members receive relevant materials on average 1-2 weeks prior to meetings.

Table E: Length of time materials are received by AC members prior to meetings

Length of Time	No. of Institutions
1 Month or more	1
2 weeks - 1 month	2
1 week - 2 weeks	8
Less than a week	4

In all 15 institutions, the CFOs declared that there was a clearly expressed agenda set out for all AC meetings. This preparation that takes place shows that the Institutions are organised and feel that the ACs are contributing. Therefore this implies that the institutions want the meetings to take place and to go according to a set agenda.

In over 70% of the institutions, AC meetings were found to take place prior to an important decision being made by the institution. This shows that the institutions value the importance of the ACs contribution.

➤ **Roles and Responsibilities**

It was established from the research findings that only 40% of the institutions had a mechanism in operation to keep the AC members up to date with current legal and regulatory issues. This might cause concern, as there is awareness that the AC duty involves much more than financial functions and needs to focus on the more qualitative factors relating to its operation both internally and externally to the organisation.

This is of critical importance especially for the Third Level Educational Sector as it involves numerous daily dealings with individuals, and both legal and regulatory functions should be at an acceptable standard. The advice is believed to be given by the AC secretary, the CFO or the internal auditors in the Institutions where such a mechanism is in operation.



In relation to members who have a financial background, according to interviewee Z, *“most people would not have financial experience”*. According to the questionnaire findings, one third of the respondents agreed that the ACs in their institution do not have a member on the board with a financial background. Table F shows the breakdown of institutions with the number of members with financial backgrounds.

Table F: Members with Financial Backgrounds on ACs

<b>Number of Members with Financial Backgrounds</b>	<b>No. of Institutions</b>
None	5
1	6
2	2
More than 2	2

This might not be as concerning as it first appears to be. According to interviewee X, *“There is a lot more to the AC role than merely financial issues. In the educational sector profit is not as crucial as in the private sector, the main aim of any educational institution is to promote and achieve the best learning environment for the students”*.

Interviewee Y, when asked if he believed that such was essential to AC success, backed this argument:

*“Well, if there was something that required particular expertise they are at liberty to get somebody external to advise them”*.

However, when asked for improvement suggestions, interviewee Z, responded by recommending this to be the case.

*“I see a need for a member on the AC to have financial expertise on the board; this person should also be independent. I feel this is extremely important due to the increased demand for expertise in the financial reporting area. This is definitely an area that must be addressed”*.

14 out of the 15 CFOs who responded declared that their institutions have set terms of reference for the AC. In all these cases, the governing body had reviewed the terms of reference. Table G, shows what was included in the terms of reference.

Table G: Terms of Reference set for the AC

<b>Duty of AC</b>	<b>No. of Institutions</b>
Review internal control	14
Review internal audit	13
Review the financial statements	12
Risk management	12
Consider value for money	9

This table shows that in 100% of institutions, which have set terms of reference, that the most common duty of ACs in the Third Level Educational sector involves reviewing the internal controls and procedures in place, in the internal control department. Findings in relation to the internal audit are also high. This suggests that the AC and the internal auditors must have a close relationship. When asked if the institutions had a direct line of communication with the internal auditors, 13 out of the 15 CFOs responded positively to this.

Other questions in the questionnaire in relation to the ACs' duty with the internal auditors showed that over 70% of the 15 ACs approved internal audit strategies and annual plans for the institutions, and that over 90% of the ACs received periodic reports from the internal auditors.

According to Interviewee Y:

*“The I.Ts have internal auditors who are employed on an agency basis by all the Institutes. They would come to us with an audit strategy and we would tell them what we want audited. They produce reports after having carried out the audit and those reports go to the AC who look at the recommendations made and ensure that they are followed up”.*

➤ **Remuneration and Resources**

According to interviewee Y:

*“Members don't get paid and they only get expenses if they live so many miles away and they are taxed on the expenses”.*

This could have an influence on the performance of the members in terms of motivation and also in terms of responsibility that comes with the role of being a member. According to interviewee X:

*“They should be paid, because then at least you could turn around when something go wrong and say that they are personally responsible. This would ensure that they put enough time, effort and thought into their duty”.*

Interviewee Y stressed the impact of AC members being taxed on these expenses.

*“AC members are getting taxed on their expenses for coming to meetings which is a joke, you have somebody coming from far away, they could drive a car all right and they would get expenses and lose 48% possibly, if they took a taxi and had to pay a taxi they would be out of pocket. That is a joke because how do you expect people to give up their time and come to meetings and then not be reimbursed”.*

However, according to interviewee Z:

*“No, I don't see a need for AC members to be paid for what they do, as AC members volunteer to take on this duty and should feel like they are contributing to their community, by fulfilling such a duty”.*

In relation to resources available to the ACs on performing their duty, interviewee X states, *“the budget is very tight”*. CFOs were asked if they felt that the AC should have more resources available to it. It was found that two thirds of the respondents felt that there should be more resources made available to AC members in order for them to perform their duty.

This means that 5 out of the 15 CFOs believed that the AC had sufficient resources. This could cause a concern. One could ask, is this due to the ACs being well funded or is it that the CFOs do not perceive the ACs role as being of importance.

➤ **Assessing Effectiveness**

The CFOs were asked whether the institution's AC performed self-assessments. It was found that over half of the Institutions did so. This can be seen to be a relatively high number taking into consideration the number of Institutions, who have only established the ACs inside the past 2-3 years.

The CFOs were asked if they agreed that ACs contributed positively to the institutions as a whole. Over 80% of the respondents agreed. The other 2 respondents did not feel that the ACs had contributed positively. Among the reasons for not agreeing included the view that there is seen to be "*no real need for them if a good financial structure is in place*".

#### **4.5 Improvements and Recommendations**

Both the interviews conducted and questionnaire constructed involved attempts to determine any improvements and recommendations that the participants could find in relation to improving the effectiveness of the ACs.

Suggestions were made in the following areas; AC membership, members' selection, resources, and the AC role in the institutions. Research participants saw a need for a set skill requirements level in order to become an AC member. Some saw the need for a greater number of "*external*" or "*private sector*" individuals on the boards. Others stressed the need for the AC to become more strategically linked to the organisation, as well as a greater focus on more non-financial issues.

In relation to the selection of members, a number of CFOs believed that "*the Minister should have less influence on the selection procedure*". A very popular suggestion throughout the research was in relation to providing remuneration for the members.



#### **4.6 Summary**

This chapter provides the findings gathered from the research concluded. It also involves a description of findings from both secondary and primary research. These findings were gathered using both descriptive and exploratory methods and include both quantitative and qualitative data. The researcher gives analysis of the key findings, which were established with regards to AC development and on AC issues within the Irish Third Level Educational Sector.

## Chapter 5

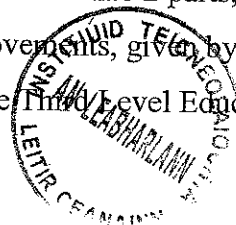
### CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Introduction

This chapter concludes the research study by discussing the research objectives set, the main findings generated with regard to these objectives, the implications of the findings, and conclusions formed based on the findings established. The strengths and limitations of the research are also discussed as well as a number of recommendations for future development in the area.

#### 5.2 Research Objectives and Main Findings

This dissertation set out to examine the development of ACs and to provide an analysis of their effectiveness within the Irish Third Level Educational Sector. It also aimed at determining any improvement suggestions in relation to AC effectiveness. The main findings of the research carried out, are divided into 2 parts; factors that contribute to AC effectiveness and suggested improvements, given by the research participants, to make ACs more effective, within the Third Level Educational Sector in Ireland.



##### 5.2.1 Factors that Contribute to AC Effectiveness

- In order to be effective, induction or training be given to AC members;
- The experts in require some level of financial knowledge or expertise in order to improve performance;
- The ability to motivate and devote time to AC meetings is necessary;
- The need for AC members to be independent from the institutions;
- The institution and especially the members on the AC can ultimately determine AC success.

### **5.2.2 Suggested Improvements**

- Consideration to be given to AC members' remuneration for their duty;
- There appears to be a need for a mechanism for updating AC members on legal and regulatory issues;
- Consideration to be given to the selection process of becoming an AC member;
- Consideration should be given to the necessary skills level needed to become a member;
- Consideration should be given to the resources available to the members;
- Experts recommend that the AC should be linked to more strategic and non-financial issues within the institutions.

### **5.3 Implications of Research Findings**

The research shows that there is a healthy interest in the area examined. The contribution of the members on the ACs is extremely important to the success and effective contribution of ACs to an organisation in the Irish Third Level Educational Sector.

The research highlights the on-going concern of taxing expenses paid to AC members, also the fact that AC members receive no remuneration for their duty. The findings of this research shows great concern on this issue and may lead to further discussion in relation to them.

### **5.4 Strengths and Limitations**

The main strengths of this dissertation are:

- An expert interview was conducted prior to other primary research;
- The opinions of the CFOs and a number of other individuals were taken into consideration when forming conclusions;
- The views of both the I.Ts and the Universities were taken into consideration;
- The research aims and objectives were achieved in the findings.

The main limitations of this dissertation are:

- The views of AC members were not taken into consideration;
- Limited resources such as time and money prevented access to more in-depth and group discussions in the area.

### **5.5 Recommendations**

The researcher recommends the use of other data collecting techniques, for example, more interviews including a group discussion. Possible participants in the group discussion could include the AC chairperson, a member of the AC, a CFO and an individual from the internal audit team. The views of the internal audit member are interesting as can be seen from the findings that the AC, in the majority of cases has direct link with the internal auditors. This would bring together a number of different views in relation to AC operation and contribution to an organisation.

As a number of institutions have only lately established an AC, the researcher feels that an examination of AC effectiveness in these institutions would be interesting in 5-10 years, as the research could set out to determine any alterations that were made to the AC in an attempt to improve performance.

### **5.6 Conclusion**

It can be seen that ACs were first developed due to the needs of the private sector. This need then progressed and led to the introduction of ACs in the public, non-profit orientated sectors, for example, the Educational Sector. Within the Third Level Educational Sector in Ireland it can be seen that ACs are in existence. The effectiveness of these ACs is dependent on a number of factors. It is evident that ACs are determined to be effective and contribute positively to the institutions overall. However, there is still scope for improvement in certain areas of AC operation.

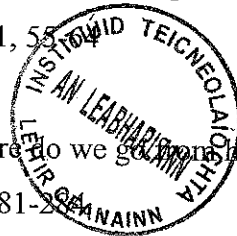
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**Appendix 2**  
**Copy of Cover Letter on Questionnaire**

Donaghmore  
Castlefin  
Co. Donegal

Chief Financial Controller,

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

6<sup>th</sup> June 2006

Dear \_\_\_\_\_,

Have you done a **good deed** today? If not, here's your chance, please read on.....

As part completion of my **Master of Accounting Degree** at Letterkenny Institute of Technology I am currently undertaking a dissertation entitled "*The development of Audit Committees internationally and an analysis of their effectiveness in the Irish educational context*". In order to complete this I need **your help** by participating in my research. It will only take **10 minutes** of your time and you can consider it your good deed for today!

The primary purpose of my study is to determine whether Audit Committees are effective in the educational context. I have broadly defined Audit Committee as a board of the governing body that is set up to independently review the governance of the third level institutions. Other studies have been carried out on the effectiveness of Audit Committees in a general context. However as to my knowledge no research has been conducted in relation to the educational context.

## Appendix 2: Copy of Cover Letter on Questionnaire

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The 1<sup>st</sup> section of the questionnaire deals with more practical questions in relation to the Audit Committees' operations and members. The 2<sup>nd</sup> section will highlight certain areas that you are asked to give your opinion on.

I trust the instructions on the questionnaire are clear and I believe the questions are brief and unambiguous.

I can assure you that all questionnaires will remain **anonymous**, no names will be mentioned in my research and all information collected will be treated as strictly confidential

I would appreciate if you could return the completed questionnaire in the **stamped addressed envelope provided by Tuesday 20<sup>th</sup> June 2006.**

If you are interested in obtaining a summarised copy of this study please provide your name and address on a separate page and enclose it with your completed questionnaire.

I would like to take this opportunity to **thank you** for your time and co-operation.

Yours Sincerely,

---

Josephine McMenamin

---

**Appendix 3**  
**Questionnaire**  
**QUESTIONNAIRE:**

Please tick one response, unless otherwise stated.

**Section A**

1. **Is the finance controller a member of the audit committee?**  
Yes   
No
  
2. **If not, is he/ she entitled to attend audit committee meetings?**  
Yes   
No
  
3. **How long has the audit committee been established in the institution?**  
(a) 5 or more years   
(b) between 3 and 5 years   
(c) between 2 and 3 years   
(d) 1 year or less
  
4. **How many members are on the audit committee?**  
(a) 6 or more   
(b) 5   
(c) 4   
(d) 3 or less
  
5. **How often does the audit committee meet?**  
(a) Annually   
(b) twice yearly   
(c) three times yearly   
(d) Other (Please specify) \_\_\_\_\_

6. **How many of the audit committee members have a financial background?**

- (a) None
- (b) One
- (c) Two
- (d) More than 2 (Please specify) \_\_\_\_\_

7. **Do all members attend on a regular basis?**

- Yes
- No

8. **Do the members receive material to be reviewed at a meeting in advance?**

- Yes
- No

9. **If yes, how long in advance would the members receive this material?**

- a) More than 1 month
- b) Between 2 weeks and 1 month
- c) Between 1 week and 2 weeks
- d) Less than 1 week

10. **Is there a clear agenda for all audit committee meetings?**

- Yes
- No

11. **Does a quorum of audit committee members attend all audit committee meetings?**

- Yes
- No

12. **Has each member declared their business interests?**

- Yes
- No

13. **How many of the audit committee members are external to the 3<sup>rd</sup> level institutions?**
- (a) All
- (b) Half
- (c) None
- (d) Other (Please specify)
14. **Does the audit committee have written terms of reference?**
- Yes
- No
15. **Are terms of reference reviewed by the governing body periodically?**
- Yes
- No
16. **Does the audit committee's terms of reference include:**
- (a) Reviewing internal control
- (b) Reviewing internal audit
- (c) Reviewing financial statements
- (d) Risk management
- (e) Considering value for money?
17. **Does the audit committee monitor how the institution guards against risk?**
- Yes
- No
18. **Does the audit committee approve, annually and in detail, the internal audit strategic and annual plans?**
- Yes
- No

19. Does internal audit have a direct line of reporting to the audit committee?

Yes

No

20. Does the audit committee receive periodic reports from the internal audit service?

Yes

No

21. Is the audit committee's role in the approval of the annual accounts clearly defined?

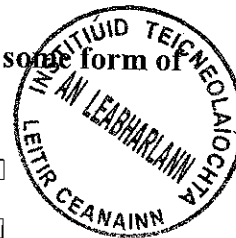
Yes

No

22. Are new audit committee members provided with some form of induction?

Yes

No



23. (a) Does the audit committee have a mechanism to keep it aware of topical legal and regulatory issues, for example, by training?

Yes

No

(b) If yes, please describe this mechanism

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24. **Are audit committee meetings scheduled prior to important decisions being made?**

Yes

No

25. **Are audit committee papers distributed in sufficient time for members to give them due consideration?**

Yes

No

26. **How long would an audit committee meeting last?**

(a) Less than an hour

(b) 1-2 Hours

(c) 2-3 Hours

(d) More than 3 Hours

27. **Does the financial statements include a description of the audit committee's establishment and activities?**

Yes

No

28. **Please rank, on a scale of 4, the importance of the following characteristics of audit committee; (1 is most important)**

(a) Accounting or financial knowledge or experience

(b) Knowledge of legal and regularly issues

(c) Independence

(d) Ability and motivation to devote time to meetings and preparation for such

29. **Does the audit committee assess its own effectiveness periodically?**

Yes

No

**Section B**

1. **Do you think that there should be more resources available to the audit committee to perform their duties?**

Yes

No

2. **Describe the process used within the institution for the selection of audit committee members. (Include selection criteria necessary)**

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3. **Do you agree with the current procedure for electing members of the governing body?**

Yes

No

4. **If no, do you have any suggestions for alternative ways?**

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5. **Do you agree that audit committees contribute positively to the institution as a whole?**

Yes

No

6. Do you see any other ways in which audit committees can become more effective within the educational context in Ireland?

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*Please use this space for any comments on the issues contained in this questionnaire.*

**Thank you again for your help**

<i>Country</i>	<i>Number</i>	<i>Membership/ Period</i>	<i>No. with financial background</i>	<i>Voluntary/ Compulsory</i>	<i>Independent</i>
<b>Ireland (Companies Act of 2003)</b>	Not fewer than 2 members	Consist of directors approved by the board of directors		For all plc's compulsory. for large private companies* if don't comply have to explain.	Majority non-executive
<b>United States of America Sarbanes-Oxley Act of 2002</b>			At least 1 must be a "financial expert"	All SEC filers- if no such committee exists then the responsibility of the entire BOD's	All independent.
<b>The United Kingdom (The Combined Code 2003)</b>	At least 3 members, 2 in case of small companies	Approved by the board for 3-year period (extendable for 2 more periods)	At least one with significant, recent & relevant financial experience	Applies to all UK listed companies if don't comply have to explain	All non-executive directors
<b>Higher Education Authority Report 2001 (Funding Council for England)</b>	No fewer than 3 members		At least 1 should have a background in finance, accounting	Recommended in Ireland (Compulsory in England)	Consist of executive & non executive.

Appendix 4: Issues in relation to ACs

<i>Country</i>	<i>Terms of Reference</i>	<i>Appointment/ Re-appointment</i>	<i>Whistle Blowing</i>	<i>Resources</i>
Ireland (Companies Act 2003)	Written, prepared and approved by the board of directors, shown to the directors and reviewed annually.	Must qualify under subsection (7)** Must not have been employed by company In 3 years proceeding		Directors must provide adequate resources.
United States of America Sarbanes-Oxley Act 2002	Have a charter set out and must follow this.		Must establish procedures for the receipt, retention and treatment of complaints received regarding accounting, internal control or auditing matters	Must have authority to seek independent advice Must have appropriate funding
The United Kingdom (The Combined Code 2003)	Set out main role & authority delegated to the AC by the board	Submitted for re-election at regular interval subject to performance	Should make arrangements for staff to raise concerns about possible improprieties In financial reporting & in other matters	Training for all members. Inductions. Company services
Higher Education Authority Report 2001 (Funding Council for England)	Include duties of the committee (determined according to own requirements)	Appointed by the governing body		Authority to obtain outside legal & other advice. Needs approval to specified limits.

<i>Country</i>	<i>Meetings</i>	<i>External Auditor</i>	<i>Non-audit Work</i>	<i>Internal Audit</i>
<b>Ireland</b> <b>(Companies Act 2003)</b>	Meet at least annually to examine whether proper books of account are kept	Advise the BOD's on appointment, monitor performance & quality of work & independence, monitor the company's relationship with the auditors	Recommend whether or not to award contracts of non-audit work to the auditor or an affiliate of the auditor	Satisfy themselves that the arrangements & resources for this dept are adequate
<b>United States of America</b> <b>Sarbanes-Oxley Act 2002</b> <b>(Addressed in Section 301)</b>		Directly responsible for the appointment, compensation, & oversight of external auditor. The auditors must report to the AC after audit report is presented.	Approve the allocation of non-audit services or delegate authority to do so to 1 or more members of the AC who are independent members of the BOD's	
<b>The United Kingdom</b> <b>(The Combined Code 2003)</b>	Recommends not less than 3 per year	primary responsibility for making a recommendation on the appointment, re-appointment & removal of the external auditor	develop & implement policy on the engagement of the external auditor to supply non-audit services	should monitor & review the effectiveness of the internal audit activities
<b>Higher Education Authority</b> <b>Report 2001</b> <b>(Funding Council for</b> <b>for England)</b>	At least twice a year	Advise on appointment & dismissal. Discuss problems with them. Meet at least a year if requested.		Consider appointment etc Review of effectiveness.

\*Large is defined in the Companies (Accounting and Auditing) Act as a company that meets the following criteria:

- (i) its balance sheet total for the year exceeds-
  - (a) €25,000,000, or
  - (b) if an amount is prescribed under *section 48 (1)(h)* for the purpose of this provision, the prescribed amount;
- (ii) the amount of its turnover for the year exceeds-
  - (a) €50,000,000, or
  - (b) if an amount is prescribed under *section 48 (1)(h)* for the purpose of this provision, the prescribed amount.

\*\*Subsection 7.

A director qualifies for appointment to the audit committee unless he or she-

- (a) is, or was at any time during the 3 years preceding appointment to the committee-
    - (i) an employee of the company or undertaking concerned, or
    - (ii) an employee of any subsidiary of the company concerned or of a subsidiary undertaking of the undertaking concerned,
- or
- (b) is the chairperson of the board of directors.