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Abstract: A useful attribute of the audit committee is to have accounting financial experts on that committee of the Board. Defond, Haan and Hu (2005) argue there is a positive market reaction to the appointment of such experts. This study analyses how many qualified accountants there are on the Boards of Australia’s largest companies. The study finds that, while many Boards have at least one qualified financial accountant on their audit committee, the great majority of members are not qualified accountants. The paper considers whether this paucity of professionally qualified accountants on audit committees has any implications for the curriculum development and learning objectives of corporate governance and related topic areas within the disciplines of accounting and auditing in undergraduate and graduate professional accounting programs within the international tertiary education sector?

Keywords: Audit Committees, Accounting Qualifications, Boards of Directors

Introduction

Universities world-wide are graduating unprecedented numbers of students in both commerce and business. Within the Australian context, students who choose the appropriate professional specialisations within the disciplines of accounting and finance in their undergraduate and/or graduate programs commonly satisfy the professional recognition requirements of CPA Australia, the Institute of Chartered Accountants in Australia and the Institute of Certified Management Accountants, often with eligibility for recognition in allied professional associations, such as the Australian Computer Society. Given the demand for ‘financial expertise’ within the membership of an audit committee and with so many graduates in the field gaining professional accounting qualifications, this study aims to determine the extent to which the audit committee membership in Australia’s Top 200 Companies demonstrate professional accounting qualifications.

Organisations globally face the constant challenge of meeting the exacting demands of corporate governance responsibilities. A particularly effective ‘vehicle’ for monitoring these responsibilities is the use of an audit committee. Accounting academics in tertiary institutions world wide, as well as, national and international professional accounting bodies have a responsibility to develop, design and deliver curricula and set learning objectives that reflect the growing importance of corporate governance in business.

Professional accounting graduates in the 21st century are increasingly seen as information specialists and in practice are also regarded as significant contributors to the decision making processes of an organisation. Their expertise in accounting and finance identifies them as being highly suitable for audit committee membership.

Selected Audit Committee Literature

Professional Accounting bodies world-wide have encouraged their memberships to actively engage in corporate governance. One obvious opportunity to engage in corporate governance activities is through membership of audit committees. These committees are a sub-committee of the Board of Directors that comprise a majority of independent/non-executive members of the Board. Given the nature of the responsibilities and duties of an audit committee, it is not surprising that the audit literature focuses on affirming the importance of financial expertise, within the committee, which is invariably described as having at least one member of the committee with financial expertise (financial literacy). Coates, Marias and Weil (2005) confirm the importance of the financial expertise of the audit committee membership, while Defond, Hann and Hu (2005) agree that the Sarbanes-Oxley (SOX) financial expertise requirement is justified and is an important determinant of the committee’s effectiveness. Defond,Hann and Hu (2005) also examined the distinction between accounting expertise and non-accounting financial expertise on audit committees, and found, that there is a positive reaction to the appointment of account-
ing experts to audit committees, but no reaction to non-accounting financial experts assignment to audit committees.

A further focus in the audit committee literature relates to the independence of audit committee membership. The surveyed literature emphasises that all members both executive and non-executive directors must be independent. Windram and Song (2004) conclude that independence is overwhelmingly seen as the most significant attribute of an audit committee member. Bedard, Chitourou and Courteau (2004) discuss the impact on independence of executive share options as audit committee members may align their interests with those of management rather than those of shareholders and thereby compromise their independence. Abbott, Parker and Peters (2004) and Srinivasan (2005) examine how the occurrence of financial statements, particularly in relation to overstating earnings impacts on membership independence. Windram and Song (2004) report that the duties of the audit committee have undergone a significant shift from the traditional reporting role to a greater focus on internal control and risk management. The effective handling of this agenda will depend on the frequency of meetings and the size of an audit committee.

Financial and Accounting Related Expertise

Since the inception of audit committees onto the global corporate landscape it has been mandatory for its membership to demonstrate financial and accounting related expertise. It is claimed that such expertise will enable the committee to properly fulfill its responsibilities, and contribute significantly to strengthening a firm’s internal controls and to preparing and publishing more reliable and relevant financial reports.

The audit committee oversees a firm’s compliance with legal and regulatory requirements and liaises with both a client’s internal and external auditors. In order to achieve these responsibilities the audit committee must maintain effective working relationships with the board of directors, management and the internal and external auditors. A recognized measure for determining the extent of an audit committee’s financial and accounting related expertise is to identify the professional accounting qualifications of its members.

In 2002, the SEC in the USA defined a financial expert as a person who demonstrated the following five attributes: “1) An understanding of generally accepted accounting principles and financial statements; 2) Experience applying such generally accepted accounting principles in connection with the accounting for estimates, accruals and reserves that are generally comparable to the estimates, accruals and reserves, if any, used in the registrant’s financial statements; 3) Experience preparing or auditing financial statements that present accounting issues that are generally comparable to those raised by the registrant’s financial statements; 4) Experience with internal controls and procedures for financial reporting; and 5) An understanding of audit committee functions.”


Following much critical comment, however, particularly in regard to attribute 3, the SEC broadened its definition to the satisfaction of critics and commentators. The significant difference between the initial and the final SEC rules focused on the attribute that limited audit committee financial experts to those individuals with direct experience in preparing or auditing financial statements. The revised attribute 3 is more flexible and incorporates those experts with experience in ‘analyzing or evaluating’ financial statements or in ‘actively supervising’ others in the preparation, auditing, analyzing or evaluating of financial statements.

Responsibilities of the Audit Committee

The responsibilities of an audit committee are extensive, involving mainly, financial and accounting related issues, hence the need for the committee’s membership to demonstrate financial and accounting related expertise. The committee’s primary responsibility is one of oversight. The key responsibilities include reviewing all matters pertaining to the financial statements, as well as, disclosure issues; overseeing the client’s relationship with the external (independent) auditor, and overseeing the client’s internal audit function.

More specifically, the following are commonly defined responsibilities of an audit committee: reviewing the client’s annual, quarterly and half yearly financial statements, reviewing with management and the external auditors any significant financial issues and judgments made in connection with the preparation of the client’s financial statements, reviewing with the external auditor any audit problems or difficulties encountered during the conduct of the external audit, examining critical accounting policies, alternative treatments, accounting adjustments, internal control issues, and any potential fraudulent activities.
Findings of the Study

This study surveys the professional accounting qualifications of the audit committee members of Australia’s top 200 Companies. The main source of the data was the Connect 4 Annual Reports database for 2004. The DatAnalysis database was used to identify the top 200 companies by market capitalization. Audit committee data including accounting qualifications and whether the audit committee member was an executive or non-executive director was located in each of the sample company’s 2004 annual reports. Five companies in the sample did not identify the accounting (or other) qualifications of their audit committee directors. Four of these companies were in the top 50 while the other company was in the second 50.

Table 1 explores the Defond, Hann and Hu (2005) hypothesis that accounting financial expertise as opposed to non financial accounting expertise in an audit committee is important, by identifying the numbers and proportions of Australia’s top firms that had at least one audit committee member with an accounting qualification, either a Chartered Accounting (CA) or a Certified Practising Accounting (CPA) qualification. The top 46 companies identify their clear desire to have some accounting financial expertise on the audit committee with 42 companies having at least one audit committee member with an accounting qualification. It is noteworthy that nearly one quarter (23.1%) of the sample firms do not have a professionally qualified accountant on their audit committee. Given Defond, Hann and Hu’s (2005) finding that there is a positive market reaction to the appointment of accounting financial experts to audit committees, many companies in the of sample may benefit from such appointments.

Table 1: Firms with at Least One Accounting Qualification in the Audit Committee

<table>
<thead>
<tr>
<th>Sample size – 195</th>
<th>2004 Directors</th>
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<tbody>
<tr>
<td>Companies by Capitalisation</td>
<td>Accounting Quals</td>
</tr>
<tr>
<td>Top 50 (4 did not identify qals)</td>
<td>42 (21.5%)</td>
</tr>
<tr>
<td>51-100 (1 did not identify qals)</td>
<td>35 (17.9%)</td>
</tr>
<tr>
<td>101-150</td>
<td>34 (17.5%)</td>
</tr>
<tr>
<td>151-200</td>
<td>39 (20.0%)</td>
</tr>
<tr>
<td>Total</td>
<td>150 (76.9%)</td>
</tr>
</tbody>
</table>

Table 2 reports the numbers of qualified chartered accountants (CAs) and certified practising accountants (CPAs) on the audit committees of the sample of 195 firms. The total number of directors on the audit committees was 691. The data are again disaggregated into quartiles with the numbers and percentages within each of these quartiles, related to the total of 691 audit committee members. In aggregate, there were slightly more Chartered Accountants (CAs) (125) on audit committees than CPAs (91). Nearly one third of audit committee members are either CAs or CPAs, while slightly over two thirds do not have accounting financial expertise qualifications. The top 46 firms again have proportionately more qualified accountants (proportionally) than the rest of the firms.

Of the total 691 audit committee members in the 195 firm sample, 689 were non executive directors while only two were executive directors (one from each of the bottom two quartiles). Of these two, one was a CPA (in the third quartile) while the other had no formal accounting qualifications (from the last quartile). These findings suggest that the largest Australian companies want an audit committee that is seen to be independent.

Current curriculum design and content while adequate it however reflects the intent of the more conventional definitions of financial and accounting related expertise, with a consequent emphasis on regulatory compliance. What needs to be coupled with this current syllabus content is material that is responsive to tertiary students better understanding the business model, management’s approach to risk management and the ever-increasing influence of International Financial Reporting Standards (IFRS) in relation to measurement and reporting issues.
Conclusion

The findings of this study demonstrate the paucity of formal accounting qualifications amongst audit committee membership of Australia’s top 200 companies. Given that a significant portion of an audit committee’s responsibilities and duties relate to financial statement and disclosure issues, significant issues of accounting measurement and disclosure and reviewing and discussing the major audit findings of both the internal and external audit, it is surprising to discover the very low percentage of the audit committee membership of Australia’s top 200 companies with professional accounting qualifications. Ultimately, the Board of Directors has the primary responsibility to oversee management regarding the conduct and integrity of the company’s financial reporting process, and it should be strongly supported by audit committee membership that demonstrates financial and accounting-related expertise as measured by professional accounting qualifications. These qualifications will provide the financial acumen that is necessary for a successfully functioning audit committee and thereby improve the credibility of the published financial statements of Australia’s top 200 companies.

Commerce and Business related degree programs need to incorporate into their curriculum design, development and delivery a set of learning objectives that demonstrate the importance of audit committees within the context of corporate governance as well as highlights the central role that professionally qualified accounting graduates play through membership of and participation in the deliberations of an organisation’s audit committee. Such participation has the potential to improve the role and quality of corporate governance globally.

References


About the Authors

*Christopher Kelly*
Chris is a Senior Lecturer in the Faculty of Business and Law and is presently the Deputy Dean of the Faculty, a position he has held since January 2005. Chris commenced his academic career in 1970 as a staff member of the Gordon Institute of Technology and he has recently completed 37 years of service with Deakin University. He researches in the areas of auditing, accounting and corporate governance.

*Dr. Bill Dimovski*
Deakin University, Australia