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The Corporate Governance Role of Audit Committees: Through the Lenses of New Zealand Institutional Investors

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This paper explores how directors of New Zealand institutional investor entities perceive the role of audit committees in their investee firms. We find that perceptions of audit committee mechanisms by directors of New Zealand institutional investor entities are distinct in terms of: (1) the directors' knowledge of audit committee mechanisms; (2) directors' evaluation of the governance role of audit committees; and (3) whether and how audit committees in investee firms affect the investment decisions of institutional investors. We argue that the identities of directors and contextualising events may have contributed to the discrete views taken by the directors of New Zealand institutional investor entities. We use institutional theory and discourse analysis to design and analyse the interviews. Our paper presents evidence from New Zealand, where the adoption of audit committees has been largely driven by regulatory changes overseas. Findings from this paper may be of interest to regulators, researchers and practitioners to make informed comparisons with observations from other countries in examining the function of audit committees and in evaluating the implications of corporate governance regulatory changes. Regulators and other corporate governance stakeholders may benefit from this paper by reflecting on the reciprocal influence between an audit committee and the institutionalisation of governance practices.

The relationship between institutional investors and audit committees is claimed to play an important monitoring role in corporate governance (Turley and Zaman 2004; Chung and Zhang 2011), but to date little is known about if and how these two parties interact. Our paper contributes to filling this gap.

Existing empirical literature on the monitoring effect of institutional investors on audit committees is largely quantitative, based on archival capital market data and corporate disclosures. Quantitative archival literature often hypothesises on and tests the determinants and implications of corporate governance mechanisms, but focuses less on the actual motivations and processes of the people that perform governance roles. Many suggest that further studies of governance mechanisms should investigate within the 'black boxes' of corporate boardrooms by studying the key actors, rituals, processes and dynamics (Gendron et al. 2004; Turley and Zaman 2007; Brennan and Kirwan 2015). The current study joins the discussions on the implications of institutional investors and audit committees by providing qualitative evidence on whether and how the investment decisions of institutional investors are affected by the existence and performance of audit committees in their investee entities. We do this by using discourse analysis of nine semi-structured interviews conducted with directors of New Zealand institutional investor entities.

The institutional setting of New Zealand offers an opportunity to explore the perceptions of institutional investors on audit committees in a principles-based corporate governance regime, which is in contrast to the rule-based regime in the United States. Findings of the current study reveal that perceptions of audit committee mechanisms by directors of New Zealand institutional investor entities are distinct in terms of: (1) the directors' knowledge of audit committee mechanisms; (2) directors' evaluation of the governance role of audit committees; and (3) whether and how audit committees in the investee firms affect investors' investment decisions. We argue that the identities of directors and publicity about financial scandals may

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have contributed to the discrete views taken by our interviewees.

The establishment of audit committees in New Zealand is largely driven by regulatory interventions domestically and internationally. We believe the current study has implications for both research and practice by shedding light on the extent of institutionalisation of the audit committee as an internal corporate governance mechanism. Our research is one of the first to adopt a qualitative methodology to investigate the perceptions of audit committees from the perspective of institutional investors.

The paper is structured as follows: section two provides a review of relevant empirical literature. This is followed in section three by an explanation of the institutional background of New Zealand, from where the qualitative data were collected. Section four explains the methodology underpinning the current research. The findings from the in-depth interviews are presented in section five. The final section concludes the paper.

Review of Relevant Empirical Literature

The monitoring aspects of corporate governance entail bringing accountability and transparency into the way firms are operated. The separation of ownership and control depicted in agency theory (Jensen and Meckling 1976) underpins a large number of empirical studies and the fundamental philosophy of corporate governance regulatory regimes. In this section, we provide a review of the relevant empirical literature on the corporate governance implications of institutional investors and audit committees most of which have used an agency theory perspective.

Monitoring by institutional investors

Institutional investors typically are financial intermediaries that hold portfolios consisting of both equity and debt investments on behalf of their clients. Thus, institutional investors are often seen as rational investors who constantly and actively balance the risk and return of their investment strategies (Bushee et al. 2019). Combining their rationality, equity holdings and/or debt contracts, institutional investors have the incentive and capacity to monitor the management of investee firms (Dharwadkar et al. 2008; Burns et al. 2010; Pérez-Calero et al. 2019). Pérez-Calero et al. (2019) carried out a meta-analysis of 127 studies and concluded that the monitoring effect of ownership concentration, including institutional investors, is subject to the legal environment of different countries. Institutional ownership has a significant positive effect on board independence in common law countries, whereas the effect in civil law countries is negative (Pérez-Calero et al. 2019). Scholars also recognise that institutional investors are not homogenous in terms of their investment strategies, which usually involve the time-horizon of investments, the nature of their portfolios, their risk appetite and their financial sophistication (Dharwadkar et al. 2008; Burns et al. 2010; Chung and Zhang 2011; Bushee et al. 2019). Despite their heterogeneity, it is expected that institutional investors would value investments in well-monitored entities, but very little is known about how these evaluations and subsequent decisions are made.

Monitoring by audit committees

An audit committee, a sub-committee of the board of directors, oversees the financial reporting and auditing matters of the firm. Prior to the regulatory imposition of the Sarbanes-Oxley Act (US Congress 2002) in the United States, literature on the establishment and composition of audit committees critically argued that very little evidence supported the contention that audit committees actually and substantively *perform* the monitoring role delegated by the board. However, audit committees may be established to present an image of good governance to the public (Bradbury 1990; Menon and Williams 1994; Spira 2003). Using the logic of agency theory, having an audit committee comprising mainly independent directors has become a widespread practice of securities issuers worldwide. An extensive body of literature has emerged regarding the association between various aspects of audit committees and their impact on enhancing financial reporting and audit quality (Bédard and Gendron 2010; McNulty et al. 2013). However, the extent of such an association is subject to notable inconsistencies (Bédard and Gendron 2010; Neville et al. 2018). Neville et al. (2018) find that only audit committee independence, a sub-construct of board independence, is significantly and negatively associated with poor financial reporting quality. Lai et al. (2017) reveal that very little research has been done on the impact of audit committee members on the appointment of high-quality auditors. Furthermore, existing research presumes the economic rationality of audit committee members and ignores the dynamics of governance decision making (Gendron and Bédard 2006). There has been a growing number of qualitative critics of audit committees whose arguments are underpinned by alternative theoretical frameworks and methodologies (Spira 2003; Gendron and Bédard 2006; Turley and Zaman 2007; Tremblay and Gendron 2011; Brennan and Kirwan 2015; Wu et al. 2018). Thus, our paper makes a contribution to the literature by adopting a qualitative methodology and using an institutional theory lens to investigate the perceptions of audit committees by institutional investors.

Do institutional investors value audit committees in their investee firms?

Institutional investors and audit committees are connected through their influence on financial reporting quality. Institutional investors are perceived as distanced, rational and risk adverse. Therefore, they would choose to invest in firms that are able to provide good quality financial information. Relatedly, audit committees bear the responsibility of appointing the external auditor. Generally speaking, institutional ownership is associated with the external audit function being performed by one of the big audit firms specialising in that industry (Ferguson and Stokes 2002). One would assume that institutional investors prefer strong audit committees in their investee firms. It is debatable whether institutional investors and audit committees, as two corporate governance devices, complement or substitute for each other. Adelopo et al. (2012) find that greater institutional ownership in United Kingdom (UK) firms correlates with an increase in audit committee activities, confirming the effects of active institutional investor monitoring. However, the effect of audit committee composition on auditor choice is complex with a range of firm-level and country-level corporate governance factors (Habib et al. 2019). For instance, Big N audit firms are not appointed for their superior quality of work but because of their connection to directors serving on the audit committees (Davison et al. 1984); independent audit committees may also be established to reduce the monitoring cost (Jiraporn et al. 2017). On the other hand, a substantial body of research posits that institutional investors trade based on private information, which indicates that some institutional investors may also benefit from opaque financial reporting (Maffett 2012). Mitra et al. (2007) reveal a significantly positive relationship between diffused institutional ownership and audit fees (an indicator of audit effort and quality), whereas a significant negative relationship exists between concentrated institutional ownership (greater than 5%) and audit fees. Kachelmeier et al. (2016) find that companies with ineffective audit committees tend to have greater institutional ownership relative to companies with fully effective audit committees.

To summarise, the relationship between institutional investors and audit committees is complex. However, research studies that specifically focus on the connections and interactions between the two governance mechanisms remain sparse. Our current study contributes to the academic discussion of these two governance mechanisms by providing qualitative evidence of how institutional investors perceive the role of audit committees in their investee firms.

Corporate Governance Regime in New Zealand

To date, research studies investigating the relationship between institutional ownership and audit committees are predominantly based on data from world-leading capital markets, for instance, in the UK or the United States (Mitra et al. 2007; Adelopo et al. 2012; Kachelmeier et al. 2016). The corporate governance regime in New Zealand has also attracted researchers to explore the determinants and implications of audit committees. Prior to any regulations or listing rules, the determination to voluntarily establish an audit committee lay with the boards of directors. Larger, more independent boards are more likely to form audit committees to conform to the expectations of 'best practice' corporate governance (Bradbury 1990; Rainsbury et al. 2008, 2009). Rainsbury (2004) found that audit committees were likely to comprise independent directors with financial expertise and experience with remuneration committees. The monitoring role of audit committees has an implication for firm audit fees. Drawing on a sample of New Zealand public sector entities who voluntarily formed audit committees from 1998 to 2000, Botica Redmayne et al. (2011) found that in for-profit public sector entities there is a positive association between audit committees and audit fees, whereas in public-benefit entities, audit committees are associated with lower audit fees.

We have chosen to explore perceptions of institutional investors in New Zealand about audit committees in their investee firms for several reasons. First, New Zealand business firms are small in size.[1] The NZX Main Board and the NZX Debt Market had 198 issuers as of 31 December 2018 (New Zealand's Exchange Limited 2018). The listed issuers in New Zealand, in particular large equity issuers, often have a concentrated rather than a diffused ownership structure (Fox et al. 2012). As a result, it is unlikely that the agency problem has pervasive implications in New Zealand. This offers us an opportunity to explore audit committees that may have been adopted for compliance or symbolic reasons (Bradbury 1990; Spira 2003) instead of performing a monitoring role to mitigate agency risk (Beasley et al. 2009).

Second, similar to the major corporate governance regulatory changes in the UK, the United States and Australia, the corporate governance regime in New Zealand has also experienced several changes since 2002 (Hay et al. 2017). A landmark for these changes was the establishment of the New Zealand Financial Markets Authority (FMA) which replaced the New Zealand Securities Commission on 1 May 2011. According to Maume and Walker (2013), the FMA has extended powers of investigation and enforcement compared with the former Securities Commission. The New Zealand corporate governance regime thus follows international trends yet it remains predominantly principles-based. The Corporate Governance in New Zealand: Principles and Guidelines (hereafter, NZ Principles) encompass eight areas of best practice in corporate governance, including the establishment and the composition of audit committees and the relationship with shareholders, which specifically includes the monitoring role of institutional shareholders.[2] The Financial Markets Authority (2018: 4) explicitly rejects the one-size-fits-all style of rules-based corporate governance and emphasises that the NZ Principles 'do not impose any new legal obligations, and reporting against them is voluntary'. Although listed companies in New Zealand must comply with the Companies Act 1993 and related legislation, such as the Financial Reporting Act 2013, at the firm level, corporate governance, including the composition and function of an audit committee, is largely determined by the board of directors rather than following stringent regulatory compliance requirements.

Third, although corporate governance reform regarding security issuers in New Zealand has been described as 'not fast' and 'lukewarm', there were calls for radical reform of the regulation of financial institutions after the global financial crisis in 2008 (Hay et al. 2017: 459). The 'rolling set of corporate failures' (Fox et al. 2012: 1) mainly involved non-listed financial institutions. The New Zealand Ministry of Economic Development (2010) announced a review of and proposed an overhaul of and amendments to a range of legislation on securities markets, which had remained largely unchanged for decades.[3] According to Maume and Walker (2013), these regulatory changes signal that New Zealand has moved from a predominantly private enforcement regime towards a more robust public enforcement regime. One would expect that these regulatory changes will also urge directors of institutional investors to be proactive in understanding and evaluating the corporate governance matters of companies they invest in.

To summarise, the corporate governance regime in New Zealand takes a largely voluntary and principles-based approach for security issuers but has an enhanced enforcement-driven approach towards financial institutions. These characteristics were the incentive for our study to explore how directors of financial institutions bear the increased liability and their perceptions of the audit committees in their investee firms.

Methodology

Firms facing similar corporate governance regimes and institutional pressures perform and respond differently (Tremblay and Gendron 2011). We join scholars using qualitative research designs, recognising that governance mechanisms are socially constructed through shared meanings and institutional logics that embody the everyday lives of those who perform governance roles (Powell and DiMaggio 1991; Ewick and Silbey 1998; Karataş-Özkan and Murphy 2010; Alvesson and Kärreman 2011).

Interview design

Face-to-face in-depth interviews were carried out to investigate how the audit committee mechanism was experienced by directors who were individually and collectively responsible for investment decisions. Following the conversational interview approach (Ewick and Silbey 1998), we developed an interview protocol that mainly comprised open-ended questions.[4] The interview protocol acted as a conversation agenda to steer the interviewees to talk about their interactions with and perceptions of audit committees in their investee firms. During the interviews, first, we encouraged the interviewees to provide examples and describe the events or typical approaches they adopted when they dealt, directly or indirectly, with audit committees in their investee firms. We also asked if they had been personally involved in any audit committees to further understand the development and interpretation of their experience. Then we explicitly addressed the issue of the compliance aspect of audit committees according to corporate governance principles and guidelines to provoke accounts that could be connected to the regulatory regime in New Zealand. In order to elicit information not already raised in existing literature, we requested the interviewees to openly discuss anything that they believed was relevant or important to the interview.

Sample selection

To recruit our interview participants, we identified the financial institutions by extracting information from the New Zealand Financial Service Providers Register, the Financial Markets Authority, and the financial services licensing body, namely the New Zealand Companies Office. To manage the scope of our study, we limited our sample selection to the licensed Superannuation and KiwiSaver schemes in New Zealand.[5] The individual directors' contact information was extracted from the Financial Service Providers Register and the New Zealand Companies Office. During March and April 2018, 138 invitations were mailed to directors identified in the sample selection process who have registered addresses in New Zealand. The invitation package included a cover letter, an information sheet, a copy of the interview protocol, a consent form to be signed to indicate acceptance of the interview invitation

Table 1 **Information about participants**

Interviewee	Type of financial institution	Chartered accountant	On an audit committee	Chair of an audit committee	Multiple directorships	Experience in Big N firms
A	Organisational superannuation scheme (Not-for-profit sector)	No	No	No	No	No
B	Investment Bank involving both Superannuation and KiwiSaver schemes	Yes	Yes	Yes	Yes	Yes
C	Financial Advisor and agent for both Superannuation and KiwiSaver schemes	Yes	Yes	Yes	Yes	Yes
D	Investment Bank involving both Superannuation and KiwiSaver schemes	Yes	Yes	Yes	Yes	Yes
E	Organisational superannuation scheme (Multinational firm)	Yes	No	No	Yes	Yes
F	Large Superannuation and KiwiSaver investment schemes (Public sector)	Yes	Yes	Yes	Yes	Yes
G	Organisational superannuation scheme (Not-for-profit)	No	No	No	Yes	No
H	Organisational superannuation scheme (Not-for-profit)	Yes	Yes	No	No	No
I	Organisational superannuation scheme (Multinational firm)	Yes	Yes	No	No	No

and a postage paid return envelope. Subsequently, 16 invitations were rejected as undeliverable. Ten signed consent forms were returned to the research team.[6] During May and August 2018, nine face-to-face interviews were carried out.[7] Information about the participants is summarised in Table 1.

The interviews ranged from 17 to 55 minutes. Each of the interviews was audio-recorded, transcribed word-for-word and edited by different members of the research team. To preserve the anonymity of the interviewees and their organisations, we assigned pseudonyms when editing the transcripts. Quotations from participants hereafter are assigned a letter from A to I. Interview transcripts were sent back to seven interviewees who had asked to review and confirm them.

We make no claim that these interviewees and their organisations comprise a representative sample of institutional investors. Rather, we hope that our findings discussed in the following section offer enough variations to induce some theoretical and empirical arguments concerning individual directors' perceptions of audit committees.

Data analysis

We adopted the discourse analysis approach (Fairclough 2003, 2005) to assist us in breaking down and categorising our interview data. Discourse, in the context of our current research, can be described as the ideology that underlies the text (i.e., the interview responses) and motivations (Locke 2004; Widdowson 2008). In our analyses, we pay attention to the contexts and situations presented in the interview data to identify the frame of reference underpinning the participants' points of view (Locke 2004). We first examined the interview data to identify a range of how the audit committee mechanism is utilised, disregarded or even rejected by the participants. These frames of reference signify the cultural and interpersonal routines (Widdowson 2008), as well as 'genres and style' embedded in interviewees' directorships (Fairclough 2005: 918). We followed the discourse analysis approach of Alvesson and Kärreman (2011: 1129) who focus on the 'historically developed systems of ideas that form institutionalised and authoritative ways of addressing a topic'. To explain the differences in the responses, we then mapped the data against the discourses and mind-sets of New Zealand corporate directors (Carroll et al. 2017) and the identities of audit committee members of New Zealand listed companies (Wu et al. 2018) to understand the ideology represented in the interviews. Carroll et al. (2017) investigated the 'paradoxes' (i.e., inconsistencies) in the directors' roles and labelled the mind-sets as 'discourses of conformance, of deliberation, of enterprise and of bounded innovation' (p. 606), but did not explain why directors have different mind-sets. Wu et al. (2018) reveal that there are at least two distinctive types of directors serving on audit committees in New Zealand listed firms: 'professional audit committee members' and 'conventional corporate directors'. The former group is disposed to conform to public expectations of audit committees, while the latter group demonstrates resistance to audit committee practices. The recognition of audit committee mechanisms cannot be taken for granted simply because of the regulatory imposition. Instead, it is subject to the constructivism and tensions of institutionalisation. In our current study, we further explore the acceptance (and the lack of acceptance) of audit committees as governance mechanisms by directors of institutional investor entities, one of the intended 'public audiences' of audit committees (Spira 2002: 69).

Findings and Discussions

We organise our analysis of the interview data into a number of distinctive themes representing the variations in interviewees' perceptions of audit committees. We also explain how we categorise our interview findings into discourses of audit committees as being symbolic indicators of good governance (Spira 2003), being utilised, being disregarded and being rejected. Then we further discuss how we interpret our interview findings as being influenced by other forces of the institutionalisation process, including the influence of public financial scandals and regulations relating to audit committees. Finally, we discuss the diversity of audit committees according to the directors' mind-sets (Carroll et al. 2017) and identities (Wu et al. 2018).

Perceptions of audit committees

To our surprise, none of our interviewees said that they had had any form of direct interaction with audit committees in their investee firms. The participants' knowledge of audit committees has been acquired by either serving on audit committees themselves, observing how audit committees behave in their own organisations or learning from governance-related publicity. Six of our participants have experience of serving on audit committees themselves as part of their directorship (see Table 1) in their own financial institutions.

Governance role of audit committees

Four interviewees (B, C, D and F) who are also chairs of audit committees provided clear and extensive accounts on how they actively rely on audit committees in the investee firms when they make investment-related decisions, but in quite different ways.

Interviewees B and D are directors of major investment banks in New Zealand, where they also serve on the audit committees. Both participants saw the audit committees as providing independent oversight on the management of financial reporting and auditing related matters. They also specifically discussed how the audit committee's role has been perceived as expanding to encompass the risk management function in investee firms. This contrasts with Jia and Bradbury's (2020) finding that it is a common practice in Australia to have a separate risk committee. However, separating the audit committee and the risk management committee has not been explicitly required in New Zealand. Interviewee B suggested that the sub-committee should be labelled to indicate their risk management functions explicitly:

> the purpose of an audit committee has started to morph … historically an audit committee was all about fundamentally just dealing with the financial statements in order to execute those financial statements that went into the market … [Now] it's about: 'Do you have an audit committee? And do you have a risk committee? Or are they now combined in some way?' In which case the mandate of that is fundamentally different.

Interviewee D from a different financial institution echoed this view, saying: 'If you just say "an audit committee", it handles a relationship with an auditor. … But risk and compliance are really important, right? So if you're in the banking world, risk and compliance is big! It can bring a company down!'

These interview quotes show that, driven by the increased regulations in the financial industry as discussed in section three (Corporate Governance Regime in New Zealand), directors of financial institutions have not only increased their awareness of compliance related risks, but also actively utilised audit committees or equivalent mechanisms to demonstrate their management of compliance risks.

Interviewee F is a director of a large public sector financial institution. He also revealed that the role of audit committees has expanded beyond overseeing financial reporting and auditing to include assurance on the firms' disclosure of non-financial information: 'And what's becoming more important is the audit, or assurance, or oversight of non-financial information. Because the non-financial information, I'd say, is not much more, but just as important, in terms of getting the message across as to how well an entity has done' (Interviewee F).

Given the large size and the complexity embedded in their institutions, the above interviewees (B, D and F) mobilised their own experience of serving on audit committees to constitute the expectation of how audit committees in general should function and develop over time.

Interviewee C also demonstrated a strong positive attitude towards audit committee mechanisms as presenting the professionalism of the board of directors in the investee firms. However, Interviewee C, at the time of the interview, worked with smaller but more diverse clients in terms of providing investment consultations and financial mediating services. He suggested that it was important to consider the governance function of audit committees when evaluating an equity acquisition or a lending opportunity: 'those organisations … where they had an audit committee, that was the best outcome, because you knew that their whole governance structure was very well organised. So, they'd thought about why they needed an audit committee' (Interviewee C). However, he perceived this mechanism from the perspective of financial advisor and investment broker. He said:

> their business is often their largest investment, [and] their largest asset. The [owners] with businesses will all want to sell their business or succession it on to the next group and take some value out of it for retirement. So the best, or the premium in terms of value, particularly for an external purchaser, is where there has been a strong audit committee, audit function, and process. That gives a premium. (Interviewee C)

Further to interview participants B, D and F, who focused on the accountability and risk management function of audit committees, Interviewee C clarified that the existence of an audit committee provided a value premium. The above four interviewees have mobilised their own experience of being audit committee members, chairing audit committees and assisting other companies to organise audit committee related matters. Furthermore, the importance of an audit committee was emphasised because it 'represents' (Interviewee C) good governance. We further probed how they rate the audit committees of their investee firms against their expectations. They consistently referred to the themes of whether an audit committee has 'the right people' and 'the right structure'.

Interviewee D asserted that the people who were involved in the governance bodies of investee firms were critical for him when making the investment decision. He repeatedly used the term 'backing' to indicate the level of reliance he put in people: 'you are investing in people, not in companies … You back a chair, a board to govern too. Are they good people? Do they know what they're doing? Are they proven? You're risking your money. It's not only your money, it's the clients' money, and you're institutional investors. You're backing them to deliver! It is serious stuff. Because you're making a judgement call on it' (Interviewee D).

Interviewee D further identified that the right people should have credible 'track records' and work as a strong team. He also emphasised how the governance bodies should share the equivalent risk as an investor: 'If I was investing in you, you'd have a profile of being successful, keeping out of trouble, you'd be proved pro forma, I'd be investing in you. … Are you really aligned with me? I'm putting my money in as an equity shareholder … Are you just getting a salary, or have you got some money at risk?' (Interviewee D).

Interviewee B also said that the membership of the board and sub-committees have a significant impact on his investment decisions. He emphasised the expertise and diversity of the overall board membership and sub-committee structures instead of individual directors' leadership or expertise: 'I'm looking at its overall governance structure, which includes from the very top, the quality and diversity of the board … when you [the director] test management: are you asking all of the right technical questions? You also have insight as to whether or not they are fluffing the answer to you. … do I think that structure is appropriate?' (Interviewee B).

This interview quote again raises the theme of the emerging role of risk management alongside the audit committee's other oversight function. However, Interviewee F suggested otherwise. Although he emphasised how his own expertise in governance and in the public sector had contributed to the audit committees he served on, he did not support that the existence and composition of the audit committee by itself would have any significant implications for investment decisions. He said:

> You would go through a due diligence. Ah, yes, you would think that that [the audit committee] would be part of It …. But I don't think whether they had an audit committee would be a strong determinant of the decision as to whether to go on or not. Because … the existence of the audit committee in the investee entity would be fairly remote … You don't interact [with it]. (Interviewee F)

Without further prompting, interviewees also gave their opinions on the implications of not having the 'right people' by referring to an underperforming listed firm, Fletcher Building, which was prominent in the media at the time of the interviews.[8] Interviewee D offered the following criticism: 'Fletcher Products is a materials business, right? … and they've put construction people now as a leader, but it's a materials business! … I wouldn't invest in Fletcher's until they get a materials person as CEO, and have materials people that are on the board.'

The publicity over Fletcher Building drew the attention of a number of our interviewees. We will further discuss the implications of publicity about corporate scandals and financial difficulties later (Financial scandals and increased compliance requirements).

So far, we have presented evidence of how some participants in our study drew on their own experience of serving on audit committees to constitute the evolving role of these committees, and how audit committees indicate the quality of governance in the context of making investment decisions. We emphasise that the audit committee mechanism may be perceived as a symbol of corporate governance (Spira 2003) because none of our interview participants reported any actual interactions with these committees in their investee firms.

Disregarding audit committees in investee firms

At the time of the interview, Interviewees A, G and H served on boards of a related group of not-for-profit organisations with responsibilities for a private superannuation scheme. Under the increased regulation requirements on statutory reporting of the superannuation scheme, the group of this not-for-profit organisation had to appoint independent directors who are specialists in financial reporting. Also, the group reviewed their relationship with an investment agent and established a formal internal audit function.

Interviewee A had been the chairperson of the group for decades. However, he was not aware that the superannuation investee firms had audit committees and had not considered this factor until being questioned during the interview. He said: 'I'm not aware that we've ever actually had a conversation in the board about companies that we have been invested in, about their audit processes, or audit committees … we haven't actually talked about it … we're not … necessarily aware that they're publishing any material or anything of that nature' (Interviewee A). Interviewee A was unfamiliar with the term 'audit committees', and except for directly answering what was prompted by the interviewer, he never voluntarily used the term during the interview.

Interviewee G stated that he served on several boards of non-profit organisations in New Zealand. However, his accounts of interacting with audit committees were also vague: 'I had asked the board to set up an internal audit committee simply to monitor things between meetings, so there was a basis of information for the board of trustees that I was accountable to … I found in a lay-board … there wasn't a huge amount of expertise' (Interviewee G). During the entire interview, Interviewee G only used the term 'audit committees' twice, including explaining why he believed an audit committee was needed by not-for-profit organisations. However, at the time of the interview none of the organisations he was involved in, according to him, had established one.

Interviewee H, a chartered accountant, claimed that the central control unit of the not-for-profit organisation had established an equivalent committee. He said: 'not from the investment decision side … [Our group] have a committee called the "Financial Review Committee". So, on an annual basis, every entity is required to send [the committee] a set of their financial statements … and this year what we're going to ask them to do also is to send that committee a copy of their management letter' (Interviewee H). Interviewee H explained that the purpose of reviewing the group-members' management letters was for the Financial Review Committee to rank and prioritise the internal control issues identified by the auditor and form a plan to resolve these issues.

The above interview quotes suggest that this group of not-for-profit organisations completely disregard the audit committee mechanism and how it is related to their investment decisions. Interviewees A and G seemed to have difficulty in clearly articulating what the role of an audit committee should be, except for acknowledging the importance to the board of an internal assurance or auditing function.

Interviewees A, G and H revealed significant insights about institutional investors, which have been rarely discussed in the existing literature. First, institutional investors include not-for-profit organisations whose objectives, operations and compliance circumstances are quite different from for-profit commercial organisations. In not-for-profit organisations, significant internal control and governance roles may still depend on volunteers on the basis of goodwill and trust rather than a principal–agent relationship. This may fundamentally affect the acceptance of audit committee mechanisms in these firms. Interviewee G provided further evidence: 'Nobody in the [group] gets paid for a directorship. So, they're all voluntary people giving their time [and] expertise … The board is not elected. It's a tapping on shoulders kind-of-thing and generally … we try and target all the various leaders of the group … to reflect the range of experience and interests of board members.'

Second, not-for-profit organisations are likely to contract out the management of their investment schemes to external agencies as a result of the lack of expertise and formal governance structures, as identified in the above interviews. Having the superannuation fund administered by an external party does not immunise against financial losses: 'Going back to 2007 and 2008 … you know, the financial markets crash … we did have one investment that did go badly. It was the broking company that had actually sold us that investment. It was … supposedly triple-A rated' (Interviewee A). This echoed the regulator's concern about the global financial crisis in 2008 (see section three, Corporate Governance Regime in New Zealand). The increased regulation requirements about financial institutions have driven financial institutions to strengthen their governance mechanisms, such as establishing a financial review committee. However, intervention by means of regulation may not lead to substantial improvements in governance practices. Our research uncovers evidence that some directors do not understand audit committees, and therefore cannot intuitively relate audit committees to the overall directorship of their own firms and the investment decisions they make.

Nonetheless, Interviewee I provided a surprising account of how an audit committee was disregarded in making investment related decisions. At the time of the interview, Interviewee I, a chartered accountant (CA), served on the board of the superannuation scheme of her organisation, which was a branch of an international manufacturing enterprise. When she was asked about her knowledge of or interactions with the audit committee of her investee firms, she replied: 'I'd say, little. … I don't have any relationship with them. They just send us the annual mandatory information, and that's all. We probably rely more on the Standard and Poor's rating [to evaluate our investment]' (Interviewee I). She further explained that her firm was a relatively small branch of the worldwide sales function of a multinational enterprise. The superannuation scheme, where she served on the board of directors, was also a small component of a global employee benefit plan centrally controlled by head office. Because the governance structure was so dispersed and not many critical financial investment decisions were made locally, her directorship and involvement in the superannuation scheme were limited to the monitoring and reporting of the internal controls within the local operation:

> I'm a CA, and I have to say that my knowledge of audit committees is really quite limited to what I learnt at university. I then came to this organisation and joined the audit committee … [which has] a representation from every single department, but in terms of what the best practice would be for an audit committee, I would say that we wouldn't have a lot of awareness of what that was. (Interviewee I)

The interview data presented so far have revealed, in our view, two extremes of institutionalisation of audit committee mechanisms. The discourses of utilising audit committees in investee firms represent the forefront of the institutionalisation process, where audit committee mechanisms are well established, recognised and mobilised by corporate directors. These directors also consciously espouse the further development of audit committee or equivalent mechanisms in adapting to the operational and compliance environment of their directorship. The discourses of disregarding the audit committees in investee firms show that this governance mechanism has not yet been understood and accepted. The organisational setting, as well as the lack of related expertise and the agency problem being remote, may have slowed down the institutionalisation of audit committees being perceived as a governance mechanism. Despite whether directors are directly involved in audit committees or not, it cannot be assumed that institutional investors overall understand the role of audit committees, let alone valuing this mechanism in investee firms. We continue to discuss interview findings where the audit committees were explicitly criticised and rejected.

Rejecting the audit committee mechanism

Interviewee E served on the board of an industrial superannuation scheme owned and administered by a multinational energy sector enterprise. Interviewee E has a background in chartered accountancy, and he had served the same company and other companies as chief financial officer and director of the superannuation scheme. He stated bluntly that whether or not the investee firm had an audit committee would have 'zero value' for him with regard to making investment decisions. He said:

> There are many organisations that have an audit committee … that they say is independent. So, in that case, should we have a separate investment committee? Should we have a separate recruitment committee? Should we have a separate … communications committee? Where do you draw the line? And what is so special [about these committees]?! To me, personally, I would not be interested in an audit committee's opinion, or the existence of an audit committee, to determine whether I make an investment decision or not. (Interviewee E)

This strong negative opinion towards audit committees was not based on Interviewee E's direct interactions or involvement with audit committees. Interviewee E also had an unfavourable impression of the mechanism of involving independent directors in the governance structure. He continued:

> the audit committees have not necessarily been an exact sub-committee of the board of directors. They've got external people also in. I completely disagree with that! Because the board is the one that is providing governance. … It doesn't need to have necessarily experience in being an auditor to be able to receive information … And you start bringing in external people! It's like saying 'we don't trust what's going on'! Right? (Interviewee E)

Although Interviewee E suggested that it was important for the board as an entirety to have directors with diverse expertise, he believed that having a dedicated audit committee undermined the authority of executives and did not provide any more governance value than a corporate board should have anyway. Therefore, he called the audit committee 'a bit of a waste of time'.

Interviewee E did not provide any specific incident or event where audit committees had or had not performed a positive role in governance since he had no direct experience with these committees. He did, however, refer to the regulatory changes discussed in section three (Corporate Governance Regime in New Zealand), his experience overseas and the significant corporate scandals in recent years to justify his views. Tremblay and Gendron (2011) point out that governance prescriptions aiming to strengthen audit committees have instead resulted in resistance and superficial conformance. Tremblay and Gendron (2011) find that regulation and prescription is irrelevant to improving firms' governance practice according to their interviewees. Our current research provides further evidence of this resistance to the institutionalisation of audit committees.

Main findings

The above findings illustrate significant variations in the perceptions of directors of institutional investor entities in New Zealand about audit committees in investee firms. The various discourses show the different stages of institutionalisation of the audit committee mechanism as a regulation-driven practice. To a certain extent, such variations can be explained by whether the director's organisation has severe and immediate agency problems. That is, other institutional forces may have also contributed to shaping our participants' perceptions about audit committees, specifically the publicity about financial scandals and the increased compliance requirements.

Financial scandals and increased compliance requirements

Although participants acknowledged they had no direct interactions with the audit committees in their investee firms, five interviewees (B, D, F, G and H), without prompting, identified well-publicised financial scandals and corporate failures as showing how audit committees should not perform. Interviewee B drew on the report by the Australian Prudential Regulation Authority (APRA) on the Commonwealth Bank scandal to highlight the risk management function of audit committees: 'One of the findings from that APRA report was effectively the disconnection that was seen between the audit committee and the risk committee, because there were different memberships of both of those committees, and they didn't share information … which caused a whole bunch of issues that would go from there.'

Interviewees D, F, G and H discussed the publicity about Fletcher Building, which was topical at the time of the interviews. As shown above under section five (Perceptions of audit committees) (1), Interviewee D used Fletcher Building as a case of not having suitable members on the board of directors. Interviewee H also pointed out that board members need to suit the particular business rather than simply demonstrate a quality required by regulation: 'Fletcher Challenge is a building company. How many directors on the board have actually got practical experience? Banging nails into buildings? If they're all professional directors, … how do they then get their head around the practical issues?'

Second, the publicity about Fletcher Building demonstrates that compliance with regulation *per se* cannot prevent corporate failures. Interviewee G said: 'I think regulations sometimes give people a false sense of security. But if … the processes of arriving at those compliances is flawed, then you're still not going to be able to obviate, are you? … Fletchers obviously are having huge problems with that.'

Third, Interviewee F attributed the downturn of Fletcher Building to overlooking the non-financial information:

> the financial statements … [are] getting too detailed. And too copious, in terms of the number of pages for an annual report and template-based [presentation] … The question is, who actually reads them?! … some of the non-financial information … is actually more valuable. And it's taken as read that the financial information will be the subject of audit … [but] it doesn't reduce the risk, because we've just had Fletcher Building … obviously it's a well-documented case.

How our participants relate this incident to their perception about the interview topic, audit committees and corporate governance in general, constitutes a way of valuing what is not 'normal' or not 'good' in relation to certain 'kinds' of directors (Gee 2012: 165).

Publicity on scandals and the causes of failure have led to increased regulations and governance reforms. However, directors and audit committee members are not passive conformers with regulations (Brennan and Kirwan 2015). Wu et al. (2018) reveal that there are two types of audit committee members, namely 'professional audit committee members' and 'conventional corporate directors'. This current study shows that professional audit committee members (represented by our interviewees B, C, D and F) may perform an active role in the institutionalisation of the audit committee mechanism by mobilising and developing this mechanism alongside their professional directorships in financial institutions. According to Wu et al. (2018), conventional corporate directors are often ignored in the literature as they are not aligned with the discourses of corporate governance regulations or guidelines as desirable members of the board or audit committees to discharge the oversight function. Our interview data show that the conventional corporate directors (represented by Interviewees A, E, G, H and I) are not committed to the discourse about audit committees. Instead, these directors perform their governance responsibilities by committing to the particular firm or particular industries rather than the membership of audit committees.

Directors' mind-sets

Some interviewees indicate a lack of understanding or a clear resistance to the audit committee mechanism even though their organisations are multinational firms and facing more complex operating and compliance issues. We draw on discourse analysis to explain our findings. The paradoxes (i.e., inconsistencies) about the directorship role are rooted in the conformance and performance aspects of governance and will remain unresolved. Our interview data analyses echo those of Carroll et al. (2017). Regardless of the variances in perceptions and acceptance of the audit committee's role, our interviewees demonstrated mind-sets of 'conformance' and 'deliberation' similar to those identified in Carroll et al. (2017).

Except for Interviewees E and I, participants emphasised the independent status of audit committees with respect to the entire board. In other words, they noted that it is important to have the audit committee and board of directors chaired by different people. This discourse of conformance is recognised by Carroll et al. (2017: 611) as 'border control'. Some examples are as follows. First, having a separate audit committee chair from the chair of the board ensures the audit committee chair can dedicate time and effort to committee related issues: '[The separate chairs] are bringing a different lens into the chairing of that meeting … you are devoting specific time to that subject. Whereas if you pulled it into the main board meeting, it could be … reduced because you're talking about something else' (Interviewee B).

Second, an audit committee that is chaired by an independent director is well positioned to mediate the auditor and management relationship: 'Ideally, you would want the chair of the audit committee to be independent … [He or she] is going to have a far more diligent oversight. The audit committee is almost like a mediation, trying to make sure that their information flows through from both sides' (Interviewee C).

Third, a full-time or professional independent audit committee chair often serves on various boards so that he or she can bring the experience and expertise required by the board: 'So, we're really dependent on advice …, you'll know a lot of questions to ask that other people might not even think about. I think there are risks when you don't have experienced full-time directors [serving on the audit committee]' (Interviewee G).

In addition to the discourses of conformance, we find 'discourses of deliberation' (Carroll et al. 2017: 613) not only through the actual interview accounts but also in the way our interviewees speak. Interviewee D believes that well-balanced audit committees provide a '*diversity of mind*' and the forum for exchanging different views and exposing the board to different perspectives. Interviewee H identified that an audit committee is needed for his organisation for the 'professional development' of his directorship. He said: 'it's about professional development too. I know that other people are better than me, and I'm happy to take their experiences, learn from it, and move on. If I don't think it's right, I will argue my point' (Interviewee H).

In addition to the accounts of deliberation above, we invite readers to re-read the interview quotes above provided by interviewees B, D and E. These interviewees often responded to the interviewer by posing rhetorical-type questions they would ask of executives, fellow directors or even themselves. They often ask a series of probing questions, starting with a clear 'yes or no' query, followed by questions about reasoning and justifications. This may indicate that directors are of an investigative mind-set (Carroll et al. 2017) when performing their directorship in relation to audit committee related matters.

The mind-sets of Carroll et al. (2017) partly explain why directors of institutional investors perceive the audit committee mechanism differently. The common discourses of conformance and deliberation do not surprise us because of the nature of our research topic. After all, audit committees are viewed as performing an oversight function for the board on audit and financial reporting related matters rather than on the firms' performance. However, we question whether the conformance discourses of directors are driven by what they perceive as the right thing to do, or merely what is required by regulatory requirements.

Concluding Remarks

In this paper, we have discussed how directors of New Zealand institutional investor entities perceive the role of audit committees in their investee firms. We analysed the discourses of a sample of directors of New Zealand financial institutions who discussed their experiences and interactions with audit committees. We showed that these two governance mechanisms, boards of directors of institutional investors and audit committees, do interact through the institutionalisation of audit committees within these financial institutions. Publicity on financial scandals, an increase in regulation, and professional audit committee members all play an active role in the process of institutionalisation of audit committees as a governance mechanism. However, not all directors of financial institutions are committed to promoting audit committees as an essential governance component of the board of directors. The establishment and function of audit committees have not been consistently accepted and utilised by institutional investors, who range from being able to critically utilise and evaluate the function of audit committees to being substantially lacking in knowledge of audit committees and why they are relevant to institutional investors.

Regulators and other corporate governance stakeholders may benefit from this paper by reflecting on the institutionalisation of audit committees as a governance practice. Audit committees appeared to play a significant role in the recommendations of the Cadbury Committee (1992) for corporate governance improvement and the prescriptions in the Sarbanes Oxley Act (US Congress 2002). Our paper presents evidence from New Zealand, where the adoption of audit committees has been largely driven by regulatory changes overseas. The current study serves as a timely evaluation on the efforts of promoting audit committees by scholars and regulators since the Cadbury Committee (1992). Thus, our findings may be of interest to regulators, researchers and practitioners to make informed comparisons with observations from other countries in examining the evolution of audit committees and evaluating the implications of corporate governance regulatory changes.

Notes

1 According to Statistics New Zealand (2018), 97% of New Zealand business entities have less than 20 employees; 70% have no paid employees.

2 The NZ Principles for corporate governance encompass: (1) ethical standards; (2) board composition and performance; (3) board committees; (4) reporting and disclosure; (5) remuneration; (6) risk management; (7) auditors; and (8) shareholder relations and stakeholder interests (FMA, 2018).

3 The Financial Markets Conduct Act (FMCA) 2013 has since replaced both the Securities Act 1978 (Securities Act) and the Securities Markets Act 1988. The FMCA 2013 has established licensing regimes for market intermediaries; further empowered the FMA to exercise enforcements forcefully, proactively and responsively; and shifted the focus on directors' liability away from the company and towards the acting individual directors.

4 The interview protocol and the invitation package were assessed and approved by the Human Ethics Committee of the authors' affiliated university.

5 Introduced in 2007, 'KiwiSaver' is a voluntary retirement savings scheme, which includes employee and employer contributions.

6 The research team comprises two of the authors and their research assistant.

7 One potential interviewee did not tick the box on the consent form to accept the interview invitation, but signed and returned the consent form. He also did not reply to any of the follow-up emails to schedule the interview. We decided not to proceed further after three follow-up emails.

8 Fletcher Building, a listed firm in New Zealand, confirmed on 22 August 2018 a net loss of $190 million for the 12 months ending 30 June 2018 in comparison to a profit of $94 million in the previous year. The company's financial issues had emerged earlier in the year which led to the resignation of Fletcher Building's chairman, Sir Ralph Norris, in February 2018. Sir Ralph also held directorships and executive positions in various listed firms and major banks in Australasia. Other directors and executives of Fletcher Building also faced public scrutiny (Smellie 2018).

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