The Relation Between Audit Committee Effectiveness and Financial Reporting Quality in Listed Companies

by

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RELATION BETWEEN AUDIT COMMITTEE EFFECTIVENESS AND FINANCIAL REPORTING QUALITY IN LISTED COMPANIES

I declare that the above dissertation is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

I further declare that I submitted the dissertation to originality checking software and that it falls within the accepted requirements for originality.

I further declare that I have not previously submitted this work, or part of it, for examination at Unisa for another qualification or at any other higher education institution.

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SIGNATURE DATE

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'I can do all things through Christ who strengthens me.' - Philippians 4:13 (NKJV)

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ABSTRACT

Corporate governance failures and poor financial reporting quality often follow when an audit committee is ineffective. This study investigated the relation between audit committee effectiveness (independent variables) and the absence of restatements as a proxy for financial reporting quality (dependent variable). Variables were analysed from public reports of 40 South African listed companies. In Phase 1, descriptive statistics revealed that 23 out of 51 audit committee effectiveness variables had sufficient variability. In Phase 2, categorical principal component analysis subsumed the 23 variables into six factor variables and their hypotheses. In Phase 3, binomial logistic regression testing identified one factor variable significantly reduced restatements. The subsumed variables are (1) the audit committee consists of four or more members, (2) the audit committee engages external auditors to provide assurance on summarised financial information, (3) the audit committee reviews the content of summarised information and (4) three or more audit committee meetings are held annually.

Keywords: audit committee effectiveness; binomial logistic regression; categorical principal component analysis; corporate governance; financial reporting quality; King Report; listed companies; private sector; restatements; South Africa

OPSOMMING

’n Ouditkomitee wat ondoeltreffend is, lei dikwels tot mislukte korporatiewe beheer en swak finansiële verslagdoeningsgehalte. Hierdie studie het die verband tussen ouditkomitee-doeltreffendheid (onafhanklike veranderlikes) en die afwesigheid van herstaterings as 'n volmag vir finansiële verslagdoeningsgehalte (afhanklike veranderlike) ondersoek. Veranderlikes is ontleed uit publieke verslae van 40 Suid-Afrikaans genoteerde maatskappye. In Fase 1 het beskrywende statistiek onthul dat 23 uit die 51 ouditkomitee-doeltreffendheidsveranderlikes voldoende veranderlikheid getoon het. In Fase 2 het die kategoriese hoofkomponent-ontleding die 23 veranderlikes in ses faktorveranderlikes en hulle hipoteses saamgevat. In Fase 3 het binomiale logistiese regressie-toetsing een faktorveranderlike geïdentifiseer wat herstaterings aansienlik verminder het. Die saamgestelde veranderlikes is dat (1) die ouditkomitee uit vier of meer lede bestaan, (2) die ouditkomitee eksterne ouditeure aanstel om gerusstelling te gee oor verkorte finansiële inligting, (3) die ouditkomitee die inhoud van verkorte inligting nagaan, en (4) drie of meer ouditkomiteevergaderings jaarliks gehou word.

Sleutelwoorde: ouditkomitee-doeltreffendheid; binomiale logistiese regressie; kategoriese hoofkomponent-ontleding; korporatiewe beheer; finansiële verslagdoeningsgehalte; King-verslag; genoteerde maatskappye; private sektor; herstaterings; Suid-Afrika

KAKARETSO

Ho hloleha ha tsamaiso ya dikgwebo le boleng bo seng hantle ba tlaleho ya ditjhelete hangata ho latela ha komiti ya tlhahlobo ya ditjhelete e sa sebetse hantle. Phuputso ena e batlisisitse kamano dipakeng tsa katleho ya komiti ya tlhahlobo ya ditjhelete (diphetoho tse ikemetseng) le ho ba siyo ha ditlhahlobo e le kemedi ya boleng ba tlaleho ya ditjhelete (diphetoho tse sa ikemelang). Diphetoho di ile tsa sekasekwa ho tswa ditlalehong tsa setjhaba tsa dikhamphani tse 40 tsa setjhabe tsa Afrika Borwa. Mokgahlelong wa 1, dipalo-palo tse hlalosang di senotse hore dikomiti tse 23 ho tse 51 tse sebetsang hantle di na le phapang e lekaneng. Mokgahlelong wa 2, tlhahlobo ya dikarolo tse ka sehloohong e kentse mefuta e 23 ka mefuta e tsheletseng ya diphapang le dikgopolo-taba tsa tsona. Mokgahlelong wa 3, tlhahlobo ya ho kgutlisa diphapang tse pedi e bontshitse phapang ya ntlha e le nngwe e fokotsehileng haholo. Diphetoho tse akaretsang ke (1) komiti ya tlhahlobo ya ditjhelete e na le ditho tse nne kapa ho feta, (2) komiti ya tlhahlobo ya ditjhelete e kopanya bahlahlobi ba ditjhelete ba kantle ho fana ka netefatso mabapi le ditaba tse akaretsang tsa ditjhelete, (3) komiti ya tlhahlobo ya ditjhelete e lekola botjha dikateng tsa tlhahisoleseding e akareditsweng le, (4) dikopano tse tharo kapa ho feta tsa komiti ya tlhahlobo ya ditjhelete di tshwarwa selemo le selemo.

Mantswe a ka sehloohong: katleho ya komiti ya tlhahlobo ya dibuka; phokotso ya dintho ya baenomiale; manollo ya karolo e ka sehloohong ya tlhophiso; tsamaiso ya dikgwebo; boleng ba tlaleho ya ditjhelete; Tlaleho ya Morena; dikhamphani tsa setjhaba; lekala la poraefete; ditlhaloso; Afrika Borwa

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LIST OF ABBREVIATIONS

AC	Audit committee
BRC	Blue Ribbon Committee
CATPCA	Categorical principal component analysis
FASB	Financial Accounting Standards Board
FRC	United Kingdom Financial Reporting Council Code
IAS	International Financial Accounting Standard
IASB	International Accounting Standards Board
IoDSA	Institute of Directors in Southern Africa
JSE	Johannesburg Stock Exchange
King I	King Report on Corporate Governance, 1994
King II	King Report on Corporate Governance in South Africa, 2002
King III	King Code of and Report on Governance for South Africa, 2009
King IV™	King IV™ Report on Corporate Governance for South Africa, 2016
King Code	King Code on Corporate Governance for South Africa
RSA	Republic of South Africa
SOX Act	Sarbanes–Oxley Act
SPSS	Statistical Package for the Social Sciences
Steinhoff	Steinhoff International Holdings N.V.
UK Code	UK Corporate Governance Code

UK	United Kingdom
US	United States
VBS	VBS Mutual Bank

CHAPTER 1: INTRODUCTION

1.1 STUDY OVERVIEW

This study investigates the relation between audit committee effectiveness and financial reporting quality in Johannesburg Stock Exchange (JSE) listed companies. Audit committee effectiveness variables were sourced from the King III Code of Governance for South Africa and the King III Report on Governance for South Africa (King III) (Institute of Directors in Southern Africa [IoDSA] 2009a:31-35; IoDSA 2009b:56-68). Financial reporting quality was proxied by restatements. Data analysed comprised audit committee and restatement disclosures in the 2015/16 annual and other reports on websites of the 40 sampled JSE-listed companies. At that time, King III applied, with the King IV™ Report on Corporate Governance for South Africa (King IV™) only becoming effective for financial periods commencing on or after 1 April 2017 (IoDSA 2016:38). Section 2.4 includes details on how the audit committee effectiveness variables changed from King III to King IV™.

Overall, the study finds that public disclosure of a higher number of variables was generally associated with the absence of restatements (higher financial reporting quality), significantly so for a higher number of disclosures regarding audit committee structure and responsibility variables, namely:

- The audit committee consists of four or more members.
- The audit committee holds three or more meetings annually.
- The audit committee engages external auditors to provide assurance on summarised financial information.
- The audit committee reviews the content of summarised information.

1.2 BACKGROUND

'An ounce of prevention is worth a pound of cure.'

Benjamin Franklin (his famous advice to fire-threatened Philadelphians in 1736)

This section brings the relation between audit committee effectiveness and financial reporting quality to the fore. First, current governance and statutory pronouncements (pronouncements) and academic research findings associated with the concept of audit committee effectiveness are considered including in both international and South African settings. Then, the consequences of audit committee failures, particularly for financial reporting quality, are addressed through a review of the spate of corporate governance failures occurring despite the presence of audit committees in international and South African listed companies over the last two decades. Last, restatements as a proxy for financial reporting quality is motivated.

1.2.1 Defining audit committee effectiveness

Globally, effective audit committees as a component of corporate governance holds great interest for researchers seeking more knowledge about audit committees' oversight role over the integrity and transparency of financial reporting, internal financial control, and the monitoring of financial risks (Hasan, Aly & Hussainey 2022:1311; Habib & Bhuiyan 2016:123; Zgarni, Hlioui & Zehri 2016:140–141; IoDSA 2009b:66; BRC 1999:1077). Audit committees oversee assurance of objective disclosure, to allow users of financial reporting an accurate assessment of top management's decisions and performance (Buallay & Al-Ajmi 2019:252; Allegrini & Greco 2013:195). Although a universal definition of audit committee effectiveness is not endorsed, various proposals in the literature offer similar definitions of audit committee effectiveness. Kalbers and Fogarty (1993:27) define audit committee effectiveness as '*the competency with which the audit committee carries out its specified oversight responsibilities',* which focuses on how audit committee members perform their oversight duties.

In more detail, DeZoort, Hermanson, Archambeault and Reed (2002:41) define an effective audit committee as one that has '*qualified members with the authority and*

resources to protect stakeholder interests by ensuring reliable financial reporting, *internal controls*, *and risk management through its diligent oversight efforts*'. This definition refers to knowledgeable and experienced (qualified) audit committee members and elaborates on the oversight responsibilities of effective audit committees (reliable financial reporting, internal controls and risk management). Another definition by Contessotto and Moroney (2014:395) states that an audit committee is effective when '*it is independent of management*, *ensures financial reporting integrity*, *appoints independent external auditors*, *monitors the audit process and oversees the risk management process*'. The third definition not only stipulates the responsibilities of effective audit committees but also specifies that they should function independently of management and appoint independent external auditors. The audit committee effectiveness variables used in this study contain all the concepts from these definitions.

1.2.2 Relation between audit committee effectiveness and financial reporting quality

Several studies have concluded that effective audit committees through their financial oversight responsibilities are associated with financial reporting quality (Safari Gerayli, Rezaei Pitenoei & Abdollahi 2021:252; Al-Shaer, Salama & Toms 2017:2; Kibiya, Che-Ahmad & Amran 2016:126; Pomeroy & Thornton 2008:305). Considering that financial reporting quality broadly rests on the monitoring of the financial reporting process, internal controls and risk management as well as the external audit function (Ashraf, Michas & Russomanno 2020:25; Bajra & Čadež 2018:152; Kusnadi, Leong, Suwardy & Wang 2016:199), Bajra & Čadež (2018:151) asserts that financial reporting quality aims to present reliable information on the financial position and performance of organisations to enable stakeholders to make informed economic decisions.

1.2.3 Audit committees – international developments

Internationally, audit committees were the focus of corporate accountability governance and statutory reform and academic research over the last three decades. Such focus arose following several corporate failures (Cole, Johan & Schweizer 2021:2; Ghafran & O'Sullivan 2017:578–579; Agrawal & Cooper 2015:169). In the United Kingdom (UK),

audit committees of listed companies have become a benchmark of corporate governance since the publication in 1992 of the first UK Corporate Governance Code (UK Code) by the Cadbury Committee (Spira 2003:180; Cadbury 1992:26). According to the 2024 UK Code, effective audit committees are directly related to financial reporting quality through their monitoring of financial statements integrity, advice to the board on the fairness of the annual report, disclosures of company position and performance to shareholders, reviewing company's risk management and internal financial controls, and assessing the effectiveness of the internal audit and external audit functions (FRC 2024a:12-13).

Similarly, in the United States (US) effective audit committees are linked to financial reporting quality. The Blue Ribbon Committee Report (BRC 1999:1070) recognises audit committees as part of a larger corporate governance process, with a focus on financial reporting oversight. As part of the audit committee's role of oversight and monitoring of financial reporting, reliance is placed on management (which includes the internal auditors) (BRC 1999:1071). The BRC highlights that a proper and well-functioning system of corporate governance exists when the audit committee, management (including internal auditors) and external auditors, *'form a three-legged stool that supports responsible financial disclosure and active and participatory oversight'* (BRC 1999:1071). The BRC asserts that the audit committee should be *'first among equals'* in the corporate governance process as it is an extension of the board and for this reason the ultimate overseer of the process (BRC 1999:1071). Also in the US, in 2002, the Sarbanes–Oxley Act (SOX Act) states that audit committees need to be established by the board of directors (board), to enhance financial reporting quality through their oversight of the financial reporting processes and auditing practices (Ghafran & O'Sullivan 2017:578; SOX 2002: Section 205).

Academic research also emphasises the governance role of an effective audit committee as a sub-committee which assists the board with the monitoring of financial reporting quality, including audit, and internal financial control oversight (Oussii & Boulila Taktak 2018:37–38; Spira 1998:30; 1999:263; 2003:182). Several authors concluded that an effective audit committee is considered a board mechanism that enhances accountability

around the financial reporting and accounting functions, hence financial reporting quality (Sulaiman 2017:353; Brennan & Solomon 2008:888; Turley & Zaman 2007:771).

1.2.4 Audit committees – South African developments

Similar to the international trend, in South Africa audit committees have been the focus of pronouncements, reforms and academic research over the last three decades.

The Companies Act No. 71 of 2008 (Companies Act) as amended by the Companies Amendment Act no. 3 of 2011 (Republic of South Africa (RSA) 2011: Section 57), introduced the requirement that all public companies (which includes listed companies) and state-owned companies, as well as companies with such a requirement in their memorandum of incorporation, should establish an audit committee (RSA 2008: Section 94(2)). According to section 94 of the Companies Act, all members of the audit committee should be directors of the company, completely independent and unrelated to the company and equipped with adequate knowledge and experience to perform their duties (RSA 2008: Section 94(4-5)). The board may delegate some of its duties to an audit committee, for example, to oversee financial reporting (Habib & Bhuiyan 2016:123; RSA 2008: Section 72(1)), without reducing its responsibilities. However, the audit committee remains responsible for the external auditor's appointment, fees and terms of engagement (RSA 2008: Section 94(10)).

Furthermore, public companies listed on the JSE in South Africa, should also comply with the JSE listing requirements to ensure the business is conducted in consideration of the public interest (JSE 2024:2). One of the JSE listing requirements relating to corporate governance, states that listed companies must appoint an audit committee under the King Code on Corporate Governance for South Africa (King Code), as amended or replaced by updated versions, from time to time (JSE 2024:12). Also, audit committees need to comply with requirements regarding their composition and responsibilities in terms of the Companies Act and the King Code (JSE 2024:46-48).

Sixteen years before the 2008 legal reform on audit committees in South Africa, the King Committee was formed in 1992 at the insistence of the IoDSA to address corporate

governance concerns in South Africa (IoDSA 1994:3, IoDSA 2022:1). In 1994, the first King Report on Corporate Governance (King I) (IoDSA 1994) was issued to promote the highest standards of corporate governance in South Africa with an integrated approach addressing the interests of a wide range of stakeholders (Vaughn & Ryan 2006:506; Kakabadse & Korac-Kakabadse 2001:307). As a result, South Africa received recognition as a pioneer and leader in corporate governance (McNally, Cerbone & Maroun 2017:483; de Villiers, Rinaldi & Unerman 2014:1047; Solomon & Maroun 2012:6).

King I requires all large public entities (including listed companies), to appoint audit committees to, among other responsibilities, assist the board by reviewing financial statements; accounting policies; effectiveness and coordination between internal audit and external audit; and significant unusual transactions, as financial reporting quality inputs (IoDSA 1994:20). In 2002, a second, updated and more comprehensive, King Report on Corporate Governance in South Africa (King II) was issued to align with changes to South African legislation, social, political and economic transformation and updated JSE listing requirements (Vaughn & Ryan 2006:506; IoDSA 2002:7). Since the main objective was to promote greater business transparency and accountability, King II adopted an approach whereby companies need to comply with the recommendations or else explain the lack of compliance (Vaughn & Ryan 2006:506). Regarding the role of the audit committee in financial reporting quality inputs, King II contains less detail than King I while similarly emphasising the review of internal auditors and external auditors and financial reporting (IoDSA 2002:33-34, 37-38; IoDSA 1994:20).

In September 2009, King III was issued with an effective date of 1 March 2010, containing principles and recommended practices (IoDSA 2009a:17). King III aligned to the statutory changes in the 2008 Companies Act and changing international corporate governance trends (IoDSA 2009a:4). One of these international trends adopted in King III Code was the change from the ‘comply or explain’ principle to ‘apply or explain’ (IoDSA 2009a:6). The ‘apply or explain’ principle means the decision to apply a recommendation differently or apply another practice to achieve the same overarching objective of the corporate governance principles, still results in compliance (IoDSA 2009a:6). Companies should therefore disclose in the annual reports all the King III principles and recommendations

that were applied or explain how those not applied with were alternatively met to allow stakeholders to have a clear understanding of their compliance with King III.

In 2010, South Africa received widespread recognition for being the first country to mandate integrated reports of listed companies through compliance of King III (McNally et al 2017:483; de Villiers et al 2014:1042; Solomon & Maroun 2012:6). As for the audit committee's financial reporting quality inputs, King III aligns to King I and King II, while specifically mentioning oversight of financial reporting, including integrated reporting, accounting policies and significant unusual transactions; financial risk management; commenting on financial statements; disclosure of sustainability issues; combined assurance, including internal auditors and external auditors; and the expertise, experience and resourcing of the finance function (IoDSA 2009a:32-34; IoDSA 2002:33-34,37-38; IoDSA 1994:20).

On 1 November 2016, the current King IV™ was issued with an effective date of 1 April 2017 (IoDSA 2016:38). King IV™ applies to a broader community of entities than the previous three King Reports did ('universal applicability') and therefore refers to organisations and governing bodies instead of companies and board of directors (IoDSA 2016:6). Sector supplements were included to make it easier for organisations to apply King IV™ as a guide for good corporate governance (IoDSA 2016:6). King IV™ (2016:7) has shifted from the 'apply or explain' approach in King III to an 'apply and explain' approach in King IV™ for organisations to substantiate how good governance was practised. Furthermore, the 75 King III principles were reduced to 17 basic principles in King IV™, with only 16 principles applying to all organisations (IoDSA 2016:7). Overall, King IV™ aims to promote corporate governance to all organisations by encouraging transparent and meaningful reporting to stakeholders when explaining how King IV™ principles were applied in the annual reports (IoDSA 2016:22). The principles and recommended practices describing the audit committee's financial reporting quality inputs correspond in King III and King IV™ (IoDSA 2016:55-56; IoDSA 2009a:32-34).

South African academic research also emphasises the role of an effective audit committee as a sub-committee which assists the board with the monitoring of financial

reporting quality (Rampershad 2022:116). Roos (2021:416) found audit committees in the (public sector/local government) add considerable value to the board through oversight and quality advice while contributing significantly to financial reporting quality measured by positive audit outcomes. The study reports that audit committees in the public sector are generally sound and in compliance with governance and statutory pronouncements, including King IV™ (Roos 2021:421). Morgan (2010:96) states that the good governance practices contained in the King Reports should be adopted to enhance audit committee effectiveness. Scholars regard the South African King Reports as corporate governance best practice (Coetzee & Msiza 2018: 89; Atkins, Solomon, Norton & Joseph 2015:30) while Erasmus & Coetzee (2018:7) regard King III as the 'best practice of its time'. There is consensus that strong corporate governance can be achieved by applying the principles and recommended practices contained in the King Reports (IoDSA 2016:7).

1.2.5 Consequences of audit committee failures for financial reporting quality

This section reviews the consequences of audit committee failures, particularly for financial reporting quality, using a review of the spate of corporate governance failures occurring over the last two decades despite the presence of audit committees in listed international and South African companies. This review considers international and South African cases in general and in the regulated banking sector.

At the turn of the twenty-first century, a series of corporate scandals at listed companies such as Enron, Tyco, WorldCom, Parmalat and Lehman Brothers caused share prices to collapse and investor confidence to decline across the world – these were consequent to weak corporate governance, including ineffective audit committees (Cole, Johan & Schweizer 2021:2; Ghafran & O'Sullivan 2017:578–579; Agrawal & Cooper 2015:169). In the US, the Enron failure was the pinnacle of poor governance specifically highlighting the critical importance of effective audit committee oversight (Sulaiman 2017:51; Dobija 2015:114; Rezaee, Olibe & Minmier 2003:532). Enron's audit committee received criticism for not having prevented or identified questionable activities within the company (Tremblay & Gendron 2011:261; Turley & Zaman 2007:766). Enron's audit committee simply accepted the independence statements of the company's external auditor, Arthur

Andersen, without evaluating the potential financial reporting quality threats inherent in the relationship between the firm and Enron (Elson & Gyves 2003:866–867).

With the collapse of WorldCom, another client of Arthur Andersen, the cry for corporate governance reform became more intense (Tremblay & Gendron 2011:261). In 2002, prompted by the Enron scandal, the SOX Act was promulgated in the US, bringing about major changes to audit, financial reporting, and corporate governance regulations (Beattie, Fearnley & Hines 2013:57). Chambers (2015:1) reports that the Japanese company Toshiba, before its accounting scandal, was regarded a pioneer in that country for adopting an audit committee consisting of independent board members similar to Western corporate governance principles. The failure at Toshiba was that the internal audit department did not have a direct reporting line to the audit committee (Chambers 2015:2).

In South Africa, the last decade witnessed many accounting scandals related to corporate governance failures, such as Steinhoff International Holdings N.V. (Steinhoff), African Bank, VBS Mutual Bank (VBS), Tongaat Hulett and KPMG that jeopardised local and international investor wealth and weakened the country's economy (Smith & Marx 2021:2). The Steinhoff case is regarded as the most scandalous corporate governance failure in the history of South Africa (Rossouw & Styan 2019:169). In the six weeks following the chief executive officer's resignation, Steinhoff recorded an astounding loss of R206 billion or 85% of its market capitalisation (Muzata 2022:152; Rossouw 2018:1). Although the audit committee comprised highly skilled and experienced South African audit professionals, the dominant chief executive officer kept crucial information away from all assurance providers, including the audit committee, rendering its oversight ineffective (Rossouw & Styan 2019:165; Naude, Hamilton, Ungerer, Malan & Klerk 2018:16). According to Naude et al (2018:16), Steinhoff possibly created a false sense of security among its investors and other stakeholders by disclosing its compliance with relevant legal and listing requirements across all jurisdictions, only to reveal 'accounting irregularities' at a later stage. Subsequently, Steinhoff announced that its 2015 and 2016 annual reports required restatement and could no longer be relied upon, provoking

concern that the board did not ensure financial reporting quality and failed to execute good corporate governance (Rossouw & Styan 2019:166; Turner & Orr 2017:1).

In 2018, VBS was placed under curatorship by the South African Reserve Bank when it was declared insolvent and bankrupt after being defrauded of approximately R2 billion (de Wet 2018:1; Motau 2018:1). The forensic investigation of VBS, led by Advocate Terry Motau, unravelled misconduct by VBS's external auditors, KPMG South Africa, one of the 'Big Four' audit firms, leading to a fine of R500 million as part of an out-of-court settlement (Moodley 2024a:1). KPMG South Africa was also linked to the Gupta-related corruption allegations and the Tongaat Hulett debacle (Moodley 2024b:1). The audit engagement partner of VBS, Mr Sipho Malaba, committed fraud by approving and signing the audit report in respect of the 2017 financial statements, although he knew the cash and cash equivalents balance was significantly misstated, raising questions about the effectiveness of audit committee oversight of the external auditors (Motau 2018:133).

Despite the requirements by the Companies Act, JSE Regulations and King III prescribing rules, principles and recommended practices addressing audit committee effectiveness (JSE 2016:55; RSA 2008: Section 94; IoDSA 2009a:31–35), public companies listed on the JSE in South Africa are still faced with financial reporting quality problems related to ineffective audit committees. Reporting on the collapse of African Bank, The Myburgh Report (2016:112-175) identified many warning signs that ought to have raised red flags to the audit committee and the board, which seem to have been ignored. For example, audit committee oversight of the external auditors appeared questionable as they accepted an unqualified audit opinion despite being aware of understated provisions (Myburgh 2016:113).

Stakeholders, regrettably, must bear the brunt of these corporate governance failures by suffering significant financial losses. A South African study on JSE-listed companies revealed the pervasiveness of the potential losses from corporate governance failures (Muzata 2022:161). Moreover, these cases caused investors and regulators to publicly question the role and integrity of the audit committee in monitoring financial reporting quality (Lee & Fargher 2018:167; Tremblay & Gendron 2011:259; Srinivasan 2005:292).

Salehi and Shirazi (2016a:1640) assert that effective audit committees are considered to fulfil a central role in preventing fraudulent financial reporting and reinstating overall stakeholder confidence. The question remains, what audit committee effectiveness variables would have prevented these financial reporting quality problems?

1.2.6 Restatements as proxy for financial reporting quality

Consistent with prior literature, restatements can be used as a proxy to measure financial reporting quality (Cohen, Hoitash, Krishnamoorthy & Wright 2014:244; Archambeault, DeZoort & Hermanson 2008:965). The Financial Accounting Standards Board (FASB) defines a restatement as 'the process of revising previously issued financial statements to reflect the correction of an error in those financial statements' (FASB 2023: Section 250-10-20). International Accounting Standard (IAS) 8 (IASB 2024: Paragraph 5) motivates the need for restatements as the correction of prior period errors, being 'omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) was available when financial statements for those periods were authorised for issue; and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud'. Thus, a 'retrospective restatement' (restatement) implies 'correcting the recognition, measurement and disclosure of amounts o[r] elements' (IASB 2024: IAS 8 Paragraph 5).

Likewise, in the literature, restatements are described as an acknowledgement of errors in the form of omissions or misstatements which require adjustments to be made to prior year annual reports, resulting from errors, including non-compliance with the prescribed accounting framework, or fraud (Pathak, Samba & Li 2021:900; Wan Mohammad, Wasiuzzaman, Morsali & Zaini 2018:3; Abbott, Parker & Peters 2004:69). The significant impact of the increasing number of restatements in organisations lead to increasing concern among stakeholders about financial reporting quality (Pathak et al 2021:900; Wan Mohammad et al 2018:3).

Prior studies reported a relation between an effective audit committee and a reduction in restatements, implying an improvement in financial reporting quality (Almaqoushi & Powell 2021:185; Khoo, Lim & Monroe 2020:359; Oradi & Izadi 2019:68; Wan Mohammad et. al 2018:15; Cohen et al 2014:270; Sharma & Iselin 2012:149). However, none of these studies were conducted in South Africa. A few South African studies focused on audit committee effectiveness, based on annual report disclosures. For example, Coetzee and Msiza (2018:95) examined the strengths and weaknesses of audit committee best practice disclosure in four South African clusters (1 private sector, 2 public entities, 3 central government, 4 local government). Although the disclosure pattern tested the strongest in the private sector, all clusters appeared to have areas for improvement in terms of disclosure shortcomings (Coetzee & Msiza 2018:95).

Some older South African studies considered public disclosures about audit committees. For example, in the public sector Moloi (2015:67) found a lack of disclosures regarding the role of audit committees in annual reports of the South African national government departments. Marx (2009:31, 36) compared information collected directly from audit committee members about their responsibilities performed to the disclosures thereof in the annual reports of the largest 40 JSE-listed companies in South Africa, ranked by market capitalisation at the time. Marx (2009:31) concluded, like Moloi (2015:67), that while data collected from audit committee members indicated that they performed their mandatory responsibilities reasonably well, disclosures thereof in annual reports were insufficient, not reflecting the true state of affairs.

It is clear that audit committees are widely recognised internationally and in South Africa for their contribution to sound financial governance. Likewise, the relation between an effective audit committee and financial reporting quality proxied by restatements has been proven by international research in multiple studies. South African studies in the public sector considered ‘the relation between disclosed audit committee effectiveness variables and the external audit opinion expressed in South African Central Government Departments’ (Msiza 2020:112) and ‘An analysis of audit committee disclosure practices in South African metropolitan municipalities’ (Kganakga, Schutte & Derbyshire 2023:95). In the private sector, a study by Rampershad (2022:12) aimed to ‘develop a graphical

and narrative framework to promote the overall effectiveness of audit committees in private sector companies in South Africa'. However, no identified prior South African study directly focused on the relation between audit committee effectiveness variables and financial reporting quality proxied by restatements in the private sector context. This study addresses this knowledge gap.

1.3 PROBLEM STATEMENT

Section 1.2 discussed the South African governance principles and statutory requirements dealing with audit committees and their responsibility for overseeing and monitoring financial reporting quality in JSE-listed companies (JSE 2016:55; RSA 2008: Section 94; IoDSA 2009a:31–35).

Section 1.2.6 also presented international literature reporting on the relation between an effective audit committee and financial reporting quality proxied by restatements. However, a gap in knowledge was identified as a lack of research on the relation between audit committee effectiveness variables and financial reporting quality proxied by restatements in South Africa in the private sector context.

From the perspective of South African audit committee practices and the related financial reporting quality landscape, problems are regularly reported in the media, also in the private sector (Armitage 2019:2). It seems that audit committees of some JSE-listed companies failed in their oversight of financial reporting quality, ascribed to audit committee ineffectiveness, including not meeting the requirements of competence attributes (KPMG 2016:2-3).

Acknowledging the internationally reported relation between an effective audit committee and financial reporting quality proxied by restatements and the gap in related South African literature amidst ongoing financial governance scandals ravaging South African JSE-listed companies, this study addresses the following research problem:

Audit committee ineffectiveness undermines financial reporting quality in JSE-listed companies.

1.4 PURPOSE STATEMENT

The study aims to investigate the relation between audit committee effectiveness and financial reporting quality proxied by restatements in JSE-listed companies.

1.5 RESEARCH OBJECTIVES AND HYPOTHESES

To realise the aim of the study, the following research objectives are pursued:

1. To identify and analyse audit committee effectiveness variables from King III (refer to Appendix A).

2. To identify and analyse audit committee disclosures in annual and other reports on websites of the 40 sampled JSE-listed companies for the disclosure or non-disclosure of audit committee effectiveness variables (as identified in research objective 1).

3. To identify and analyse the absence or presence of restatement disclosures as proxy for financial reporting quality in annual reports of the 40 sampled JSE-listed companies.

4. To apply categorical principal component analysis (CATPCA) to develop the hypotheses for measuring the relation between audit committee effectiveness variables and the absence or presence of restatements.

Objective 4 produced the following six audit committee effectiveness variables, expressed as research hypotheses:

> *H_1 There is a positive relation between AC[1] meeting interaction and the absence of restatements.*

[1] The abbreviation AC for audit committee was used when referring to research hypotheses, audit committee variables and factors, and related discussions.

H_2 There is a positive relation between AC regulatory role and the absence of restatements.

H_3 There is a positive relation between AC sustainability reporting and combined assurance oversight and the absence of restatements.

H_4 There is a positive relation between AC risk and reporting oversight and the absence of restatements.

H_5 There is a positive relation between AC structure and responsibility and the absence of restatements.

H_6 There is a positive relation between AC internal and external assurance oversight and consulting and the absence of restatements.

1.6 IMPORTANCE OF THE STUDY

Many studies have been conducted on audit committee effectiveness (Lisic, Neal, Zhang & Zhang 2016: 1199; Contessotto & Moroney 2014:393; Beasley, Carcello, Hermanson & Neal 2009; Gendron & Bédard 2006:218) and its important role in establishing and maintaining good corporate governance (Dobija 2015:113). Taking a further step, international researchers also investigated the relation between these effective audit committees as vital components of corporate governance and financial reporting quality, proxied by restatements of financial statements (Khoo et al 2020:359; Oradi & Izadi 2019:68; Cohen et al 2014; Sharma & Iselin 2012:149). Considering the demolishing impact financial reporting failures have on investors and other stakeholders, focus on audit committee effectiveness is essential. Investors and other stakeholders have access to disclosures about audit committees in publicly available annual reports as their main means of assessing audit committee effectiveness.

Given that there are currently no studies in South Africa that investigate the relation between audit committee effectiveness variables (a proxy for audit committee effectiveness) and restatements (a proxy for financial reporting quality) in the annual reports of JSE-listed companies, a gap worthy of being addressed exists (refer to Section

1.2). Moreover, the ongoing scandals impacting JSE-listed companies points to a problem that needs to be addressed (refer to Sections 1.2.5 and 1.3).

This study aims to fill the stated gap in knowledge causing the stated problem by determining the relation between audit committee ineffectiveness and financial reporting quality proxied by restatements in JSE-listed companies. The results of this study will contribute to the existing body of literature on audit committee effectiveness, particularly in South Africa. More specifically, the results would guide organisational management and audit committees in South Africa and internationally on areas where audit committee effectiveness may be improved toward achieving financial reporting quality. It may also assist financial reporting regulators and professional bodies concerned with audit committees (e.g., IoDSA and the South African Institute of Chartered Accountants [SAICA]), when designing training and guidance interventions aimed at improving audit committee effectiveness.

1.7 DELINEATIONS AND LIMITATIONS

Although this study applied the research design and research quality considerations best suited to achieve its purpose, certain limitations were noted.

First, this study was delimited to audit committees of public companies listed on the JSE in South Africa.

Second, the study was delimited to a sample comprising 40 JSE-listed companies, which included the top 20 companies as well as 20 companies ranking from number 81 to 100 based on market capitalisation on the JSE on 9 November 2015. The results of the study can be regarded as broadly representative of the entire population of JSE-listed companies as the top 20 companies represented 74% of the total market capitalisation at the time (Deloitte 2014:3). According to the market capitalisation of listed companies on the date of sampling, the 40 companies represented 94% of the market capitalisation of the total population.

Third, audit committee effectiveness variables were delimited to the King III recommended practices (IoDSA 2009a:31-35; IoDSA 2009b:56-68). King III was used,

as King IV™ became effective for financial periods commencing on or after 1 April 2017 (IoDSA 2016:38). Section 2.4 includes detail on how the audit committee effectiveness variables changed from King III to King IV™.

Fourth, the proxy for financial reporting quality was delimited to restatements.

1.8 DEFINITIONS OF KEY TERMS

Assurance providers: Organisations have internal and external independent assurance providers to help the board fulfil its oversight responsibilities (Decaux & Sarens 2015:60). Assurance providers include, but are not limited to, the internal auditors and external auditors (IoDSA 2016:68; Decaux & Sarens 2015:61; IoDSA 2009b:62–66).

Audit committee effectiveness: Audit committees are considered effective if they are independent of the board, oversee risk management, appoint and monitor external auditors and ensure the integrity (quality) of financial reporting (Contessotto & Moroney 2014:395).

Audit committee effectiveness – factor variables: In this study, the term refers to newly formed factor variables derived from applying the CATPCA statistical technique. This technique was applied to reduce the number of individual audit committee effectiveness variables from 51 to 6 (refer to Sections 3.5.3, 3.6.1.2 and 4.2.1).

Audit committee effectiveness – individual variables: In this study, the term refers to the 51 individual audit committee effectiveness variables identified by analysing Chapter 3 of King III (IoDSA 2009:31-35; Appendix A). Section 2.4 provides an overview of these variables, including a comparison to King IV™ variables.

Audit committee and restatement disclosures: Publicly available information about audit committees and restatements, including in annual and other reports and information on company websites. In this study, restatements were identified from the 2015/16 annual reports on the websites of JSE-listed companies.

Corporate governance: ‘Corporate governance is the system by which companies are directed and controlled’ (Cadbury 1992: par. 2.5) by those on the board and sub-

committees (comprising executive and non-executive directors) for the benefit of all stakeholders.

Financial reporting quality: Financial reporting quality aims to ensure that reliable information on the financial position and performance of organisations is presented to stakeholders for informed economic decision-making (Bajra & Čadež 2018:151).

Financial reporting quality inputs: Financial reporting quality inputs include oversight of financial reporting, such as integrated reporting; accounting policies and significant unusual transactions; financial risk management; commenting on financial statements; disclosure of sustainability issues; combined assurance (i.e. internal auditors and external auditors); and the expertise, experience and resourcing of the finance function (IoDSA 2016:51-54; IoDSA 2009:32-34; IoDSA 2002:33-34, 37-38; IoDSA 1994:20).

JSE-listed companies: Companies with a primary or secondary listing on the JSE.

Pronouncements: Corporate governance and statutory pronouncements (e.g. the King Reports and the Companies Act of 2008 (IoDSA 2016; IoDSA 2009a; IoDSA 2009b; IoDSA 2002; IoDSA 1994; RSA 2008: Section 94).

Restatements: The FASB Section 250 defines a restatement as 'the process of revising previously issued financial statements to reflect the correction of an error in those financial statements' (FASB 2023: Section 250-10-20). The IAS 8 (IASB 2024: Paragraph 5) motivates the need for restatements as the correction of prior period errors, with these being:

> omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) was available when financial statements for those periods were authorised for issue; and (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.

Thus, a ‘retrospective restatement’ (restatement) implies ‘correcting the recognition, measurement and disclosure of amounts o[r] elements of financial statements as if a prior period error had never occurred’ (IASB 2024: IAS 8 Paragraph 5).

Stakeholders: According to Freeman (1984:52), a stakeholder is ‘any group or individual who can affect or is affected by a business’.

1.9 RESEARCH METHODOLOGY

The purpose of this South African study was to determine the relation between audit committee effectiveness variables based on the King III recommended practices and the absence of restatements as a proxy for financial reporting quality in annual and other reports on websites of sampled JSE-listed companies. A literature study was performed on the background and significance of audit committees and the variables related to their effectiveness and financial reporting quality. The sample of the study consisted of 40 South African JSE-listed companies selected based on their market capitalisation on 9 November 2015. The sample of 40 comprised the top 20 companies, as well as companies ranked number 81 to 100 at the time.

The content of King III was analysed to identify audit committee effectiveness variables; 51 variables were populated into an excel spreadsheet (refer to Appendix A) (research objective 1). Next, a positivist approach using content analysis of documents (Bowen 2009:27) was applied to collect and analyse disclosure and non-disclosure of audit committee effectiveness variables (research objective 2) and the absence or presence of restatement disclosures (research objective 3) for 2015/2016 of the 40 sampled JSE-listed companies. Research objective 4 was addressed in three phases. Phase 1 consisted of descriptive statistics, using the Statistical Package for the Social Sciences (SPSS) to analyse 51 audit committee effectiveness variables in the form of frequencies. Descriptive statistics highlighted sufficient variability in 23 variables across 40 companies. In Phase 2, CATPCA was used to categorise the 23 variables into six factor variables and hypotheses. In Phase 3, binomial logistic regression tested these hypotheses.

1.10 ETHICAL CONSIDERATIONS

Ethical approval was required for collecting and analysing secondary data, comprising publicly available information about audit committees and restatements, including in annual and other reports as well as information on the websites of the sampled companies. Ethical approval to conduct this study was granted by the University of South Africa. Specific approval was obtained from the Research Ethics Review Committee within the College of Accounting Sciences on 8 June 2016, reference number 2016_CAS_028 before data collection and analysis commenced.

1.11 OUTLINE OF STUDY CHAPTERS

The rest of this dissertation is presented in four chapters, as follows:

Chapter 2: Literature review

The second chapter examines how the audit committee as a component of corporate governance responds to agency problems. The chapter also discusses financial reporting quality, proxied by restatements, audit committee responsibilities, audit committee effectiveness variables and related disclosures.

Chapter 3: Research methodology

The third chapter describes the research methodology, particularly how the quantitative approach and the content analysis design were applied, in combination with descriptive statistics, factor analysis and binomial logistic regression to produce valid and reliable results. The results of Phase 1 descriptive statistics of data analysis are provided. Ethical and quality considerations are also documented.

Chapter 4: Data analysis and interpretation

The fourth chapter presents the results of additional data analysis conducted during Phases 2 and 3. It explains how factor analysis was used in Phase 2, particularly the CATPCA method and how further descriptive statistics were performed on the newly developed factor variables. Then it explains how in Phase 3, binomial logistic regression

analysis was applied to test the hypotheses formed in Phase 2, particularly the relationship between the newly developed factor variables, which serve as proxies for audit committee effectiveness and the absence or presence of restatements.

Chapter 5: Conclusion

The fifth chapter presents the conclusion of the study. The chapter reflects on the key results that relate to the purpose and research objectives of the study, as well as the limitations of the study. Lastly, recommendations are made for further research.

1.12 CONCLUSION

Governance and statutory pronouncements and international academic research recognise the positive relation between audit committee effectiveness and financial reporting quality, often proxied by restatements. Despite numerous reported and ongoing audit committee failures affecting financial reporting quality in listed companies over the past two decades, no prior South African study has focused on this topic in the context of the private sector. Responding to this gap in knowledge, this study aimed to determine the relation between audit committee effectiveness, proxied by disclosures of audit committee effectiveness variables, and financial reporting quality, proxied by restatements presented in the annual and other reports on websites of 40 JSE-listed companies. The results are likely to contribute to the academic debate on audit committee effectiveness and provide practical insights for achieving financial reporting quality by strengthening the role and functioning of audit committees.

The next chapter contextualises the relation between audit committee effectiveness and financial reporting quality within the governance and statutory pronouncements and theoretical and substantive literature.

CHAPTER 2: LITERATURE REVIEW

2.1 INTRODUCTION

Chapter 1 declared the aim of this study as investigating the relation between audit committee effectiveness and financial reporting quality, proxied by restatements, in JSE-listed companies. This chapter contextualises the relation between audit committee effectiveness and financial reporting quality within international and local governance and statutory pronouncements and theoretical and substantive literature. Section 2.2 defines corporate governance, explains how agency problems were behind the origin of corporate governance and how audit committees, as a component of corporate governance, respond to agency problems. Section 2.3 defines financial reporting quality and its two proxies—earnings management and restatements. Section 2.4 discusses audit committee effectiveness variables, including characteristics, responsibilities and recommended disclosures.

2.2 AUDIT COMMITTEES AS COMPONENT OF CORPORATE GOVERNANCE RESPONDING TO AGENCY PROBLEMS

This section briefly considers definitions of corporate governance before explaining how agency problems contributed to the introduction of corporate governance as a means for directing and controlling managers (agents) of owners and mitigating agency problems.

2.2.1 Defining corporate governance

Most authors agree that corporate governance primarily acts as tool whereby companies are directed and controlled (Haskovec 2012:8; IoDSA 1994:1 par. 2; Cadbury 1992:152.5) to protect financial reporting quality, particularly capital investments (Abdel-Meguid, Samaha & Dahawy 2014:199). Although corporate governance originally focused on shareholders (Brennan & Solomon 2008:886; Shleifer & Vishny 1997:773), its focus widened to include all stakeholders (IoDSA 2016:48; Brennan & Solomon 2008:890; Kolk 2008:3; Blair 2005:33).

Global definitions of corporate governance are heterogeneous, akin to varying international business practices (Chanda, Burton & Dunne 2017:1267; Sonmez & Yildırım 2015:23; Aguilera & Jackson 2003:460). Thus, a universal definition of 'good governance' is absent (Chanda et al 2017:1267; Cohen, Krishnamoorthy & Wright 2010:757; Aguilera & Jackson 2003:447). Historic, cultural and financial differences between countries lead to categorisation of corporate governance into Anglo-American, German (European) and Japanese models (Sonmez & Yildırım 2015:24). Despite a few differences, these three models agree that shareholders should appoint the board of directors (Sonmez & Yildırım 2015:24-28). Developing countries mostly adopt corporate governance in line with the Anglo-American model (West 2006:6; Reed 2002:230). Likewise, South Africa mainly adopted corporate governance practices from the UK Code, the Anglo-American model (West 2006:7).

2.2.2 Agency problems and the origin of corporate governance

The origin of corporate governance is difficult to determine as scholars' opinions differ on when corporate governance principles were first applied. In the eighteenth century, most owners of companies were responsible for all managerial functionalities. Thereafter in the nineteenth century, corporate governance (direction and control) of corporations was complicated by so-called 'agency problems' when managers were appointed as agents of owners in the first limited liability companies (Marx & van der Watt 2011:59; Eisenhardt 1989:58). Using managers as agents is necessary when an organisation has owners who are unable to partake in the daily direction and controlling of the organisation (Fama & Jensen 1983:322). Jensen and Meckling (1976:308) define such an 'agency relationship' as an agreement where one person '(the principal)' appoints another person '(the agent)' to perform certain duties on their behalf, which entails certain 'decision-making authority' to be assigned to the 'agent'.

In terms of the agency theory, management should be independently monitored to ensure they act in the best interest of principals (owners) instead of their own (Dobija 2015:133; Fama & Jensen 1983:304; Jensen & Meckling 1976:313). However, the agent / principal relationship complicates monitoring, due to 'information asymmetry' between owners and

managers who act as owner's agents in directing and controlling an organisation – hence agency problems (Bendickson, Muldoon, Liguori & Davis 2016:439).

Corporate governance was introduced to mitigate agency problems. Traditionally, boards of directors and external audit oversaw the direction and control exercised by managers as agents of owners. The Cadbury Report (1992:48) made the board accountable to owners for managing the company on their behalf, thus protecting capital markets (Cohen, Krishnamoorthy & Wright 2002:573). While senior management is a dominant role player in governance by 'setting the tone at the top' (Compernolle 2018:906), the board should provide independent oversight and hold management accountable to owners (Morgan 2010:90; Cohen et al 2002:579; BRC 1999:1078). In addition to the board, increased disclosures of governance practices by companies mitigate information asymmetry (Haldar & Raithatha 2017:252). Thus, external audit's assurance of disclosures helps to mitigate agency problems (Soliman & Ragab 2014:2).

As business activities grew in complexity, board sub-committees were introduced in support of boards' expanding roles and responsibilities (Xie, Davidson & DaDalt 2003:299). Although King III (IoDSA 2009b:20) contends that the board is responsible for the corporate governance of a company, the board may delegate certain functions to its sub-committees, however, without abdicating their legal responsibilities (IoDSA 2009b:46). The audit committee is one such sub-committee, responsible for overseeing and balancing the roles and interests of all corporate governance role-players (Ahmed Haji 2015:762; Soliman & Ragab 2014:5; Klein 2002:376; Ferreira 2008:93) associated with financial reporting quality (Habib & Bhuiyan 2016:123; Wu, Hsu & Haslam 2016:243; Ahmed Haji 2015:762; Bédard & Gendron 2010:194). Importantly, the audit committee remains accountable to the board and the board to owners (Ferreira 2008:93, 96). Unsurprisingly, numerous studies on audit committee effectiveness were contextualised in agency problems (Bilal, Chen & Komal 2018:255; Haldar & Raithatha 2017:256; Setiany, Hartoko, Suhardjanto & Honggowati 2017:241; Inaam & Khamoussi 2016:182; Archambeault et al 2008:986). The costs associated with corporate governance, including audit committees, are known as 'agency costs' (Sonmez & Yildırım 2015:29; Fama & Jensen 1983:304;).

2.2.3 Audit committees' contribution to mitigating agency problems

The audit committee as a board sub-committee critically supports the board's financial reporting quality oversight role, thus mitigating agency problems associated with capital investments (Oussii & Boulila Taktak 2018:37; Lary & Taylor 2012:336). As for the audit committee's financial reporting quality inputs, South Africa's King Reports are aligned (IoDSA 2016:51-54; IoDSA 2009a:32-34; IoDSA 2002:33-34,37-38; IoDSA 1994:20).

Similarly to governance and statutory pronouncements, the literature mentions that audit committees' financial reporting quality oversight includes oversight of management's financial reporting (Oussii & Boulila Taktak 2018:37; Lary & Taylor 2012:336); identification and management of financial risks and controls; integrated reporting (Lary & Taylor 2012:337; IoDSA 2009:56; DeZoort et al 2002:40); as well as oversight of internal and external auditors (Bananuka, Nkundabanyanga, Nalukenge & Kaawaase 2018:143; Brennan & Kirwan 2015:470). Thus, an effective audit committee is a key component of corporate governance's ability to mitigate agency problems (Habib & Bhuiyan 2016:123; Bédard & Gendron 2010:180). Refer to Section 1.2 for current pronouncements and research findings associated with the concept of audit committee effectiveness internationally and in South Africa and the consequences of audit committee failures for financial reporting quality. Next, Section 2.3 builds a deeper understanding of financial reporting quality and useful proxies thereof.

2.3 FINANCIAL REPORTING QUALITY

Clearly, the focus of audit committees' responsibilities is oversight of financial reporting quality (IoDSA 2009b:59-60; RSA 2008: Section 94(7)(f)-(h)). Financial reporting quality is important for 'users' demand' (what is expected by the users of financial statements) and 'investors' protection' (transparent and complete financial statements) (Salehi & Shirazi 2016:1640). Irrespective of the origin of the demand, financial reporting quality is vital to a wide audience as it mitigates the agency problem of information asymmetry existing between managers (agents) and owners (principals) (Salehi & Shirazi 2016:1640; Chen, Hope, Li & Wang 2011:1256). Therefore, financial reporting quality needs to be constantly measured and monitored.

Rather than define financial reporting quality, prior studies have used proxies (Habib & Bhuiyan 2016:126). The academic literature mostly uses either one proxy or two proxies when measuring financial reporting quality, namely, earnings management (abnormal accruals) or their consequences, namely, restatements (Firoozi, Magnan & Fortin 2019:98; Cohen et al 2014:243). Each proxy is considered next, followed by a discussion of the literature on the relation between financial reporting quality and several audit committee effectiveness variables.

2.3.1 Earnings management

Earnings management is defined in numerous ways by researchers. Schipper (1989:92) defines it as management's 'purposeful intervention in the external financial reporting process with the intent of obtaining some private gain'. Similarly, Healy and Wahlen (1999:368) define 'earnings management occurs when managers use judgement in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers'. Regardless of the definition adopted, earnings management reduces financial reporting quality while it is inherently unobservable by financial statement users. In studying audit committees' role to mitigate distortions in financial reporting it was found that audit committee independence and financial expertise relates to lower earnings management (Nikulin, Smirnov, Sviridov & Bandalyuk 2022:1491). However, this study does not use earnings management as a proxy for financial reporting quality.

2.3.2 Restatements

The FASB defines a restatement as 'the process of revising previously issued financial statements to reflect the correction of an error in those financial statements' (FASB 2023: Section 250-10-20). The IAS 8 (IASB 2024: Paragraph 5) motivates the need for restatements as the correction of prior period errors, being 'omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) was available when financial statements for those periods were authorised for issue; and (b) could reasonably

be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud'. Thus, a 'retrospective restatement' (restatement) implies 'correcting the recognition, measurement and disclosure of amounts o[r] elements of financial statements as if a prior period error had never occurred' (IASB 2024: IAS 8 Paragraph 5). The determination of whether a prior period error requires restatement rests on the materiality of the change (IASB 2024: IAS 8 Paragraph 42).

In agreement with the FASB and IAS 8, the literature defines a restatement as a revision of a previously issued financial statement to correct an error, often to amend non-compliance with generally accepted accounting principles (Wan Mohammad et al 2018:6). Every restatement confirms the occurrence of material omissions or misstatements in prior financial statements (Abbott et al 2004:69). Research shows that the tendency for restatements increases when the results of published financial statements are below analysts' predictions (Wan Mohammad et al 2018:6), possibly pointing to manipulation.

Clearly, restatements suggest poor financial reporting quality, undermining the credibility of financial reporting (Bhuiyan, Opare & Ahmed 2024:1). Although the causes behind restatements might be unintentional, the audit committee can be key to reducing the incidence of financial restatement (Wan Mohammad et al 2018:6), since audit committees serve as a watchdog for financial reporting quality and the audit process (Bruynseels & Cardinaels, 2014:29). Confirming the relation between the audit committee and financial reporting quality, Section 94(7)(h) of the Companies Act (RSA 2008) in South Africa requires audit committees to make submissions to the board on any matter concerning the company's accounting policies, financial control, records and reporting. Likewise, according to King III (IoDSA 2009a:31-35) read with King II (IoDSA 2002:33-34,37-38) and King I (IoDSA 1994:20) the audit committee's financial reporting quality responsibilities focus on oversight of financial reporting.

In conclusion, several studies have reported a positive relation between financial reporting quality and several audit committee variables (Lin & Hwang 2010:65). Next, audit committee effectiveness variables and their relation to financial reporting quality are explained based on governance and statutory pronouncements and the academic literature.

2.4 AUDIT COMMITTEE EFFECTIVENESS VARIABLES

Prior studies commonly discuss audit committee effectiveness in terms of specific variables addressing for example, the independence and financial expertise of audit committee members, the frequency and attendance of audit committee meetings, audit committee size and financial reporting quality inputs, namely financial reporting quality responsibilities (Alkilani, Hussin & Salim 2019:95).

Audit committee effectiveness variables and related disclosures are prescribed or recommended in governance and statutory pronouncements, for example, the Companies Act and the King Reports (IoDSA 2016:55-56; IoDSA 2009a:31-35; RSA 2008: Section 94), while the literature provide evidence of their relation to financial reporting quality. In accordance with King IV™, the governing body (board) may delegate their financial oversight role to the audit committee (for example, Principle 15, Recommended Practice 40) (IoDSA 2016:69). Stakeholders and researchers typically use such disclosures as proxies of audit committee effectiveness. The following sub-sections discuss these requirements and their relation to financial reporting quality.

2.4.1 Audit committee independence

Independence is recognised by regulators as a vital characteristic for audit committees to execute their functions effectively (Habib & Bhuiyan 2016:123; Bédard & Gendron 2010:200). Besides, an independent audit committee is a significant role player in corporate governance (IoDSA 2009b:56). Independence of a director is defined in King III as ‘the absence of undue influence and bias which can be affected by the intensity of the relationship between the director and the company’ (IoDSA 2009b:119). King IV™ explains independence as ‘the exercise of objective, unfettered judgement’ and ‘the

absence of an interest, position, association or relationship which, when judged from the perspective of a reasonable and informed third party, is likely to influence unduly or cause bias in decision-making' (IoDSA 2016:13).

Globally, the independence of audit committee members is supported by legislation and corporate governance codes. For instance, in the UK, the UK Code requires that all audit committee members should be independent non-executive directors (FRC 2024a:12). Similarly, in the US, Section 301(3)(A) of the SOX Act (2002) requires all audit committee members should be both independent and non-executive directors. Long before the promulgation of the SOX Act, the US's BRC Report on Improving the Effectiveness of Corporate Audit Committees recommended the majority of audit committee members should be independent directors (BRC 1999:1079).

In line with the global trend, South Africa's governance and statutory pronouncements make independence of audit committee members a requirement. While the South African Companies Act does not explicitly mention the independence of audit committee members, it is implied by stipulating that audit committee membership is precluded for one who is or was:

- Concerned with the 'day-to-day management' of the company's or its related companies' activities in the prior year (RSA 2008: Section 94(4)(b)(i));
- A leading officer or permanent employee, of the company or its related companies, in the preceding three financial years (RSA 2008: Section 94(4)(b)(ii));
- One of the company's major suppliers or customers, which can compromise the director's objectivity (RSA 2008: Section 94(4)(b)(iii));
- Connected to any of the previous examples (RSA 2008: Section 94(4)(c)).

Contrary to the Companies Act, the King reports contain specific requirements dealing with audit committee members' independence. While King I recommended a majority of non-executive directors as audit committee members, King II introduced that the majority should not only be non-executive directors, but also independent directors. (IoDSA 2002:38; IoDSA 1994:20). King III changed King II's requirement of having a majority of independent non-executive audit committee members to having exclusively independent

non-executive directors as audit committee members (IoDSA 2009a:31; IoDSA 2002:38). Similar to King III, King IV™ and the UK Code also requires audit committees to only consist of independent non-executive directors (FRC 2024a:12; IoDSA 2016:56; IoDSA 2009b:57). In line with the Companies Act requirement, King III stipulates non-executive directors should refrain from being involved in daily management activities (IoDSA 2009b:53–54) while King IV™ clarifies that an independent non-executive director is someone who is in no position to interfere with the management of the company (IoDSA 2016:51). King III (IoDSA 2009:38-39) further describes an independent non-executive director as someone who:

- Has no jurisdiction over management's decisions (IoDSA 2009b:38);
- Holds no direct or indirect material interest in the company and its related companies (IoDSA 2009b:38);
- Is not employed in an executive capacity or appointed as the group's external designated auditor, senior legal adviser or is a family member of someone in this capacity in the preceding three financial years (IoDSA 2009b:38–39);
- Is, besides being a director, not a professional adviser to the company or the group (IoDSA 2009b:39);
- Has no association through external parties, for example being a director of a major customer or supplier, which can put their independence into jeopardy (IoDSA 2009b:39);
- Receive remuneration that is contingent upon the performance of the company (IoDSA 2009b:39).

Thus, clear consensus exists between the global and South African requirements distinguishing independent and non-independent audit committee members.

Several academic studies considered the important indirect and direct relation between independent non-executive directors as audit committee members and effective financial reporting quality oversight (Liu, Lobo, Yu & Zheng 2023:1299; Chee & Tham 2021:44). Since independent audit committee members have no conferred interests in an organisation, the probability increases for improved audit committee oversight, implying

improved financial reporting quality (Bilal et al 2018:257). Klein (2002:378) found an independent audit committee can competently execute its various oversight functions, implying improved financial reporting quality. In terms of agency theory, audit committees independently oversee management to avert any opportunistic activities, implying improved financial reporting quality (Dobija 2015:133). Even agency costs can be reduced by an independent audit committee because of the effective monitoring of management's activities, implying improved financial reporting quality (Bilal et al 2018:257).

The independence of audit committee members is also instrumental to audit committees' financial reporting quality role of overseeing the independence of internal and external auditors (Wu et al 2016:241). Also, independent audit committee members are related to both the quality of management's financial reporting and firm performance by them restraining management's opportunistic behaviour aimed at manipulating financial results in their self-interest (Srinidhi, Gul & Tsui 2011:1612; Klein 2002:398). Furthermore, independent audit committee members who possess financial expertise are positively related to sound internal financial controls (Krishnan 2005:671) and reduce the occurrence of earnings restatements (Soliman & Ragab 2014:25; Abbott et al 2004:69).

Several more authors provide examples of the direct relation between independent non-executive directors as audit committee members and financial reporting quality. For example, Appiah & Amon (2017:309) conclude from a UK context that the financial reporting process and ultimately an organisation's continued existence, is enhanced by an independent audit committee. Similarly, Lin & Hwang (2010:67) find a positive relationship between an independent audit committee and financial reporting quality. Thus, a 'high-quality' independent audit committee is less susceptible to the influence of management (Lee & Fargher 2018:168; Li, Mangena & Pike 2012:923; Karamanou & Vafeas 2005:458) resulting in improved prevention of poor financial reporting (Lee & Fargher 2018:171; Gendron & Bédard 2006:221; Abbott et al 2004:69; Abbott, Parker & Peters 2000:17). Contrariwise, where less than 50% of the audit committee members are independent, oversight does not make a significant contribution to financial reporting quality (Velte & Stiglbauer 2011:17).

Some researchers considered the relation between the independence of audit committee members and earnings management and restatements (refer to Sections 2.3.1 and 2.3.2 where these are explained). For example, Klein (2002a:375) reports a negative relation between earnings manipulation and audit committee independence, while another study indicated the presence of an independent audit committee can result in less financial restatements (Wan Mohammad et al 2018:17; Inaam & Khamoussi (2016:189; Shafie & Zainal 2016:200; Soliman & Ragab 2014:25) Abbott et al 2004:69). However, some earlier studies did not find a significant relation between audit committee independence and restatements (Lin, Li & Yang 2006:929; Reitenga & Tearney 2003:278; Xie et al 2003:307).

In summary, governance and statutory pronouncements and prior literature support the positive relation between an independent of audit committee and financial reporting quality.

2.4.2 Audit committee financial expertise

Audit committee financial expertise is also widely recognised as a key audit committee effectiveness variable. By the end of 2003, all major US stock markets (NYSE, NASDAQ, and AMEX) started requiring that all audit committee members should be financially literate, while at least one member had to have financial expertise (Agrawal & Chadha 2005:371). The SOX Act considers a ‘‘financial expert’’ as a person who has acquired expertise ‘through education and experience as a public accountant or auditor or a principal financial officer, comptroller, or principal accounting officer of an issuer, or from a position involving the performance of similar functions’ (SOX 2002: s301(5)). In addition, audit committees may appoint independent advisers (SOX 2002: s301(5)). The UK Code (FRC 2024a:12) makes it the board’s responsibility to ensure one audit committee member has ‘recent and relevant financial experience’. In addition, the UK Code (FRC 2024a:12) stipulates competence in the sector in which a company operates for the audit committee as a whole. These global requirements align to the earlier suggestion of the BRC that every audit committee should have one member with ‘accounting or related

financial management expertise' while all committee members should be 'financially literate' upon appointment or in a reasonable period thereafter (BRC 1999:1073).

In South Africa, the Companies Regulations of 2011 (RSA 2011: Section 42) stipulate that a third of audit committee members should have 'academic qualifications, or experience, in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource management'. King III (IoDSA 2009a:32) was unspecific as to the collective skills required by the audit committee, stipulating 'audit committee members collectively should have sufficient qualifications and experience to fulfil its duties'. The King IV™ (IoDSA 2021:56) is more specific, requiring that audit committees as a whole should possess the 'financial literacy, skills and experience to execute their duties effectively'. While audit committees need to be vigilant, informed and diligent in their oversight of the financial reporting process, their financial expertise contributes to their effectiveness (Treadway 1987:41). Thus, broad consensus exists between the global and South African requirements dealing with audit committee expertise.

Several academic studies considered the important indirect and direct relation between having financial expertise on the audit committee and effective audit committee oversight of financial reporting quality. Studies mostly report a positive relation between audit committee financial expertise and audit committee effectiveness, with the most positive relation noticeable when the committee also includes financial expertise (Alkilani, Hussin & Salim 2019:104; Lee & Park 2019:132; Cohen et al 2014:243). Specific financial reporting quality inputs related to audit committee financial expertise are highlighted in numerous studies. By example, public accounting financial expertise on the audit committee is related to management's propensity to implement internal audit recommendations (Oussii & Boulila Taktak 2021:659) as well as a decreased risk of material misstatement, improved audit processes, a decrease in reported material control weaknesses and less goodwill impairments (Krishnamoorthy, Bruynseels, De Groote, Wright & Van Peteghem 2023:75).

Likewise, several studies reported audit committee financial expertise reduced internal control weaknesses (Krishnan & Visvanathan, 2008:827; Lisic et al 2016:1204). Considering the relation between audit committee financial expertise and earnings management in public companies in the US, specifically the audit committee chair's accounting financial expertise was related to less earnings management (Krishnamoorthy et al 2023:75). Some studies also reported a relation between increased audit committee financial expertise with a decrease in earnings management, indicating higher financial reporting quality (Inaam & Khamoussi, 2016:179; Lin & Hwang, 2010:57). Moreover, audit committee members with accounting (financial) expertise were found to reduce the negative impact of financial reporting complexities which may result in restatements (Chychyla, Leone, Minutti-Meza 2019:247).

Concerning restatements, several studies reported having an independent member on the audit committee with financial expertise decreased the incidence of restatements, pointing to higher financial reporting quality (Chen & Komal, 2018:257, Wong, 2011:113 Agrawal & Chadha, 2005:371). Furthermore, when audit committee members have both accounting financial expertise and industry expertise the incidence of restatements and discretionary accruals decreases (Cohen et al 2014:270). A recent study reported the incidence of restatements declined when audit committees included information technology expertise (Ashraf et al 2020:23).

In summary, governance and statutory pronouncements and prior literature support the positive relation between audit committee financial expertise, particularly in the field of accounting, and financial reporting quality.

2.4.3 Audit committee size

The size of an audit committee is acknowledged as an audit committee effectiveness variable by various governance and statutory pronouncements. Decades ago, the BRC suggested a minimum size of three members (BRC 1999:1073) while the SOX Act does not stipulate a minimum number of members. In alignment with the BRC's suggestion, the UK Code (FRC 2024a:12), the Companies Act (RSA 2008: Section 94(2)) and King III (IoDSA 2009a:31) also require a minimum of three members, while the UK Code

reduce the number to a minimum of two members for smaller companies. King IV™ is less specific, stipulating a 'sufficient number' of audit members to be acceptable (IoDSA 2016:50).

In line with governance and statutory pronouncements, many scholars found that audit committee size has a positive effect on financial reporting. Masmoudi (2021:19) found financial reporting quality to be higher when audit committees are larger in size, the members are independent, are financial experts and frequent meetings occur. Another study found the size of the audit committee together with financial and accounting expertise increases the monitoring of financial reporting quality by the audit committee (Engrawes, Feng, Lu & Shan 2020:2361). Also, audit committee size together with independence was found to have a positive impact on financial reporting quality, measured by the completeness corporate governance disclosures (Ha 2022:17; Raimo, Vitolla, Marrone & Rubino 2020:530).

2.4.4 Audit committee frequency of meetings

Another audit committee effectiveness variable contributing to financial reporting quality is the frequency of meetings held. Surprisingly, the frequency of audit committee meetings is not specified in the BRC (1999:1089-1094), the SOX Act (2002: Section 202(3)), the UK Code (FRC 2024:9), the Companies Act (RSA 2008: Section 94) or King IV™ (IoDSA 2016:55-56). In contrast, King III suggests that a minimum of two audit committee meetings should be held per annum (IoDSA 2009a:30). Studies have found that more frequent audit committee meetings result in timely release of financial statements, contributing to financial reporting quality and less earnings management (Syofyan, Septiari, Dwita & Rahmi 2021:1; Hasan, Kassim & Hamid 2020:278, Buallay & Al-Ajmi 2019:260). Particularly, frequent communication between audit committee members, such as during frequent meetings, together with independence, financial expertise and the size of the audit committee significantly contribute to enhanced financial reporting quality (Masmoudi 2021:19).

2.4.5 Overseeing financial reporting quality inputs

Governance and statutory pronouncements describe the audit committee's financial reporting quality inputs (IoDSA 2016:51-54; IoDSA 2009:32-34; IoDSA 2002:33-34, 37-38; IoDSA 1994:20).

In line with governance and statutory pronouncements, the literature reports effective audit committees, as measured by their independence, financial expertise, frequent attendance of meetings, and the size of the committee, are related to higher financial reporting quality (Masmoudi 2021:19; Safari Gerayli et al 2021:251).

Data comprised the audit committee and restatement disclosures in the 2015/2016 annual reports and other public reports as well as information from the websites of the 40 sampled JSE-listed companies. At that time, King III applied. King IV™ became effective for financial periods commencing on or after 1 April 2017. While it is imperative to consider the latest governance and statutory pronouncements applicable to the study, a comparison between the recommended practices in King III and King IV™ was performed.

2.4.5.1 Financial reporting oversight

Table 2.1 compares the recommended practices for audit committee financial reporting oversight in King III and King IV™.

Table 2.1: King III and IV comparison of audit committee financial reporting oversight

King III	IoDSA 2009a	King IV™	IoDSA 2016
The audit committee should have regard to all factors and risks that may impact on the integrity of the integrated report.	3.4.1	The audit committee should provide independent oversight of the effectiveness of the organisation's assurance functions and services, including combined assurance arrangements (external audit, internal audit finance function) and the integrity of the financial statements and other external reports. The audit committee should oversee the management of financial and other risks that affect the integrity of all external reports issued.	Principle 8:51(a-b) Principle 8:54
The audit committee should review and comment on the financial statements included in the integrated report.	3.4.2	The audit committee should disclose significant matters that the audit committee has considered in relation to the financial statements and how these were addressed by the audit committee.	Principle 8:59(b)
The audit committee should review the disclosure of sustainability issues in the integrated report to ensure that it is reliable and does not conflict with the financial information.	3.4.3	The audit committee should oversee that the combined assurance model is designed and implemented, other external assurance providers such as sustainability and environmental auditors, external actuaries and external forensic fraud examiners and auditors.	Principle 15:42
The audit committee should recommend to the board to engage an external assurance provider on material sustainability issues.	3.4.4	The audit committee should oversee that the combined assurance model is designed and implemented, other external assurance providers such as sustainability and environmental auditors, external actuaries and external forensic fraud examiners and auditors.	Principle 15:42
The audit committee should consider the need to issue interim results.	3.4.5		
The audit committee should review the content of the summarised information.	3.4.6		
The audit committee should engage the external auditors to provide	3.4.7		

assurance on the summarised information.

The audit committee oversees the financial reporting quality of financial statements by monitoring financial reporting processes, internal and external assurance functions and the company's risk management including significant financial reporting judgements (FRC 2024a:12-13; IoDSA 2016:51-54; IoDSA 2009a:32-33; RSA 2008: Section 94(f)-(i); SOX 2002: Section 205(a); BRC 1999:1091). The audit committee disclosures include information on their monitoring of the integrity of financial statements (IoDSA 2016:32; IoDSA 2009a:32).

The literature reports financial reporting quality is enhanced by appointing audit committees with financial expertise (Krishnamoorthy et al 2023:75), who engage in frequent, meaningful committee meetings, as well as meetings with internal audit, external audit, management and the board (Beasley et al 2009:112). In addition, audit committee oversight of the sufficiency and appropriateness of financial disclosures result in more reliable and robust financial statements (Haldar & Raithatha 2017:262).

2.4.5.2 Combined assurance oversight

Table 2.2 compares the recommended practices for audit committee combined assurance oversight in King III and King IV™.

Table 2.2: King III and IV comparison of audit committee combined assurance oversight

King III	IoDSA 2009a	King IV™	IoDSA 2016
The audit committee should ensure that the combined assurance received is appropriate to address all the significant risks facing the company.	3.5.1	The audit committee should provide independent oversight of the effectiveness of the organisation's assurance functions, with specific focus (among others), on combined assurance arrangements.	Principle 8:51(a)
		The audit committee (governing body) should satisfy itself that the combined assurance is effective and sufficiently robust to place reliance on the combined assurance impacting on the integrity of an organisation's external reports.	Principle 15:46
The relationship between the external assurance providers and the company should be monitored by the audit committee.	3.5.2	The audit committee should oversee that the combined assurance model is designed and implemented to address an organisation's risks and material matters by to monitoring independent assurance service providers (e.g. external auditor).	Principle 15:42

King III introduced the concept of combined assurance and the audit committee's role therein for the first time in 2009, while King IV™ retained the concept (IoDSA 2016:56; IoDSA 2009:33). This explains why earlier governance and statutory pronouncements like the BRC (1999), the SOX Act (2002) and the Companies Act (2008) are silent on this topic. Interestingly, the UK Code of 2024 makes no specific reference to combined assurance.

Literature finds combined assurance creates consistency through a common language among all assurance providers, thus supporting boards and audit committees in their respective oversight duties (Decaux & Sarens 2015:75). Moreover, investor confidence and the reliability of financial and non-financial information in integrated reports are

reportedly enhanced by combined assurance which is coordinated by the audit committee (Hoang & Phang 2021:175).

2.4.5.3 Finance function oversight

Table 2.3 compares the recommended practices for audit committee financial function oversight in King III and King IV™.

Table 2.3: King III and IV comparison of audit committee finance function oversight

King III	IoDSA 2009a	King IV™	IoDSA 2016
Every year a review of the finance function should be performed by the audit committee.	3.6.1	The audit committee should provide independent oversight of the effectiveness of the organisation's assurance functions, with specific focus (among others), to the finance function.	Principle 8:51(a)
The results of the review (of the finance function) should be disclosed in the integrated report.	3.6.2	The audit committee's views on the effectiveness of the finance function should be disclosed.	Principle 8:59(f)

King III and King IV™ are the only governance and statutory pronouncements which require the audit committee to perform a review of the finance function as well as to disclose the results of the review in the integrated report (financial statements). Thus, the finance function as part of the audit committee's duties is not specifically mentioned in the BRC, the SOX Act, the Companies Act, or the UK Code. One may thus assume such oversight is inherent in the audit committee's financial reporting oversight discussed in Section 2.4.5.1. The literature also mentions that one of the audit committee's important roles is to oversee the finance function as part of determining the integrity of the financial reporting process (Haddad, El Ammari & Bouri 2021:19).

2.4.5.4 Internal audit oversight

Table 2.4 compares the recommended practices for audit committee internal audit oversight in King III and King IV™.

Table 2.4: King III and IV comparison of audit committee internal audit oversight

King III	IoDSA 2009a	King IV™	IoDSA 2016
The audit committee is responsible for the appointment and/or dismissal of the chief audit executive.	3.7.1	The governing body (board) should approve (responsible) the appointment and removal of the chief audit executive.	Principle 15:52, 57
The audit committee is responsible for the performance assessment of the chief audit executive.	3.7.1	The chief audit executive should report to the audit committee on the performance of duties and functions that relate to internal audit.	Principle 15:56
The audit committee should approve the internal audit plan.	3.7.2	The audit committee should monitor on an ongoing basis that internal audit follows an approved internal audit plan.	Principle 15:58
The audit committee ensures that the internal audit function is subject to independent quality review as and when the committee determines it appropriate.	3.7.3	The audit committee should ensure that an external independent quality review is conducted at least once every five years.	Principle 15:60

All the governance and statutory pronouncements, except for the SOX Act, requires the audit committee to oversee the internal audit function, including approving the internal audit plan and oversight of the chief audit executive's effectiveness, including the appointment and dismissal (FRC 2024a:12; IoDSA 2016:56,70; IoDSA 2009a:33-34; RSA 2008: Section 94(8)(g)(i); BRC 1999:1084-1085). King III and King IV™ requires the audit committee to meet annually with internal auditors without management being present (IoDSA 2016:56; IoDSA 2009a:31). Similarly, the BRC stipulates that formal mechanisms should be implemented to facilitate confidential exchanges between the internal auditor and the audit committee (BRC 1999:1090). The requirement to hold meetings between the audit committee and internal audit is not specified in the SOX Act, Companies Act and the UK Code.

The literature reports an internal audit function which is monitored by the audit committee contributes significantly towards risk management and regulatory compliance to ultimately have a positive effect on financial reporting quality (Bananuka & Nkundabanyanga 2023:1117). In addition, the audit committee's oversight and active

involvement in the internal audit function result in a greater contribution by internal auditors to the external audit, potentially increasing financial reporting quality (Oussii & Boulila Taktak 2021:659; Alzeban & Sawan 2015:68-69).

2.4.5.5 Risk oversight

Table 2.5 compares the recommended practices for audit committee risk oversight in King III and King IV™.

Table 2.5: King III and IV comparison of audit committee risk oversight

King III	IoDSA 2009a	King IV™	IoDSA 2016
The charter of the audit committee should set out its responsibility regarding risk management.	3.8.1	The audit committee should oversee the management of financial and other risks that affect the integrity of the external reports issued by the organisation.	Principle 8:54
The audit committee should specifically have oversight of financial reporting risks.	3.8.2.1	The audit committee should oversee the management of financial and other risks that affect the integrity of the external reports issued by the organisation.	Principle 8:54
The audit committee should specifically have oversight of internal financial controls.	3.8.2.2	Disclosure: The audit committee's views on the effectiveness of the design and implementation of internal financial controls, and on the nature and extent of any significant weaknesses in the design, implementation or execution of internal financial controls that resulted in material financial loss, fraud, corruption or error.	Principle 15:59(e)
The audit committee should specifically have oversight of fraud risks as it relates to financial reporting.	3.8.2.3	Disclosure: The audit committee's views on the effectiveness of the design and implementation of internal financial controls, and on the nature and extent of any significant weaknesses in the design, implementation or execution of internal financial controls that resulted in material financial loss, fraud, corruption or error.	Principle 15:59(e)

The audit committee should specifically have oversight of information technology risks as it relates to financial reporting.	3.8.2.4	The audit committee should not be a member of the management of financial and other risks that affect the integrity of the external reports issued by the organisation.	Principle 8:54

Risk management oversight by the audit committee is focused on ensuring reliable financial reporting. Only three governance and statutory pronouncements mention audit committee oversight of risk management, namely, King III, King IV™ and the 2024 UK Code (FRC 2024:12-14; IoDSA 2016:55-56; IoDSA 2009:34). Thus, the US's BRC and the SOX Act is silent on such oversight. The literature reports on audit committees' significant role in risk management outcomes contributing to the quality of financial reporting (Bananuka & Nkundabanyanga 2023:1117; Cohen, Krishnamoorthy & Wright 2017:1203-1204; Contessotto & Moroney 2014:413).

2.4.5.6 External audit oversight

Table 2.6 compares the recommended practices for audit committee external audit oversight in King III and King IV™.

Table 2.6: King III and IV comparison of audit committee external audit oversight

King III	**IoDSA 2009a**	**King IV™**	**IoDSA 2016**
The audit committee must nominate the external auditor for appointment	3.9.1		
The audit committee must approve the terms of engagement and remuneration for the external audit engagement	3.9.2		
The audit committee must monitor and report on the independence of the external auditor	3.9.3	The audit committee is satisfied that the external auditor is independent of the organisation.	Principle 8:59(a)
The audit committee must define a policy for non-audit services by the external auditors and must approve the contracts for non-audit services	3.9.4	The audit committee is satisfied that the necessary policy and controls to address the provision of non-audit services are in place.	Principle 8:59(a)(i)

The audit committee should be informed of reportable irregularities identified and reported by the external auditor	3.9.5		
The audit committee should review the quality and effectiveness of external audit process	3.9.6	The audit committee should provide independent oversight of the effectiveness of the organisation's assurance functions, with a specific focus (among others), on the external assurance service providers.	Principle 8:51(a)

There is consensus across all the governance and statutory pronouncements that the audit committee plays a significant role in the oversight of the external audit function. The audit committee should oversee the entire external assurance function, including recommending the external auditors for appointment, approving the terms of engagement and remuneration of the external auditors, monitoring their independence and overseeing the quality and effectiveness of the external audit process (FRC 2024b:1-2,3-5; IoDSA 2016:56,70; IoDSA 2009a:33-34; RSA 2008: Section 94(7); SOX 2002: s301(2); BRC 1999:1084-1085). The BRC, King III and King IV™ further requires annual meetings of the audit committee with the external auditors, without management being present (IoDSA 2016:56; IoDSA 2009a:31; BRC 1999:1090). However, the minimum number of annual meetings between the audit committee and external auditors are not specified. The SOX Act, Companies Act and the UK Code does not mention meetings between the audit committee and the external auditors.

The literature supports the positive influence of audit committee oversight of the external audit function on financial reporting quality, particularly oversight of the external auditor selection and external audit quality (Alves 2013:158; Srinidhi et al 2011:1613). Specifically, audit committee oversight of the external audit function is associated with fewer restatements, implying increased financial reporting quality (Bratten, Causholli & Sulcaj, 2022:22). Moreover, when the external auditors report insights about management's assumptions and uncertain future events to audit committees financial reporting quality benefits (Fiolleau, Hoang & Pomeroy 2019:125).

2.4.6 Audit committee disclosures

Audit committees should disclose all the statutory and other relevant oversight duties carried out in their capacity as one of the board sub-committees. Table 2.7 compares the recommended practices for audit committee disclosures in King III and King IV™.

Table 2.7: King III and IV comparison of audit committee disclosures

King III	IoDSA 2009a	King IV™	IoDSA 2016
The audit committee should report to the board on its statutory duties and duties assigned to it by the board	3.10.1	The audit committee discloses key areas of focus during reporting period, number of meetings attended, and external advisers who attended meetings, whether it has fulfilled its responsibilities.	Principle 8:50
The audit committee must report to the shareholders on its statutory duties: how its duties were carried out	3.10.2.1	The audit committee discloses key areas of focus during reporting period, number of meetings attended, and external advisers who attended meetings, whether it has fulfilled its responsibilities.	Principle 8:50
The audit committee should report to the shareholders on its statutory duties: if the committee is satisfied with the independence of the external auditor	3.10.2.2	The audit committee is satisfied that the external auditor is independent of the organisation.	Principle 8:59(a)
The audit committee should report to the shareholders on its statutory duties: Audit committee's view on financial statements and accounting practices	3.10.2.3	The audit committee discloses key areas of focus during reporting period, number of meetings attended, and external advisers who attended meetings, whether it has fulfilled its responsibilities.	Principle 8:50
		The audit committee should disclose significant matters that the audit committee has considered in relation to the financial statements and how these were addressed by the audit committee.	Principle 8:59(b)

The audit committee should report to the shareholders on its statutory duties: whether internal financial controls are effective	3.10.2.4	Disclosure: The audit committee's views on the effectiveness of the design and implementation of internal financial controls, and on the nature and extent of any significant weaknesses in the design, implementation or execution of internal financial controls that resulted in material financial loss, fraud, corruption or error.	Principle 8:59l
The audit committee provides a summary of its role and details on its composition, number of meetings and activities in the integrated report	3.10.3	The audit committee discloses its role, responsibilities, functions, composition, each member's qualifications and experience, number of meetings.	Principle 8:50
The audit committee should recommend the integrated report for approval by the board	3.10.4	The audit committee has the power to make decisions regarding statutory duties and is accountable in this regard.	Principle 8:52

All the governance and statutory pronouncements required that the audit committee should disclose in its report included in the annual financial statements how its functions were carried out, as well as provide its view on the external auditor's independence, the financial statements and accounting practices and the effectiveness of internal financial controls addressing risks (FRC 2024a:12-13; FRC 2024b:5-6; IoDSA 2016:56,70; IoDSA 2009a:33-34; RSA 2008: Section 94(7); SOX 2002: s202(2); BRC 1999:1087).

According to King III and King IV™, the audit committee disclosures should further include a summary of its role, composition, number of meetings and whether they recommend the integrated report for approval by the board (IoDSA 2016:54-56; IoDSA 2009a:35). Disclosure of the audit committee's role, composition, the number of meetings and the recommendation of the integrated report for approval is not required in terms of the BRC, the SOX Act, the Companies Act and the UK Code. The literature finds investor confidence improves when disclosures about committee oversight are reported in annual reports (Bratten et al 2022:22).

Section 2.4 supports this study's premise of a potential relation between audit committee effectiveness variables and financial reporting quality, particularly proxied by restatements. This premise forms the basis of data collection and analysis toward achieving this study's research objectives.

2.5 CHAPTER SUMMARY

This chapter discussed the relation between audit committee effectiveness and financial reporting quality within the context of governance and statutory pronouncements and the theoretical and substantive literature. Restatements were identified as an appropriate proxy for financial reporting quality and the relevance of audit committee effectiveness variables contained in governance and statutory pronouncements for enhancing financial reporting quality was justified.

Next, Chapter 3 presents the research methodology.

CHAPTER 3: RESEARCH METHODOLOGY

3.1 INTRODUCTION

Chapter 2 contextualised the relation between audit committee effectiveness and financial reporting quality within the governance and statutory pronouncements and theoretical and substantive literature. The need for effective audit committees to oversee high-quality financial reporting in annual reports, using agency theory as a framework was highlighted. This chapter describes the research methodology of this study that aims to investigate the relation between audit committee effectiveness and financial reporting quality proxied by restatements in the context of annual reports of JSE-listed companies.

In the first part of the chapter, the research paradigm and design are motivated. The chapter further focuses on the research method that was applied and describes how data was collected and analysed in three phases. The ethical considerations and limitations of the study are discussed in the latter part of the chapter.

3.2 RESEARCH PARADIGM AND DESIGN

All scientific research is conducted within a specific paradigm or philosophical 'worldview' as a way of viewing one's research material (Saunders, Lewis & Thornhill 2019:130; Creswell & Creswell 2018:5; de Vos, Strydom, Fouché & Delport 2011:40–41). Babbie (2020:30) further explains that a research paradigm provides a logical framework which systematises what is seen and how it is understood. Paradigms are vital to the research design in that they impact the nature of a research question concerning, 'what is to be studied' and 'the manner in which [it] is to be studied' (Terre Blanche, Durrheim, Painter 2006:40). Included in the research paradigm is a basic set of beliefs that guide inquiries and actions, motivating the research design selected to answer the research question (Creswell & Creswell 2018:5; de Vos et al 2011:298) namely ontology, epistemology and methodology (Terre Blanche et al 2006:40; Guba & Lincoln 1994:108).

The ontological position of this study is that a single reality exists, specifying the form and nature of reality and what is known about it, according to the researcher's beliefs and

perceptions (Saunders et al 2019:133; Guba & Lincoln 1994:107). This study accepts the annual and other reports on websites of the JSE-listed companies that were analysed as part of the data collection as true and real.

Logically following on from the ontological position indicating what reality is, epistemology questions the nature of knowledge and truth, referring to how the researcher believes knowledge of a particular reality can be acquired (Bell, Bryman & Harley 2022:30). This study adopted positivism as the epistemological position (Bell et al 2022:31), in which companies' disclosures are considered real and true, providing observable and measurable facts in accordance with governance and statutory pronouncements (Saunders et al 2019:145). Positivists believe that an objective reality, unaffected by personal experience, exists and has verifiable and absolute mechanisms revealing cause-and-effect relationships (de Vos et al 2011:6; Babbie & Mouton 2001:23). Only phenomena that are observable, and hence confirmed by the senses, can genuinely be warranted as knowledge (Bell et al 2022:31; de Vos et al 2011:6). The resultant epistemological position of this study was that knowledge can be gained through objective observations of the disclosures used.

Further to the research paradigm and epistemology, the appropriate research design, which involves the plan of collecting and analysing data, should be determined (Babbie 2020:89). Creswell (2014:34) highlights the importance of having a research design that corresponds to a 'worldview' and the relevant procedures to be implemented into practice. According to Hofstee (2006:108) and de Vos et al (2011:143), the research design sets out the necessary steps to be followed to achieve the research objectives.

This study followed a positivist quantitative research design, with agency theory as a perspective to address the research objectives. Empirically, audit committee effectiveness variables were coded through content analysis of audit committee disclosures by JSE-listed companies. Following descriptive analysis, further data analysis involved the creation of hypotheses to test the relation between the audit committee effectiveness variables and financial reporting quality, proxied by the absence or presence of restatements.

Table 3.1 provides meaning and implication to the paradigm and assumptions relevant to this study.

Table 3.1: Research paradigm and assumptions

Paradigm	**Positivism**
Ontology	*What do we know?* • Real, external, independent • One true reality
Epistemology	*What and how can we know it?* • Scientifically determinable • Observable and measurable facts • Law-like generalisations
Methodology (design)	*How can we acquire knowledge?* • Experimental design • Quantitative content analysis • Hypothesis testing

Source: Own design, based on Saunders et al (2019:144) and Guba (1994:109)

Timing is also important in the design and execution of research, especially when research findings are generalised (Babbie 2020:105). Two research designs can be considered for dealing with the time aspect, namely, cross-sectional and longitudinal studies (Babbie 2020:105). In cross-sectional studies, samples of populations are studied at a specific point in time as opposed to a single group of the population over different time periods in longitudinal studies (Leedy & Ormrod 2015:157). This study adopted a cross-sectional design as the data of the sampled companies was quantitatively analysed for the same 2015/2016 financial reporting period.

Further to the cross-sectional approach, a relevant experimental design for the study had to be identified. As a part of the study's quantitative approach, a quasi-experimental design was applied in the absence of randomisation and control groups, analysing relationships between independent variables and a dependent variable (White & Sabarwal 2014:2; de Vos et al 2011:149). A quasi-experimental design is applied when a researcher aims to determine if the independent variables affect the outcome of a dependent variable (de Vos et al 2011:145). Likewise, this study aims to test the relation between disclosed audit committee effectiveness variables (independent variables) and

the absence or presence of restatements (dependent variable). In this study, the independent variables are based on the recommended practices promoting audit committee effectiveness, in chapter 3 of King III (IoDSA 2009:31-35). The dependent variable, representing the absence or presence of restatements in annual reports, implies the audit committee's effective or ineffective contribution to financial reporting quality (Carcello, Neal, Palmrose & Scholz 2011:389; IoDSA 2009b:32; Klein 2002:376). During data analysis, hypotheses were developed to test the relation between the disclosed audit committee effectiveness variables and restatements, consequently investigating a social phenomenon as postulated by positivism (Bell et al 2022:31).

3.3 METHODOLOGY

Methodologically, a study may follow a quantitative, qualitative or mixed methods research approach (Saunders et al 2019:174). These approaches are different from each other in terms of their purposes, methods of collection and analysis of the data as well as evaluating the data quality (de Vos et al 2011:63). A quantitative research approach is typically associated with positivism, particularly when applying highly structured data collection techniques (Saunders et al 2019:176).

A quantitative approach involves numerical data in comparison to non-numerical data used by qualitative and both numerical and non-numerical data in mixed methods approaches (Leedy & Ormrod 2015:23-24). This study follows a quantitative research approach that numerically presents and explains the phenomena of reflected observations, which entails analysing disclosures of independent and dependent variables in companies' disclosures (Babbie 2020:412). According to de Vos et al (2011:181), the data in quantitative studies are collected in a structured manner to achieve quantifiable data, similar to the method of this study, where data was captured on a pre-designed spreadsheet. Positivist researchers make deductions when studying problems quantitatively and objectively by identifying and assessing cause-and-effect relationships, like the independent variables impacting the dependent variables in this study (Leedy & Ormrod 2015:99). Hypothesis testing in quantitative methods is more

likely to be found in experimental studies than in survey research, in line with the research design of this study, discussed in Section 3.2 (Bryman 2016:149).

In comparison, a qualitative approach explores and understands the significance that individuals or groups attribute to a social or human problem (Creswell & Creswell 2018:4). Researchers use a qualitative approach to answer questions about the complex nature of phenomena while understanding and describing the phenomena from the participant's perspective (de Vos et al 2011:64). Smaller samples are used in qualitative research while the bulk of the data collection is generally subjective due to the researcher's close involvement (Leedy & Ormrod 2015:99). A mixed methods approach combines the quantitative and qualitative approaches which can address different research objectives providing a more comprehensive image of the phenomenon (Leedy & Ormrod 2015:100). In this approach a researcher may, for example, analyse both numerical data quantitatively and report on human behaviour of participants. However, in this study, the quantitative approach is most suitable for testing the relation between audit committee effectiveness variables and the absence or presence of restatements in companies' disclosures.

In determining the disclosure and non-disclosure of the audit committee effectiveness variables in the analysed annual and other reports on websites of the JSE-listed companies, content analysis as a method for document analysis was used (Bowen 2009:28). Document analysis involves a systematic procedure of reviewing and evaluating printed and electronic data (Bowen 2009:27). Krippendorff (1989:403) defines content analysis as a research technique that reaches replicable and valid conclusions from the data in relation to the context. Expanding on the latter definition, content analysis uses analytical techniques to generate results which are then put into context and its objective is to test a hypothesis rather than develop it (White & Marsh 2006:30, 41). Although a collection of terms is subsumed under the term 'content analysis', the exclusive subjects being analysed in this research method are texts in various forms (Bos & Tarnai 1999:660). Similarly, Mouton (2013:165) and Leedy and Ormrod (2015:275) specify that the texts or documents to be analysed can include letters, annual reports, legal documents and 'content' refers to words, pictures, symbols and more. Likewise,

Neuendorf (2017:204) elaborates on content analysis, describing it as a quantitative analysis of message characteristics performed systematically and objectively that includes both 'human-coded analysis' and 'computer-aided text analysis' (CATA).

Notably, content analysis has a long history of use in many industries and the frequency of its use by researchers is increasing (Neuendorf 2017:201). The content analysis method may be applied to either quantitative data in a deductive manner or to qualitative data in an inductive manner (Elo & Kyngäs 2008:109). Quantitative content analysis is deductive and intends to test hypotheses or address questions derived from theories or prior research (Zhang & Wildemuth 2008:319; White & Marsh 2006:35). In contrast, qualitative content analysis is inductive as it grounds the analyses of topics and themes with conclusions from these into the data (Zhang & Wildemuth 2008:319; White & Marsh 2006:35). In this study, the disclosures of audit committee effectiveness variables in the content of annual and other reports on websites of the JSE-listed companies was deductively analysed and captured quantitatively on a pre-developed spreadsheet keeping objectivity in mind throughout.

Nevertheless, there are limitations involved in the content analysis method. Content analysis is a flexible method without clear guidelines (Elo & Kyngäs 2008:113) and the representativeness of analysed texts may be limited (Krippendorff 1989:407; Mouton 2013:166). The unit of measurement in content analysis is words, which can be differently interpreted by different people and can easily be taken out of context (Barac & Moloi 2010:23). However, according to Weber (1990:37), the use of word categories created by high-frequency words is more beneficial than themes. The data in content analysis are separated into sampling units, data collecting units, and units of analysis, as these units may not be similar (White & Marsh 2006:29). Methods of collecting data in content analysis include the collection of data after identifying a sample of specific information to be analysed, followed by coding the material into 'predetermined and precisely defined characteristics' (Leedy & Ormrod 2015:276). In content analysis, data can be analysed by counting the frequencies of specific characteristics in relation to the collected data as well as involving descriptive or inferential statistical methods depending on the research questions (Leedy & Ormrod 2015:276). The purpose of this study was to determine the

relation between audit committee effectiveness variables and the absence or presence of restatements in the annual reports of JSE-listed companies.

In this study, a quantitative content analysis was employed to collect data aimed at addressing the purpose and research objectives of this study.

3.4 SAMPLING

This section explains how the study's population and sample were selected. The population of a study sets boundaries according to the specific research focus area at hand (de Vos et al 2011:223). For example, a group of organisations associated with a particular research problem can serve as a population (de Vos et al 2011:223). Although it would be unrivalled to test the entire population in a study, it is frequently predetermined (Etikan, Musa & Alkassim 2016:1-2), and commonly impractical to collect data from an entire population (de Vos et al 2011:224; Saunders et al 2009:260). In certain instances when a population is relatively small and it meets specific criteria, the total population may be tested (Etikan et al 2016:3). However, Saunders et al (2009:260) indicate that testing the entire population will not necessarily provide more useful results than testing a representative sample.

3.4.1 Population

In this study, the population of interest consisted of public companies listed on the JSE in South Africa, forming part of the private sector. The Bureau van Dijk database was employed in determining the population of the study, considering a significant representation of a portion of companies in relation to all JSE-listed companies according to market capitalisation rankings. On 9 November 2015, the top 100 JSE-listed companies based on their market capitalisation ranking, represented a substantial 95% of the total number of JSE-listed companies at the time (Erasmus, Coetzee, Du Preez & Msiza 2021:167). Consequently, it was resolved for the top 100 JSE-listed companies to serve as a well-represented sample of the population of JSE-listed companies. Furthermore, all JSE-listed companies are mandated to adhere to the JSE listing requirements (JSE 2024:2) including adherence to South African governance and

statutory pronouncements, namely the King Reports and the Companies Act. The data collection and analysis therefore involved applying the audit committee effectiveness variables from King III (Appendix A) which was applicable at the time of data collection, when analysing disclosures in the 2015 and 2016 annual and other reports on websites of the 40 sampled JSE-listed companies (IoDSA 2009a:17). King IV™ became effective to companies with financial years commencing on or after 1 April 2017 which was outside of the timeline for this study already in progress (IoDSA 2016:38).

3.4.2 Sample selection

Sampling techniques can be divided into two main types, namely, probability sampling (or representative) or non-probability sampling methods (Saunders et al 2009:287). In the former, all units have an equal probability of being selected as opposed to the latter which requires judgement and not providing all units with an equal chance to be included in the sample (Etikan et al 2016:1). Probability sampling techniques require a certain type of sampling frame and are therefore considered to be more time-consuming than non-probability techniques (Saunders et al 2009:291). Hence, non-probability sampling is often selected as a more affordable, easier and faster method to implement than probability sampling (Etikan et al 2016:1). Depending on the quantitative or qualitative nature and aim of a particular study it is important to determine which of the numerous non-probability sampling techniques will be most relevant (Etikan et al 2016:1; de Vos et al 2011:231).

Non-probability purposive sampling is used by researchers who understand the characteristics of the entire population of interest. It is also known as judgemental sampling in that the sample comprises units based on their characteristics according to the judgement of the researcher (de Vos et al 2011:232). The sampled units should likely contain most of the characteristics of the population (de Vos et al 2011:232). The application of judgement in purposive sampling ensures that appropriate samples are selected to respond to the research objectives of the study (Laerd Statistics 2012:1; Saunders et al 2009:287; Tongco 2007:147).

In this study, non-probability purposive sampling was considered the most appropriate method to select a sample of companies listed on the JSE in South Africa. Tongco (2007:147) states that purposive sampling may be used in both quantitative and qualitative studies. Although purposive sampling is mostly used in qualitative studies, this sampling method is also used in quantitative studies as the sampling method is determined by the objective of the study (Etikan et al 2016:4).

In this study, non-probability purposive sampling was used to select a sample from the top 20 companies as well as the 20 companies ranking from 81 to 100 based on market capitalisation listed on the JSE on 9 November 2015. This purposive sampling technique is referred to as 'extreme/deviant case sampling', which is used when a study seeks to develop 'best practice' and focus on 'what not to do' after analysing variations (Etikan et al 2016:3).

3.4.3 Sample size

An inverse relationship exists between the size of the population and the size of a sample; the larger the population, the smaller the sample may be in relation to the population, and vice versa (de Vos et al 2011:224). However, when populations comprise less than 50 units and probability sampling is applied, it is advisable to collect data from the entire population (Saunders et al 2009:291). In this study, the population of the top 100 JSE-listed companies was large enough to select a sample as their market capitalisation represented 95% of the total number of JSE-listed companies at the time as indicated by the Bureau van Dijk database. Furthermore, Saunders et al (2009:291) recommend the minimum sample size required for statistical analyses should be 30 units, while far smaller samples are allowed when the research objectives of a study do not require statistical analysis.

While larger samples may assist in reaching more representative and accurate conclusions, it also holds the risk that most of the results are classified as statistically significant, causing them to be overly sensitive (de Vos et al 2011:224). On the contrary, too small sample sizes may cause overall insensitivity of the results (de Vos et al 2011:224). Consideration should also be given to the level of confidence and accuracy

which is required by the results and the expected categories for analysis according to the respective research objectives (Saunders et al 2009:291). The selected sample consisted of 40 companies, therefore exceeding the minimum prescribed sample size of 30 to perform statistical analyses, as recommended by Saunders et al (2009:291).

Purposive samples are not considered to be statistically representative of the total population (Saunders et al 2009:287); however, it is notable that the 40 companies, sampled according to their market capitalisation on 9 November 2015, represented 75% of the market capitalisation of the top 100 JSE-listed companies on that date.

3.5 DATA COLLECTION AND CAPTURING

This section explains the process followed in collecting and capturing the data that was used to address the study's research objectives.

3.5.1 Secondary data source

Data can be divided into two categories, namely, primary data (which derives from an original source) and secondary data (information gathered by others) (Vartanian 2010:3). Secondary data can be seen as earlier primary data created for different purposes by other researchers (Greatorex 2014:1; Hox & Boeije 2005:593; Smith 2008:3). Secondary data are primarily employed in descriptive and explanatory research and comprise both quantitative (numeric) and qualitative (non-numeric) data (Saunders et al 2009:307). In this study, secondary data were collected from the publicly available annual and other reports on websites of the 40 sampled JSE-listed companies to perform statistical analyses. The document analysis protocol as described by (Bowen 2009:27) was applied. The reports were selected and downloaded under the 'Investor Relations' or 'Investors' tab of the respective websites.

3.5.2 Data collection and capturing

Data comprised disclosed and not disclosed audit committee effectiveness variables and the absence or presence of restatements in sampled secondary data. Listed companies are required by the King III Code to establish audit committees and include in the annual

report an audit committee report detailing their composition, responsibilities and duties performed (IoDSA 2009a:35). While some companies included the required disclosure in their 'Audit Committee Report' or 'Audit and Risk Committee Report' in the annual report, others included it as a separate report on their respective websites. Examples of various reports containing audit committee disclosures include integrated reports, annual financial statements, audit committee reports and companies' audit reports. In this study, the generic term 'audit committee and restatement disclosures' is used in referring to the respective reports. The downloaded reports were scrutinised for non-financial information relating to audit committees and named for the purposes of this study 'audit committee effectiveness variables' which made up the independent variables utilised for statistical analysis in this study. More specifically, a word search was conducted for the term 'audit committee' and other keywords included in Appendix A to search and locate audit committee effectiveness variables based on King III for data capturing purposes (IoDSA 2009a:31-35) in the disclosures. During this process, detailed notes (Appendix A), describing how disclosures were deductively related to each audit committee effectiveness variable were documented, continuously updated and refined. In this manner, it makes it possible to reperform the search and derive at the same results. A second word search was performed for the term 'restatement' in the 2016 annual and other reports to find disclosures on restatements as corrections to the 2015 financial statements.

Data was captured in an Excel spreadsheet and coded as a '1' when audit committee effectiveness variables were disclosed and coded as a '-1' for non-disclosure of audit committee effectiveness variables. Restatements were coded as follows; '-1' for the absence and '1' for the presence of restatements. The researcher's colleague cross-checked the spreadsheet for the accuracy of coding.

In Chapter 4, descriptive statistics of coded data are presented in stacked bar charts depicting frequencies as the nature of the data is categorical.

3.5.3 Independent and dependent variables coded

The independent variables utilised for the statistical analysis in this study were named 'audit committee effectiveness variables' for the purposes of this study. Forty-nine audit committee effectiveness variables were based on the recommended practices in King III, paragraphs 3.1.1.–3.1.5, 3.2.1.–3.2.7., 3.3.1–3.3.3, 3.4.1–3.4.7., 3.5.1.–3.5.2, 3.6.1–3.6.2., 3.7.1.–3.7.3., 3.8.1.–3.8.2.4., 3.9.1.–3.9.6., 3.10.1.–3.10.4. Two additional variables were added for the sake of variation, first, more than three audit committee members, and second, more than two audit committee meetings per annum. Thus, a total of 51 variables were used. Appendix A contains the King III recommended practices for each of the audit committee effectiveness variables, (IoDSA 2009a:31-35) and the reference to the relevant King III paragraph as well as the aspect coded during content analysis.

King III was issued in 2009 in response to the Companies Act of 2008, providing more detailed recommendations about audit committee oversight. Since JSE-listed companies are mandated by the Companies Act to appoint audit committees (RSA 2008: Section 94(2)), it is important to compare the audit committee effectiveness variables identified in King III to the related requirements in the Companies Act. Table 3.2 presents this comparison.

Table 3.2: Comparison between King III and the Companies Act of 2008

No	Audit committee effectiveness variables in the King III Code	Addressed in legislation (√) or not (x)	Companies Act of 2008
1.	Listed and state-owned companies must establish an audit committee.	√	Section 94(2)
2.	All other companies should establish an audit. committee and define its composition, purpose and duties in the memorandum of incorporation.	X	Not a Companies Act requirement
3.	The board should approve the terms of reference of the audit committee.	X	Not a Companies Act requirement
4.	The audit committee should meet as often as necessary to fulfil its functions but at least twice a year.	X	Not a Companies Act requirement
5.	The audit committee had more than two meetings during the year (additional variable created).	x	Not a Companies Act requirement

6.	The audit committee should meet with internal auditors at least once a year without management being present.	x	Not a Companies Act requirement
7.	The audit committee should meet with external auditor at least once a year without management being present.	x	Not a Companies Act requirement
8.	All the members of the audit committee should be independent non-executive directors.	√	Section 94(4)(b)
9.	The audit committee should consist of at least three members.	√	Section 94(2)(b)
10.	The audit committee consists of more than three members (additional variable created).	x	Not a Companies Act requirement
11.	The chairman of the board should not be the chairman or member of the audit committee.	x	Not a Companies Act requirement
12.	The audit committee collectively should have sufficient qualifications and experience to fulfil its duties.	√	Section 94(5)
13.	The audit committee members should keep up to date with the developments affecting the required skill set.	x	Not a Companies Act requirement
14.	The audit committee should be permitted to consult with the specialist or consultants subject to a board approval process.	x	Not a Companies Act requirement
15.	The board must fill any vacancies on the audit committee.	√	Section 94(6)
16.	The board should elect the chairman of the audit committee.	x	Not a Companies Act requirement
17.	The chairman of the audit committee should participate in setting and agreeing on the agenda of the committee.	x	Not a Companies Act requirement
18.	The chairman of the audit committee should be present at the annual general meeting.	x	Not a Companies Act requirement
19.	The audit committee should have regard to all factors and risks that may impact on the integrity of the integrated report.	x	Not a Companies Act requirement
20.	The audit committee should review and comment on the financial statements included in the integrated report.	x	Not a Companies Act requirement
21.	The audit committee should review the disclosure of sustainability issues in the integrated report to ensure that it is reliable and does not conflict with the financial information.	x	Not a Companies Act requirement
22.	The audit committee should recommend to the board to engage an external assurance provider on material sustainability issues.	X	Not a Companies Act requirement
23.	The audit committee should consider the need to issue interim results.	X	Not a Companies Act requirement
24.	The audit committee should review the content of the summarised information.	X	Not a Companies Act requirement
25.	The audit committee should engage the external auditors to provide assurance on the summarised information.	X	Not a Companies Act requirement

26.	The audit committee should ensure that the combined assurance received is appropriate to address all the significant risks facing the company.	X	Not a Companies Act requirement
27.	The relationship between the external assurance providers and the company should be monitored by the audit committee.	X	Not a Companies Act requirement
28.	Every year a review of the finance function should be performed by the audit committee.	√	Section 94(7)(f)(iii)
29.	The results of the review (of the finance function) should be disclosed in the integrated report.	X	Not a Companies Act requirement
30.	The audit committee is responsible for the appointment and/or dismissal of the chief audit executive.	X	Not a Companies Act requirement
31.	The audit committee is responsible for the performance assessment of the chief audit executive.	X	Not a Companies Act requirement
32.	The audit committee should approve the internal audit plan.	X	Not a Companies Act requirement)
33.	The audit committee ensures that the internal audit function is subject to independent quality review as and when the committee determines it appropriate.	X	Not a Companies Act requirement
34.	The charter of the audit committee should set out its responsibility regarding risk management.	X	Not a Companies Act requirement
35.	The audit committee should specifically have oversight of financial reporting risks.	X	Not a Companies Act requirement
36.	The audit committee should specifically have oversight of internal financial controls.	√	Section 94(7)(g)
37.	The audit committee should specifically have oversight of fraud risks as it relates to financial reporting.	X	Not a Companies Act requirement
38.	The audit committee should specifically have oversight of information technology risks as it relates to financial reporting.	x	Not a Companies Act requirement
39.	The audit committee must nominate the external auditor for appointment.	√	Section 94(7)(a) Section 94(7)(c)
40.	The audit committee must approve the terms of engagement and remuneration for the external audit engagement.	√	Section 94(7)(a) Section 94(7)(b)
41.	The audit committee must monitor and report on independence of the external auditor.	√	Section 94(7)(f) Section 94(8)(a) Section 94(8)(b)
42.	The audit committee must define a policy for non-audit services by the external auditors and must approve the contracts for non-audit services.	√	Section 94(7)(d) Section 94(7)(e)
43.	The audit committee should be informed of reportable irregularities identified and reported by the external auditor.	√	Section 94(8)(c)

44.	The audit committee should review the quality and effectiveness of external audit process.	√	Section 94(7)(f)(iii) Section 94(7)(g)(ii)
45.	The audit committee should report to the board on its statutory duties and duties assigned to it by the board.	√	Section 94(7)(h)
46.	The audit committee must report to the shareholders on its statutory duties: how its duties were carried out.	√	Section 94(7)(f)(i)
47.	The audit committee should report to the shareholders on its statutory duties: if the committee is satisfied with the independence of the external auditor.	√	Section 94(7)(f)(ii)
48.	The audit committee should report to the shareholders on its statutory duties: audit committee's view on financial statements and accounting practices.	√	Section 94(7)(f)(iii)
49.	The audit committee should report to the shareholders on its statutory duties: whether internal financial controls are effective.	√	Section 94(7)(f)(iii)
50.	The audit committee provides a summary of its role and details on its composition, number of meetings and activities in the integrated report.	X	Not a Companies Act requirement
51.	The audit committee should recommend the integrated report for approval by the board.	X	Not a Companies Act requirement

Source: Author

The information in Table 3.3 indicates that King III contains more stringent recommendations to regulate audit committees than the Companies Act.

The dependent variable of this study is the absence or presence of restatements in the annual reports following the 2015/2016 financial year as a proxy of the financial reporting quality of the 40 sampled companies. The presence of restatements in the 2016 annual reports of companies imply their 2015 financial statements required significant corrections.

3.6 DATA DEVELOPMENT AND ANALYSIS

SPSS version 26 software was used for the analysis of the data in three phases. Included in the data analysis were descriptive statistics (3.6.1), factor analysis (CATPCA) (3.6.2) and binomial logistic regression (3.6.3). The first phase discusses the literature and descriptive statistics in the form of frequencies. The second phase discusses the literature and factor analysis (in the form of CATPCA). The third phase discusses the literature and binomial logistic regression analysis.

3.6.1 Phase 1: Descriptive statistics

As a pre-step for CATPCA, descriptive statistics techniques were applied in the form of frequencies. Descriptive statistics describe the general nature of the obtained data (Leedy & Ormrod 2015:29). In this sub-section, the results of the descriptive statistics on individual independent variables and dependent variables are discussed and presented.

In SPSS, frequencies were run to determine which of the 51 independent variables contributed towards achieving the study's aim. Table 3.3 presents the frequency of disclosure of the 51 audit committee effectiveness variables of the 40 sampled JSE-listed companies. The descriptive statistics reflect the number of companies that disclosed each independent variable. Disclosure of audit committee effectiveness variables does not imply the variables were actually or correctly implemented.

Table 3.3: Frequencies of disclosure of audit committee effectiveness variables

No.	Audit committee effectiveness variables (independent variables)	Number of companies disclosing each variable	Disclosure per variable (%)	Non-disclosure per variable (%)
1.	Established AC	40	100	0.0
2.	AC composition, duties and purpose defined in memorandum of incorporation – reference made in annual report	40	100	0.0
3.	AC holds minimum of 2 meetings	40	100	0.0
4.	Info published that supports independence and capacity of AC members	40	100	0.0
5.	Statement that AC has sufficient qualifications and experience	40	100	0.0
6.	AC consists of minimum 3 members	40	100	0.0
7.	Chairman of AC is not chairman of board	40	100	0.0
8.	AC review and comment on Financial Statements	40	100	0.0
9.	AC monitors relationship between external assurance providers and company	40	100	0.0
10.	AC performs annual review of the finance function	40	100	0.0
11.	AC oversight of internal financial controls	40	100	0.0
12.	AC nominates external auditor for appointment	40	100	0.0
13.	AC approves terms and fees of engagement and remuneration of external auditor	40	100	0.0
14.	AC monitors and reports on independence of external auditor	40	100	0.0
15.	AC define policy and approves non-audit services by external auditor	40	100	0.0
16.	AC reports to board on its statutory and assigned duties	40	100	0.0
17.	AC reports to shareholders how statutory duties were carried out	40	100	0.0
18.	AC reports to shareholders its satisfaction with independence of external auditors	40	100	0.0

19.	AC reports to shareholders the AC view on financial statements and accounting practices	40	100	0.0
20.	AC reports to shareholders whether internal financial controls are effective	40	100	0.0
21.	AC provided summary of role and details on composition, number of meetings and activities in integrated report	40	100	0.0
22.	Statement that board fills AC vacancies/details if not	39	97.5	2.5
23.	Results of finance function review is disclosed in integrated report	39	97.5	2.5
24.	AC oversight of financial reporting risk	38	95.0	5.0
25.	AC recommends integrated report for approval to the board	38	95.0	5.0
26.	AC terms of reference approved by board	37	92.5	7.5
27.	AC have regard to all factors and risks that may impact on the integrity of the integrated report	37	92.5	7.5
28.	AC holds three or more meetings	36	90.0	10.0
29.	Statement that AC members keep up to date	33	82.5	17.5
30.	AC review quality and effectiveness of external audit process	33	82.5	17.5
31.	AC engage the external auditors to provide assurance on the summarised financial information	31	77.5	22.5
32.	AC considers the need to issue interim results	30	75.0	25.0
33.	AC meets with external audit annually	28	70.0	30.0
34.	AC approves internal audit plan	28	70.0	30.0
35.	AC oversight of fraud risk related to financial reporting	28	70.0	30.0
36.	AC oversight of IT risk related to financial reporting	27	67.5	32.5
37.	AC consists of four or more members	26	65.0	35.0
38.	Statement that AC may consult specialists or consultants subject to a board-approved process	26	65.0	35.0
39.	AC review content of summarised information	25	62.5	37.5

40.	AC risk management role described in charter	25	62.5	37.5
41.	AC ensure that combined assurance received is appropriate to face all significant risk	24	60.0	40.0
42.	AC meets with internal audit annually	23	57.5	42.5
43.	AC review disclosure of sustainability issues in integrated report	23	57.5	42.5
44.	AC is responsible for the performance assessment of the chief audit executive	22	55.0	45.0
45	The chairman of the audit committee should be present at the annual general meeting	17	42.5	57.5
46.	AC is responsible for the appointment/ dismissal of the chief audit executive	16	40.0	60.0
47.	AC ensures that internal audit function is subject to independent quality review	15	37.5	62.5
48.	AC recommends to the board to engage an external assurance provider on material sustainability issues	9	22.5	77.5
49.	Statement that AC chairman involved in setting/ agreeing AC agenda	7	17.5	82.5
50.	A statement that AC informed of reportable irregularities identified and reported on by external auditor	6	15.0	85.0
51.	Statement that board elects AC chairman / details if not	3	7.5	92.5

Source: Author

The results in Table 3.3 indicate that 21 of the 51 audit committee effectiveness variables were disclosed by all 40 companies while six audit committee effectiveness variables were disclosed by more than 90% but less than 100% of the companies. Overall, 44 out of the total 51 (86.3%) audit committee effectiveness variables were disclosed by more than 50%. Thus, Table 3.3 shows that seven (7) of the 51 audit committee effectiveness variables were disclosed by less than 50% of the companies.

Only audit committee effectiveness variables that indicate sufficient variability across the companies were used for further descriptive analysis. The audit committee effectiveness variables (21 variables), which were fully disclosed by all companies indicated no variability and were omitted from further analysis as they would not contribute to achieving the aim of the study. Also, the audit committee effectiveness variables that were disclosed

by less than 10% and more than 90% of companies (six variables between 91% and 99% and one variable below 10%) were omitted from further analysis as their contribution towards the aim of the study would be insignificant.

Table 3.3 shows the remaining 23 (highlighted in blue) of the 51 audit committee effectiveness variables that were considered to have sufficient variability (10% to 90% of disclosed and non-disclosed variables). Considering possible sampling instability with smaller samples (Linting & van der Kooij 2012:15) a 10% minimum variability was used to obtain optimal results from CATPCA. Smaller samples require sufficient variation for the model to be stable enough, for valid results. The 23 variables used for further data analysis represented 45.1% of all variables.

These 23 variables were analysed further in Phases 2 and 3. The next section discusses factor analysis using CATPCA as the statistical method employed for further data analyses of the data in Phase 2.

3.6.2 Phase 2: Factor analysis - Categorical Principal Component Analysis (CATPCA)

Factor analysis is a statistical technique used to reduce or condense the information contained in a number of individual variables into a smaller set of new, combined dimensions or factors, with minimum loss of information to reflect the majority of the data in the original variables (Hair, Black, Babin & Anderson 2019:127; Linting, Meulman, Groenen & van der Kooij 2007:337). The word ‘factor’ (in factor analysis) is defined as a linear combination of original variables representing implicit dimensions of the original set of variables (Hair et al 2010:123). In this study, the term ‘factor variable’ is used to refer to a new independent variable formed. CATPCA was applied for creating factor variables.

CATPCA is a method of factor analysis aimed at data reduction while analysing nonlinear relationships between variables (Kemalbay & Korkmazoğlu 2014:735; Linting & van der Kooij 2012:25; Linting, Meulman, Groenen & van der Kooij 2007:356). It is most valuable when the effective interpretation of relationships between objects is hindered by

a large number of variables (Linting et al 2007:336). This study employed the SPSS software tool to implement CATPCA.

The aim of using CATPCA was to make statistical sense of the combined impact of the 23 audit committee effectiveness variables with sufficient variability on the dependent variable, namely the absence or presence of restatements. Thus, CATPCA statistically reduced the 23 individual independent variables (expected to contribute to the aim of this study) based on their factor loadings. The reduction is explained in Sections 3.6.2.1 and 3.6.2.2 below, and presented in Section 4.2.1.

3.6.2.1 Determining the number of factors to be formed

The number of factors in a study may not exceed the total number of individual independent variables. In this study, a total number of 23 individual independent variables were further analysed by forming factors. The number of factors from the results of CATPCA, was determined by considering the eigenvalues and Cronbach's alpha. According to Hair et al (2010:92), the number of variances reported in a factor is shown by eigenvalues. Eigenvalues determine the optimal number of factors, with the extent of variance in an original variable considered significant when the eigenvalue is above 1 (Hair et al 2010:109). Similarly, the widely recognised and good criterion, the Kaiser-Guttman rule, also states the number of factors is equal to the number of factors with eigenvalues greater than 1 (Newsom 2023:1). In conjunction with eigenvalues, the Cronbach's alpha coefficients were considered to confirm the reliability and consistency of factors. Generally, the minimum Cronbach's alpha value to indicate consistency, is 0.7 although a lower value of 0.6 may be considered depending on the nature of the data (Hair et al 2010:125). Also assisting in the determination of the number of factors, is the well-known scree criterion (Fabrigar, Wegener, MacCallum & Strachan 1999:293). The scree plot in Figure 4.1 reflects the 23 individual independent variables on the x-axis and their eigenvalues on the y-axis. The 'elbow' in the pattern, identifies the last factor that accounts for a considerable amount of variance in the data. The location of this elbow assists to determine the appropriate number of factors by denoting the insignificance of subsequent factors. For this study, the number is six. Table 4.1 presents both the

eigenvalues and Cronbach's alpha results for the six factors. Next, factor loadings of the six new factors were considered.

3.6.2.2 Analysis of factor loading and labelling

Factor loading is defined as the 'correlation between the original variables and the factors' (Hair et al 2010:92). This proves the potential difficulty to allocate an all-inclusive name to the newly formed factors. As part of data reduction, factor loading is applied to determine the relevance and significance of individual independent variables subsumed in each of the new factors (Hair et al 2010:99).

The minimum value of a factor loading of an individual independent variable in absolute terms to be relevant for determining and interpreting the underlying structure of a factor variable is approximately 0.3 to 0.4 while factor loadings of 0.5 or above are deemed to be significant and those below 0.3 weak (Hair et al 2010:117). For the purposes of this study, six factor variables met the assumption of consisting of individual independent variables with factor loadings of greater than 0.3 in absolute value. These are presented in Table 4.2 to Table 4.7. The six factor variables are:

1. AC meeting interaction (three variables).
2. AC regulatory role (five variables).
3. AC sustainability reporting and combined assurance oversight (three variables).
4. AC risk and reporting oversight (four variables).
5. AC structure and responsibility (four variables).
6. AC internal and external assurance oversight and consulting (four variables).

As an applicable pre-step to binomial logistic regression, the CATPCA method thus reduced the 23 individual independent variables to six factor variables for further data analysis. To achieve the aim of the study, hypotheses were developed for each of the six factor variables as part of further data analysis (Section 4.2).

Next, binomial logistic regression was used to test the relation between each of the six factor variables and the absence or presence of restatements.

3.6.3 Phase 3: Binomial logistic regression

In the third phase of data analysis, binomial logistic regression was used to test the relation between the factor variables depicting audit committee effectiveness and the absence or presence of restatements. A binomial logistic regression (also referred to as logistic regression), predicts the probability of an observation (disclosure of audit committee effectiveness variables and restatements) sorted into one of two categories of a dichotomous dependent variable (Laerd Statistics, 2018:1). A dichotomous variable has two distinct values, based on one or more independent variables that can be either continuous or categorical (Laerd Statistics, 2018:1). There are only two possible outcomes when using binomial logistic regression, 'success' or 'failure' (Penn State 2024:1; Hosmer 2013:125).

When conducting binomial logistic regression, certain assumptions apply, as noted in Table 3.4. These assumptions should first be met first to ensure valid results.

Table 3.4: Binomial logistic regression assumptions

Assumptions
The dependent variable should be measured on a dichotomous scale.
One or more independent variables are involved, which can be either continuous (i.e. an interval or ratio variable) or categorical (i.e. an ordinal or nominal variable).
There should be independent observations.
The dependent variable should have mutually exclusive and exhaustive categories.
A linear relationship should exist between any continuous independent variables and the logit transformation of the dependent variable.

Source: Own design, based on Laerd Statistics (2018:1)

Section 4.3.1 includes a discussion on whether or not the research results of this study met the above-mentioned assumptions. Section 4.3.2 presents the results of Phase 3.

3.7 RESEARCH QUALITY

Positivist researchers, ensuing a quantitative research design, use the 'canons of scientific inquiry' related to reliability and validity to assess the quality of research (Saunders et al 2019:213). De Vos et al (2011:172) state that before implementing a

study, a researcher should ensure the measurement instruments and procedures incorporate acceptable levels of reliability and validity. Since this study followed a quantitative research design within a positivism paradigm, the procedures for data collection and data analysis need to be considered for reliability and validity.

3.7.1 Reliability

Reliability fundamentally refers to the extent to which variables and concepts are consistent and stable in what they intend to measure (Bell et al 2022:174; Hair et al 2019:3). Research is deemed reliable if the administration of a similar instrument consistently yields similar results under comparable conditions (de Vos et al 2011:178). In this study, the analysis of annual and other reports of JSE-listed companies in South Africa for disclosures relating to the audit committee effectiveness variables identified in King III and restatements can be repeated to achieve the same results and is thus deemed reliable (IoDSA 2009a:31-35).

3.7.2 Validity

Validity refers to the extent to which an empirical measure reflects the real meaning of the concept under consideration and to measure what is intended to be measured (Babbie 2007:146; Bell et al 2022:175; de Vos et al 2011:172; Leedy & Ormrod 2015:114). Further, validity presumes reliability; thus, if variables are not reliable, they may also not be valid (Bryman 2012:173).

Different strategies are implemented to support the validity of research results and two concepts, namely, internal validity and external validity, originated in discussions of quantitative research (Leedy & Ormrod 2015:103). According to Leedy and Ormrod (2015:103), internal validity indicates the magnitude to which the research design and data generated by the study permit researchers to draw accurate conclusions about cause-and-effect and other relationships within the data. Likewise, de Vos et al (2011:153) indicate that internal validity is the extent to which changes in the dependent variables are imputable to the independent variables. The eternal validity focuses on the degree to which the results of a study can be ‘generalised’ to other contexts and

populations (Leedy & Ormrod 2015:105; de Vos et al 2011:153). Strategies to enhance external validity include using a representative sample and enabling replication in a different context (Leedy & Ormrod 2015:105). The sample in this study, as explained in Section 3.4.1, effectively represented almost the entire population of JSE-listed companies. The study can also be replicated. Given the support in the literature (Section 2.4) for the relation between audit committee effectiveness variables and financial reporting quality proxied by restatements they are deemed reliable and also valid to achieve the research objectives of the study.

3.8 ETHICAL CONSIDERATIONS

Ethical considerations in research that need to be envisaged are extensive, and they should be reflected on throughout the entire research process (Creswell 2014:90). Ethical clearance was obtained from the University of South Africa to collect secondary data from the websites of listed companies. The Research Ethics Review Committee within the College of Accounting Sciences granted the specific approval on 8 June 2016 with reference number 2016_CAS_028 (Appendix B). Throughout the study, research ethics were duly considered. The downloaded secondary data comprising annual and other reports and information on company websites of the 40 sampled JSE-listed companies and the coded spreadsheets will be stored safely for a period of five years.

3.9 LIMITATIONS

This study is limited to an analysis of disclosures on audit committees in publicly available documents of 40 JSE-listed companies, for financial periods ending 2015 and 2016. The sample of companies is based on the market capitalisation of 9 November 2015. Disclosures on audit committees was analysed in terms of the King III Code requirements. It was not possible to analyse the company documentation for King IV™ requirements, as King IV™ became effective for financial periods commencing on or after 1 April 2017 (IoDSA 2016:38). It should be noted that the findings from the study, based on a specific sample, cannot be extrapolated to the entire population of JSE-listed companies.

3.10 CHAPTER SUMMARY

This chapter described the research methodology applied in the study. Each step within the research process was discussed in different sections.

In the next chapter, the results obtained from the three phases of data analysis are presented and discussed.

CHAPTER 4: DATA ANALYSIS AND INTERPRETATION

4.1 INTRODUCTION

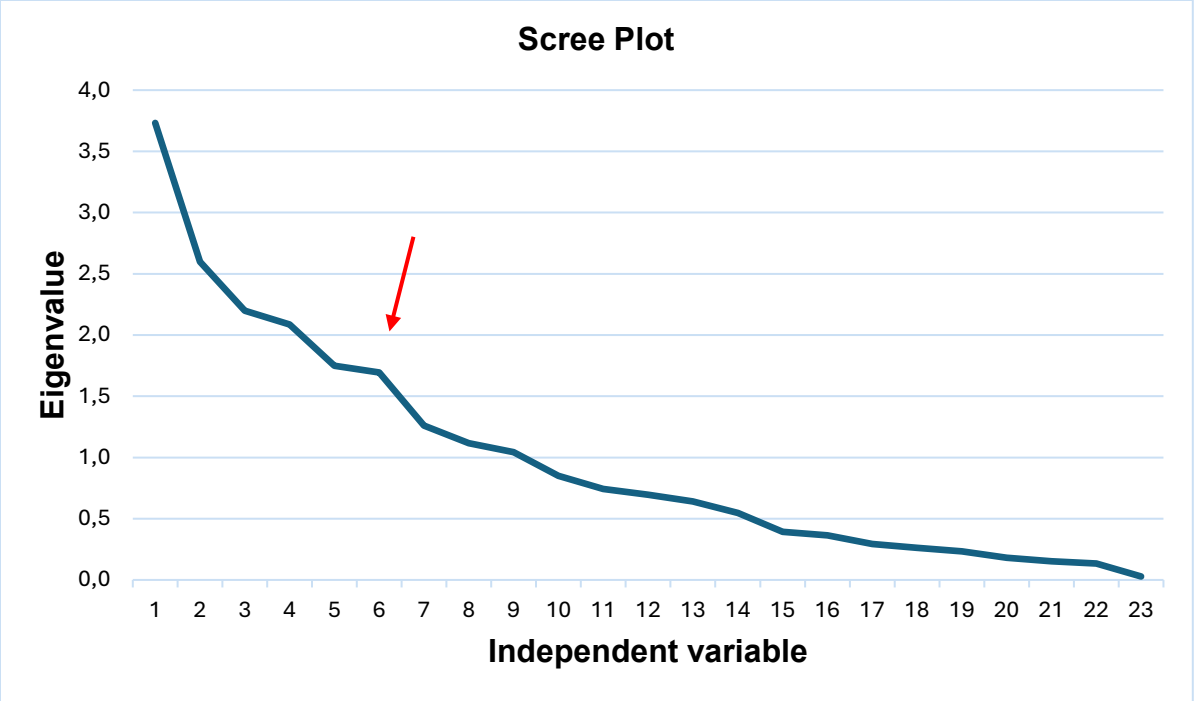
In Chapter 3, the methods applied in the data analysis for this study were described. The results of the first part of the data analysis, named Phase 1 – descriptive statistics, were also provided. This chapter presents the results of additional data analysis conducted during Phases 2 and 3 of the study. Factor analysis was used in Phase 2 (Section 4.2), particularly the CATPCA method, and further descriptive statistics were performed on the newly developed factor variables. In Phase 3 (Section 4.3), binomial logistic regression analysis was applied to test the hypotheses formed in Phase 2. Binomial logistic regression analysis indicated the relationship between the newly developed factor variables, which serve as proxies for audit committee effectiveness and the absence or presence of restatements. Section 4.4 concludes the chapter.

4.2 PHASE 2: FACTOR DEVELOPMENT FOR FURTHER DATA ANALYSIS

Phase 2 presents the results in two sections, namely, the results of analysing the data from Phase 1 for possible data reduction by way of factor analysis using CATPCA, and the further descriptive statistics on factor variables created for analysis during Phase 3.

4.2.1 Factor development – CATPCA

The results of the factor analysis applying the CATPCA method are presented in this section in graphs, text and tables. The results include the eigenvalues and Cronbach's alpha results to test the validity and reliability of each factor variable. Each of the factor variables is presented with a new name, resulting in a newly formed hypothesis for analysis during Phase 3. The number of factor variables resulting from CATPCA was determined by considering the eigenvalues and Cronbach's alpha coefficients, as discussed in Section 3.6.1.2. The eigenvalues of the 23 individual independent variables that were used for further analysis are reflected in the scree plot shown in Figure 4.1.



Extraction method: CATPCA

Source: Author

Figure 4.1: Scree plot

As part of factor development, CATPCA aims to represent the original 23 audit committee effectiveness variables that were found to have sufficient variability following descriptive statistics into the least number of factor variables, whilst maximising the variance of the original data explained by the factor variables. In this dataset, based on eigenvalues larger than 1, (which is in line with the rule of thumb discussed in Section 3.6.2) and the curve of the scree plot in Figure 4.1, it appears that either four or six factor variables might be optimal for data reduction.

Table 4.1: Cronbach's alpha coefficients and eigenvalues of factors

Factor variable	Cronbach's alpha coefficient	Total (eigenvalue)	% of variance
1	0.676	2.616	11.375
2	0.674	2.581	11.220
3	0.616	2.399	10.431
4	0.644	2.398	10.426
Total			**43.452**
5	0.578	2.039	8.866
6	0.571	2.025	8.804
Grand Total	0.971	14.058	**61.122**

Extraction method: CATPCA

Source: Author

According to Table 4.1, the percentage of variance explained by the number of factor variables found that four variables only account for 43.452% of the variance, while six factor variables account for 61.122% of the variation in all the factor variables. Therefore, the six factors explain a larger proportion of the variation of the original 23 individual independent variables identified in Phase 1 descriptive statistics (Table 3.3). Furthermore, Table 4.1 shows that the overall Cronbach's alpha coefficient of 0.971 indicates a good fit, and each factor variable has a Cronbach's alpha coefficient of above or very close to 0.6 and an eigenvalue greater than 1. Considering these results, adequate support exists to reduce the data to six factors for further analysis to address the research questions of the study (Linting & van der Kooij 2012:12).

4.2.1.1 Discussing factor loadings, labelling factor variables, and developing hypotheses

CATPCA provided a pattern based on the highest loadings to indicate which of the variables should be grouped to reduce the data to six factors. Tables 4.2 to 4.7 present the factor loadings of the variables as identified by CATPCA. Appropriate labels were created for the six identified factor variables based on the individual variables included in each factor variable.

As indicated in Section 3.6.2, individual independent variables producing a factor loading of close to, or above 0.6 are considered significant, while the minimum factor loading of individual independent variables to be included in a factor variable is between 0.3 and 0.4. Each of the six newly created factor variables, along with its hypothesis, are discussed and presented below.

Table 4.2: Factor variable 1 – AC meeting interaction

Individual independent variables included in factor variable 1	Factor loading
AC meets with external auditors annually	0.928
AC meets with internal auditors annually	0.804
Chairman of the AC should be present at the annual general meeting	0.480

Extraction method: CATPCA

Source: Author

Table 4.2 presents factor variable 1, which consists of three of the 23 individual independent variables. Each independent variable had a factor loading ranging from 0.480 to 0.928, which is considered acceptable. Factor variable 1 is labelled 'AC meeting interaction', as all variables disclose the audit committee's attendance and interaction at various meetings (with external auditors and internal auditors and at the annual general meeting).

Literature supports this factor variable, finding the effectiveness of audit committee oversight is influenced by meetings between audit committees and internal auditors, external auditors and management (Zaman & Sarens 2013:498). Furthermore, frequent meetings between audit committees and external auditors also improve audit quality (Beattie et al 2013:56). Likewise, active audit committee oversight enhances internal audit quality (Abdullah, Ismail & Smith 2018:395).

It is recommended by King III that the audit committee should meet annually with the external and internal auditors in the absence of management and the audit committee chairman should be present at the annual general meeting (IoDSA 2009a:31-32). Thus, higher levels of disclosure of independent variables included in the audit committee meeting interaction factor variable are likely to indicate higher effectiveness of the audit

committee, contributing to a higher level of financial reporting quality. Considering that the absence of restatements is used as a proxy of high-level financial reporting quality, the following hypothesis is developed:

> *H_1 There is a positive relation between AC meeting interaction and the absence of restatements*.

Table 4.3: Factor variable 2 – AC regulatory role

Individual independent variables included in factor variable 2	Factor loading
AC approves internal audit plan	0.739
AC risk management role described in charter	−0.700
Statement that AC chairman is involved in setting/agreeing to the AC agenda	−0.678
AC ensures that internal audit function is subject to independent quality review	0.643
AC considers the need to issue interim results	0.520

Extraction method: CATPCA

Source: Author

Table 4.3 shows that factor variable 2 consists of five of the 23 individual independent variables. Each independent variable had a factor loading ranging from 0.520 to 0.739, which is considered acceptable. Factor variable 2 is labelled 'AC regulatory role', as all individual variables refer to various audit committee responsibilities. Two of the individual variables relate to the audit committee's responsibility towards the internal audit function, a third to its risk management responsibility, a fourth to its role in preparing the audit committee agenda and a fifth to the audit committee's responsibility to consider the need to issue interim results. Recommendation 3.8.1 of King III requires the audit committee charter to include its responsibilities concerning risk management (IoDSA 2009a:34).

Supporting this factor variable, the literature reports that audit committee members play a significant role in risk management practices, indicating a direct link to the quality of financial reporting (Cohen, Krishnamoorthy & Wright 2017:1203-1204). Also, prior studies indicate a strong mutual interdependence between the effectiveness of the audit committee and the internal audit function (Martinov-Bennie, Soh & Tweedie 2015:749;

Zaman & Sarens 2013:512; Zain & Subramaniam 2007:894). Furthermore, evidence confirms a positive relationship between effective audit committees and disclosure of interim results (Mangena & Pike 2005:344).

Thus, the 'AC regulatory role' is essential for a higher level of financial reporting quality. Considering that the absence of restatements is used as a proxy of high-level financial reporting quality, the following hypothesis is developed:

> *H_2 There is a positive relation between AC regulatory role and the absence of restatements*.

Table 4.4: Factor variable 3 – AC sustainability reporting and combined assurance oversight

Individual independent variables included in factor variable 3	Factor loading
AC recommends to the board to engage an external assurance provider on material sustainability issues	0.705
AC reviews disclosure of sustainability issues in the integrated report	0.659
AC ensures that combined assurance received is appropriate to face all significant risks	0.632

Extraction method: CATPCA

Source: Author

Table 4.4 reveals factor variable 3 consists of three of the 23 individual independent variables. Each independent variable had a factor loading ranging from 0.632 to 0.705, which is considered significant. Factor variable 3 is labelled 'AC sustainability reporting and combined assurance oversight', as two of the individual variables relate to the audit committee's oversight in terms of sustainability issues. The third individual variable refers to the audit committee's oversight of combined risk assurance to mitigate significant risks.

Studies reported in the literature support the result that audit committees have a significant positive impact on credible sustainability reporting, resulting in more sustainable transparency for company stakeholders (Tumwebaze, Bananuka, Kaawaase, Bonareri & Mutesasira 2021:n.p.; Buallay & Al-Ajmi 2019:260; Al-Shaer & Zaman 2018:973). Also, through the proper implementation of combined assurance, the audit

committee can effectively exercise its oversight role (Erasmus & Matsimela 2021:6; Decaux & Sarens 2015:75) and significant risk can be addressed by combining various assurance approaches (Decaux & Sarens 2015:75).

Thus, 'AC sustainability reporting and combined assurance oversight' is vital for a higher level of financial reporting quality. Considering that the absence of restatements is used as a proxy of high-level financial reporting quality, the following hypothesis is developed:

> *H_3 There is a positive relation between AC sustainability reporting and combined assurance oversight and the absence of restatements*.

Table 4.5: Factor variable 4 – AC risk and reporting oversight

Individual independent variables included in factor variable 4	Factor loading
AC oversight of information technology risk related to financial reporting	0.679
AC oversight of fraud risk related to financial reporting	0.675
Statement that AC members keep up to date	0.663
AC is responsible for the performance assessment of chief audit executive	0.461

Extraction method: CATPCA

Source: Author

Table 4.5 presents factor variable 4, which consists of four of the 23 individual independent variables. Each independent variable had a factor loading ranging from 0.461 to 0.679, which is considered acceptable. Factor variable 4 is labelled 'AC risk and reporting oversight', as two of the individual variables refer to the audit committee's oversight of information technology and fraud risk, the third individual variable focuses on the audit committee's responsibility to remain technically updated, and the fourth individual variable requires its oversight on performance assessment of the chief audit executive.

Supporting this factor variable, literature reports the presence of an audit committee technology expert substantially improves the quality of financial reporting (Ashraf et al 2020:23). Also, independent audit committees with professional experience in corporate financial reporting have a reduces fraudulent financial reporting (Wilbanks, Hermanson &

Sharma 2017:21). The FRC (2024a:12) requires at least one of the audit committee members to have recent and relevant financial experience, which aligns to members keeping their knowledge up to date, as required by King III (IoDSA 2009a:32).

Thus, higher levels of disclosure on audit committee risk and reporting oversight are likely to indicate more effective audit committee oversight and a higher level of financial reporting quality. Considering that the absence of restatements is used as a proxy of high-level financial reporting quality, the following hypothesis is developed:

> *H_4 There is a positive relation between AC risk and reporting oversight and the absence of restatements*.

Table 4.6: Factor variable 5 – AC structure and responsibility

Individual independent variables included in factor variable 5	Factor loading
AC consists of four or more members	0.727
AC engages external auditors to provide assurance on the summarised financial information	0.720
AC reviews the content of summarised information	0.598
AC holds three or more meetings	0.441

Extraction method: CATPCA

Source: Author

Table 4.6 shows that factor variable 5 consists of four of the 23 individual independent variables. Each independent variable had a factor loading ranging from 0.441 to 0.727, which is considered acceptable. Factor variable 5 is labelled 'AC structure and responsibility', as one of the individual variables relates to the audit committee's composition, two relate to the audit committee's oversight of summarised financial information and one relates to frequent audit committee meetings.

Supporting this factor variable, the literature finds that audit committees which meet frequently result in fewer discrepancies and higher audit quality, attributed to effective monitoring and the positive influence on the extent of the disclosures (Aljaaidi, Sharma & Bagais 2021:904; Buallay & Al-Ajmi 2019:260; Appuhami & Tashakor 2017:414; Inaam & Khamoussi 2016:191). Concerning audit committee size, several authors report a

positive relation between a larger audit committee, particularly with members who are financial experts, and higher financial reporting quality (Ha 2022:17; Raimo et al 2020:530; Masmoudi 2021:19; Engrawes, Feng, Lu & Shan 2020:2361).

Thus, 'AC structure and responsibility' is important for a higher level of financial reporting quality. Considering that the absence of restatements is used as a proxy for high-level financial reporting quality, the following hypothesis is developed:

> *H5 There is a positive relation between AC structure and responsibility and the absence of restatements.*

Table 4.7: Factor variable 6 – AC internal and external assurance oversight and consulting

Individual independent variables included in factor variable 6	Factor loading
A statement that AC informed of reportable irregularities identified and reported on by external auditor	0.694
AC is responsible for the appointment/dismissal of chief audit executive	0.649
AC reviews quality and effectiveness of external audit process	0.589
Statement that AC may consult specialists or consultants subject to a board-approved process	−0.475

Extraction method: CATPCA

Source: Author

Table 4.7 presents factor variable 6, which consists of four of the 23 individual independent variables. Each independent variable had a factor loading ranging from 0.475 to 0.694, which is considered acceptable. Factor variable 6 is labelled 'AC internal and external assurance oversight and consulting', as three variables related to the audit committee's oversight of assurance role-players and one to the audit committee's ability to make use of consultants. Supporting this factor variable, the literature reports when audit committees have proper financial accounting expertise the reliance placed on internal audit's work by the external audit increases, resulting in fewer audit delays, thus indicating higher financial reporting quality (Oussii & Boulila Taktak 2018:49).

Thus, 'AC internal and external assurance oversight and consulting' is essential for high-level financial reporting quality. Considering that the absence of restatements is used as a proxy of the highest level of financial reporting quality, the following hypothesis is developed:

> *H_6 There is a positive relation between AC internal and external assurance oversight and consulting and the absence of restatements*.

4.2.2 Further descriptive statistics on factor variables

Further descriptive statistics on the six factor variables are presented in Table 4.8 in the form of minimum and maximum recorded, means and standard deviations. Each individual variable included in a factor variable was coded as a value of 1 when disclosed. These descriptive statistics are based on the sum of the disclosures made by the companies for all the variables included in the specific factor variable. Therefore, each factor variable could have a maximum value of the number of individual variables that the respective factor is composed of.

Table 4.8: Further descriptive statistics on the six factor variables

Factor variables	Popu-lation	Mean	Stand. dev.	Min. recorded	Max. recorded	Max. possible
AC meeting interaction	40	1.7000	1.1811	0	3	3
AC regulatory role	40	2.6250	0.9524	0	4	5
AC sustainability reporting and combined assurance oversight	40	1.4000	1.0813	0	3	3
AC risk and reporting oversight	40	2.7500	1.2142	0	4	4
AC structure and responsibilities	40	2.9500	1.1536	0	4	4
AC internal and external assurance oversight and consulting	40	2.0250	0.8912	0	4	4

Extraction method: descriptive statistics

Source: Author

As shown in Table 4.8, incidents were recorded where all or none of the individual variables subsumed in each factor variable were not disclosed by one or more companies, as gathered from a minimum value of 0 for the sum of the number of disclosures of a factor variable. On average, 1.7 of the three variables included in 'AC meeting interaction' were reported on by the companies, with the maximum showing that some companies reported on all three variables included in this factor. On average, 2.63 of the five variables included in 'AC regulatory role' were reported on by the companies, where the maximum shows that some companies reported on four of the possible five variables. Therefore, no companies reported on all five variables included in this factor, while some companies did not report on any of the five variables.

On average, 1.4 of the three variables included in 'AC sustainability reporting and combined assurance oversight' were reported on by the companies, where the maximum shows that some companies reported on all three variables included in this factor while others did not report on any. On average, 2.75 of the four variables included in 'AC risk and reporting oversight' were reported on by the companies, where the maximum shows that some companies reported on all four variables included in this factor, while others did not report on any. On average, 2.95 of the four variables included in the 'AC structure and responsibility' was reported on by the companies, where the maximum shows that some companies reported on all four variables included in this factor, while others did not report on any.

On average, 2.03 of the four variables included in 'AC internal and external assurance oversight and consulting' were reported on by the companies, where the maximum shows that some companies reported on all four variables included in this factor, while others did not report on any. Based on the proportion of the average number of variables reported out of the possible maximum number per factor variable, the companies tended to have a lesser tendency to report on 'AC regulatory role' individual variables than on the other five factor variables.

A discussion and results of the descriptive statistics in the form of frequencies are presented next. This provides insights into the distribution of the number of variables reported in each of the factor variables. Figures 4.2 to 4.7 support the discussion.

As shown in Figure 4.2, 32.5% (13 of 40) of the companies disclosed all three individual independent variables subsumed in the 'AC meeting interaction' factor variable, while 62.5% (25 of 40) disclosed at least two (i.e. two or three individual independent variables). The remaining 25% (10 of 40) of companies provided no or insufficient disclosure pertaining to all three individual independent variables contained in Recommended Practices 3.1.5 and 3.3.3 in King III (IoDSA 2009a:31-32). This is concerning, as the King III requirements are mandatory for companies listed on the JSE (IoDSA 2009a:5-6). Examples of insufficient disclosure include companies disclosing that their internal or external auditors have unrestricted access to the chairman of the audit committee without stipulating that the internal or external auditors did indeed meet with the audit committee during the respective financial period.

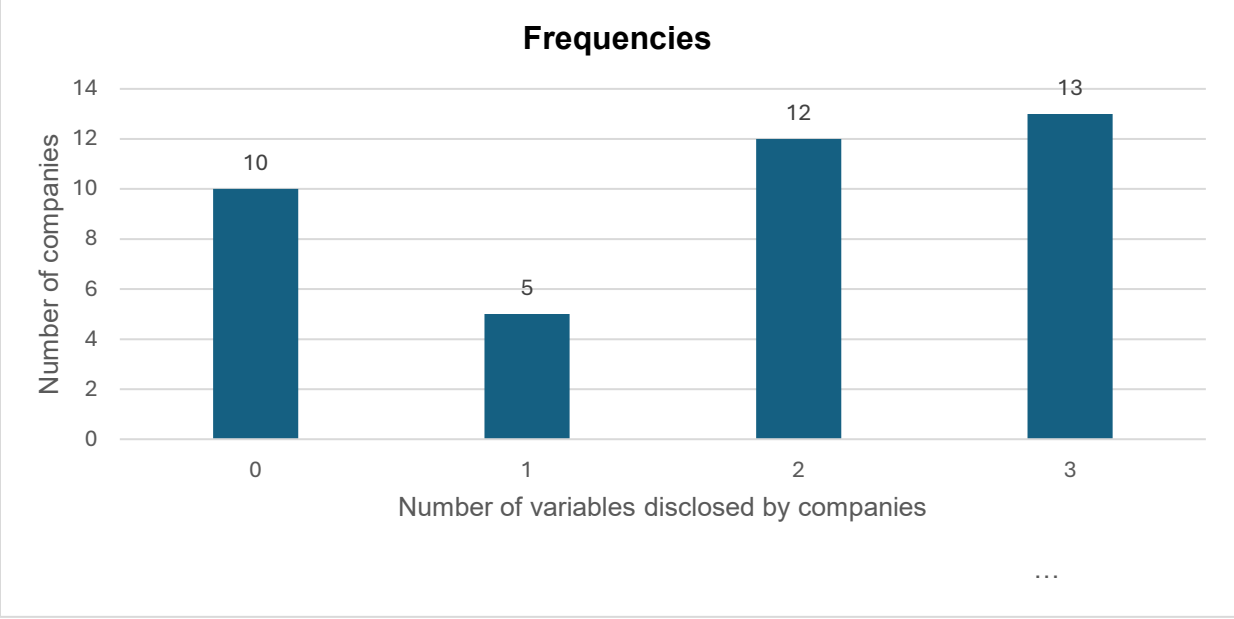


Figure 4.2: Factor variable 1 – AC meeting interaction

Source: Author

As shown in Figure 4.3, only 12.5% (5 of 40) of the companies disclosed four of the five individual independent variables subsumed in the 'AC regulatory role' factor variable, while 67.5% (27 of 40) disclosed at least three of the individual independent variables. None of the companies disclosed all five of the individual independent variables. Only one of the 40 companies did not disclose any of the individual independent variables. Specifically, for the individual independent variable 'AC approves internal audit plan' the disclosure mentioned the audit committee reviewed the internal audit plan but not that they approved it. Some companies also did not disclose the 'AC risk management role described in charter' individual independent variable contained in this factor variable. This was because they did not mention having an audit committee charter but mentioned the audit committee's risk management role was addressed in the committee's terms of reference. Very few companies disclosed the individual independent variable 'Statement that AC chairman involved in the setting/agreeing AC agenda', as they merely disclosed that this was managed on a board level. The majority of companies' audit committees mentioned they reviewed the internal audit function but did not mention whether internal audit was subject to an independent quality review as per the individual independent variable 'AC ensures that internal audit function is subject to independent quality review'.

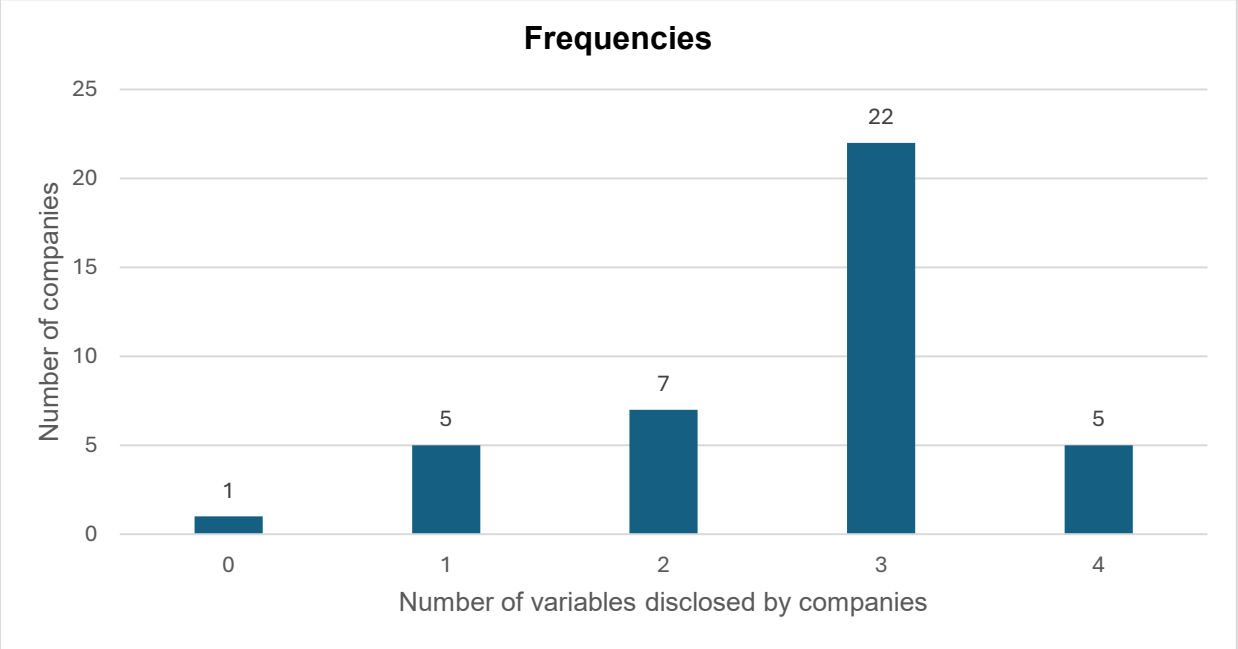


Figure 4.3: Factor variable 2 – AC regulatory role

Source: Author

As shown in Figure 4.4, only 20% (8 of 40) of the companies disclosed all three of the individual independent variables subsumed in the 'AC sustainability reporting and combined assurance oversight' factor variable, while an additional 25% (10 out of 40) disclosed two of the three individual independent variables. Therefore, 45% of the companies disclosed at least two of the three independent variables. This non-disclosure was mainly related to insufficient disclosure on the audit committee's role in sustainability issues, and more specifically, in terms of the individual independent variable 'AC recommends to the board to engage an external assurance provider on material sustainability issues'. Some companies did not mention the term, 'combined assurance' from the individual independent variable 'AC ensures that combined assurance received is appropriate to face all significant risks' but referred separately to the assurance provided by both internal and external audits.

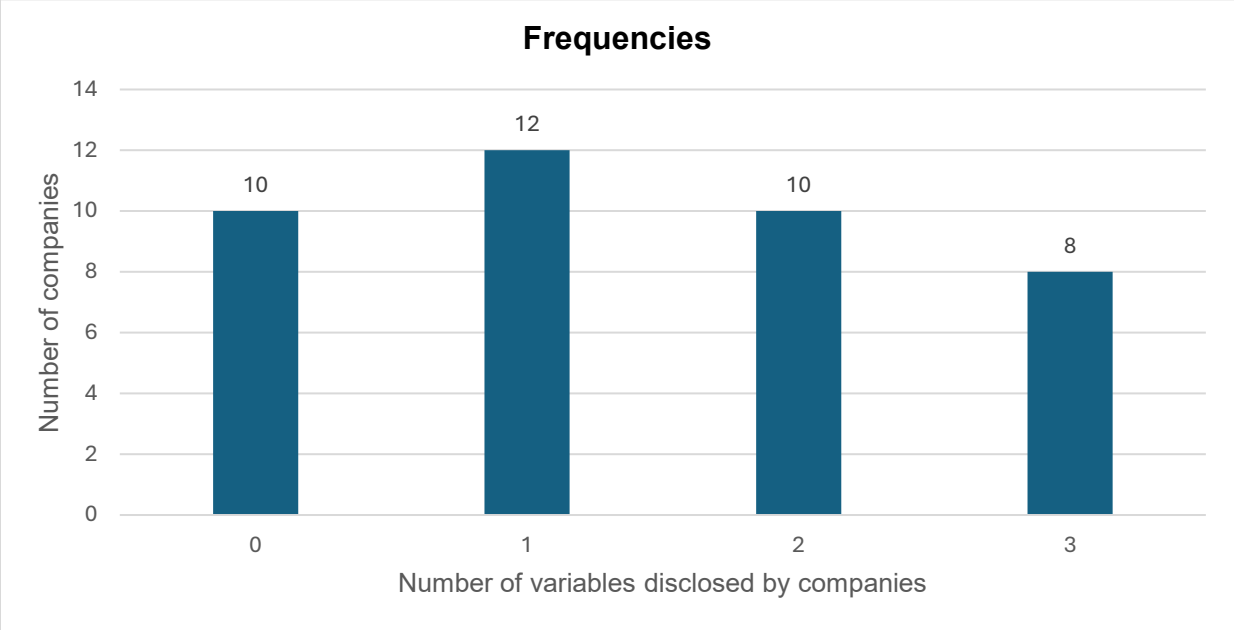


Figure 4.4: Factor variable 3 – AC sustainability reporting and combined assurance oversight

Source: Author

As shown in Figure 4.5, only 30% (12 of 40) of the companies disclosed all of the individual independent variables subsumed in the 'AC risk and reporting oversight' factor variable. Of the companies, 72.5% (29 of 40) disclosed at least two of the individual independent variables included in this factor variable. The non-disclosure was mainly due to companies not disclosing their audit committees' oversight role specific to information technology and fraud risks. Furthermore, some companies only provided disclosure on the audit committee's responsibility to internal audit performance assessment in general and not specifically to the chief audit executive as per the individual independent variable, 'AC is responsible for the performance assessment of chief audit executive'.

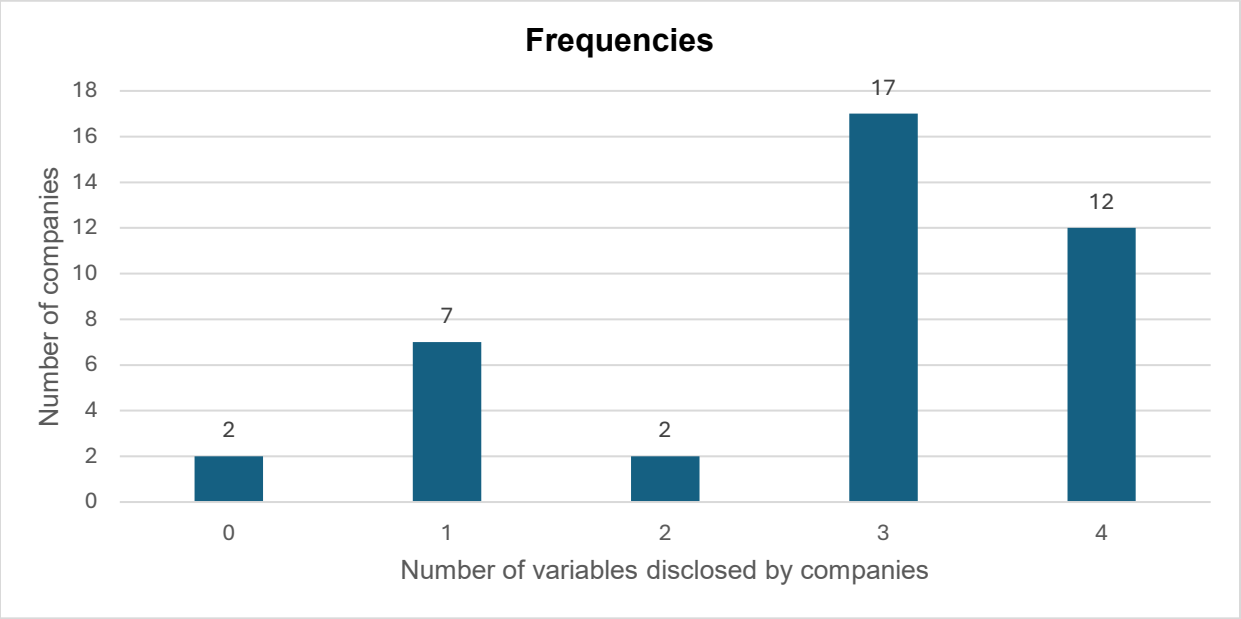


Figure 4.5: Factor variable 4 – AC risk and reporting oversight

Source: Author

As shown in Figure 4.6, a more passable 42.5% (17 of 40) of the companies disclosed all, and an additional 27.5% (11 of 40) disclosed three of the individual independent variables subsumed in the 'AC structure and responsibility' factor variable. It is evident that factor variable 5, 'AC structure and responsibility', in comparison to the other factor variables, presents higher levels of disclosure. The individual independent variable that contributed mostly to lower levels of non-disclosure is 'AC holds three or more meetings'.

Of the companies, 36 (96%) disclosed that a minimum of three audit committee meetings were held during the 2015 financial year.

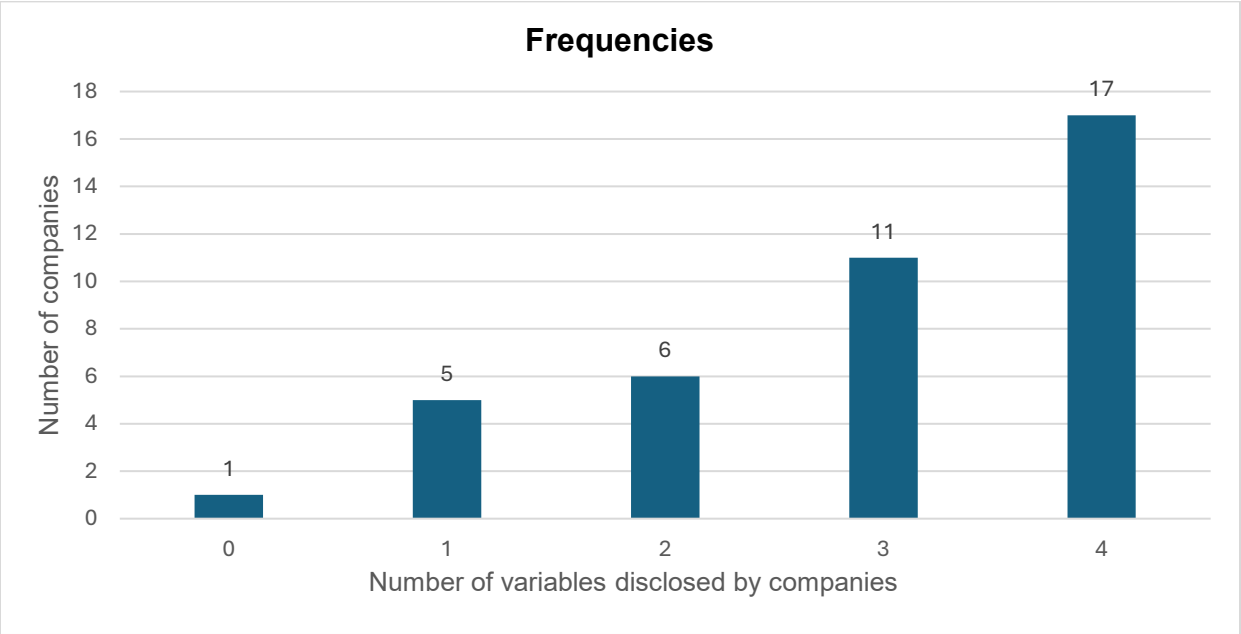


Figure 4.6: Factor variable 5 – AC structure and responsibility

Source: Author

As shown in Figure 4.7, only 5% (2 of 40) of the companies disclosed all the individual independent variables subsumed in the 'AC internal and external assurance oversight and consulting' factor variable. Most of the companies only reported on two of the individual independent variables (45% or 18 of 40). This non-disclosure was attributed to various individual independent variables. Very few companies disclosed information on the role that audit committees play when reportable irregularities are identified and reported by the external auditor as well as on the audit committee's responsibility of appointing or dismissing the chief audit executive. Lastly, in terms of the individual independent variable, 'Statement that AC may consult specialists or consultants subject to a board-approved process', companies only disclosed that their remuneration committee consulted specialists, and not the audit committee as well.

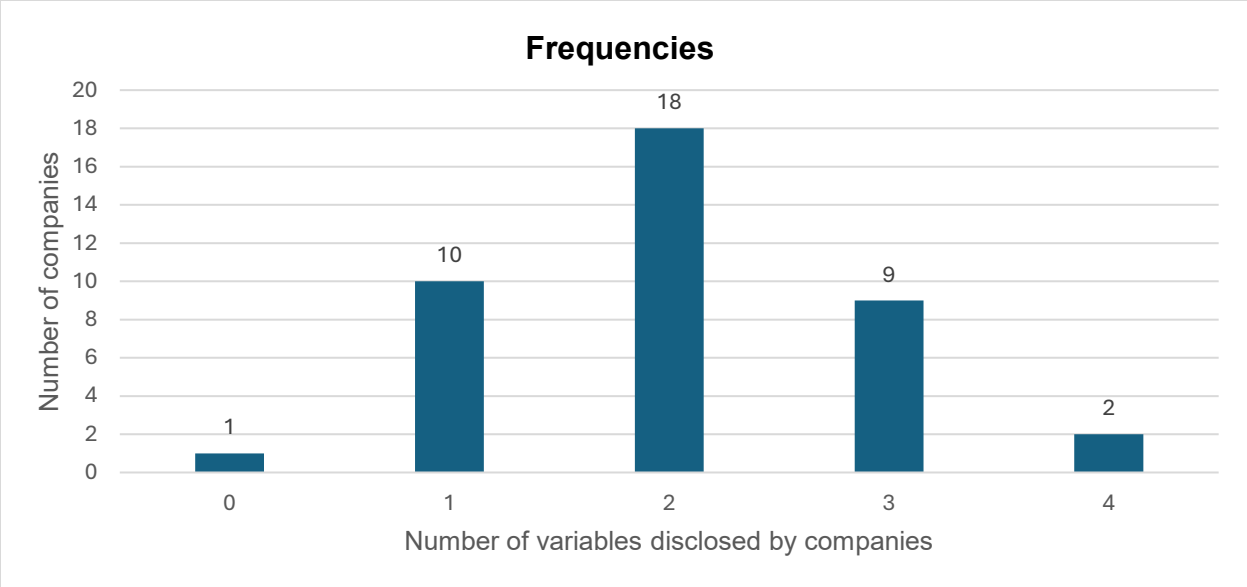


Figure 4.7: Factor variable 6 – AC internal and external assurance oversight and consulting

Source: Author

This section presented the results of further descriptive statistics on the six factor variables derived using CATPCA in the form of frequencies. The next section presents and interprets the results using the binomial logistic regression as a statistical technique used to test the hypotheses developed during Phase 2.

4.3 PHASE 3: BINOMIAL LOGISTIC REGRESSION

4.3.1 Assumptions for logistic regression

Binomial logistic regression, often referred to as logistic regression, was used to test the six newly developed hypotheses and relationships to the absence of restatements. Logistic regression assists in predicting the probability that an observation falls into one of two categories of a dichotomous dependent variable based on one or more independent variables that can be either continuous or categorical (University of Miami 2020:3; Laerd Statistics 2018:1; Wuensch 2014:1). To conduct a logistic regression, certain assumptions should first be met to ensure valid results, as discussed in

Section 3.6.2. Table 4.9 summarises the results, addressing each assumption to ensure that the data are appropriate for logistic regression.

Table 4.9: Logistic regression assumptions

Assumption	Met by data in this study
The dependent variable should be measured on a dichotomous scale.	✓ Restatement is either yes or no.
One or more independent variables, which can be either continuous (i.e., an interval or ratio variable) or categorical (i.e., an ordinal or nominal variable).	✓ All newly created variables (factor variables) are nominal.
There should be independent observations.	✓ All observations made from the analysis of reports are independent.
The dependent variable should have mutually exclusive and exhaustive categories.	✓ A company can either conduct a restatement or not.
A linear relationship between any continuous independent variables and the logit transformation of the dependent variable.	*Not applicable to this study as independent variables are categorical in nature.*

Source: Own design, based on Laerd Statistics (2018:1)

As part of the logistic regression, the independence of independent variables is tested by considering the correlations or linear relationships between the newly created factor variables.

Table 4.10: Linear relationship (Pearson's correlation coefficients)

Factor variables	AC meeting interaction	AC regulatory role	AC sustainability reporting and combined assurance oversight	AC risk and reporting oversight	AC structure and responsibility	AC internal and external assurance oversight and consulting
AC meeting interaction	1.000	−0.334	−0.012	−0.200	0.053	−0.047
AC regulatory role	−0.334	1.000	−0.009	−0.381	−0.311	−0.376
AC sustainability reporting and combined assurance oversight	−0.012	−0.009	1.000	−0.103	−0.105	−0.283
AC risk and reporting oversight	−0.200	−0.381	−0.103	1.000	−0.276	−0.224
AC structure and responsibility	0.053	−0.311	−0.105	−0.276	1.000	−0.011
AC internal and external assurance oversight and consulting	−0.047	−0.376	−0.283	−0.224	−0.011	1.000

Source: Author

Table 4.10 shows the correlations between the factor variables to determine whether the assumption of independence of the independent variables for logistic regression has been met. The results indicate that there is some correlation between the factor variables, with a maximum value that shows a correlation coefficient of −0.381, which is considered relatively weak. The assumption has therefore been met.

4.3.2 Results of logistic regression

Table 4.11 presents the results of the goodness-of-fit tests for using the binomial logistic regression model. These tests determine whether binomial logistic regression is appropriate for the data.

Table 4.11: Goodness-of-fit

Test	Chi-squared	df	Sig. (*p*-value)	Result
Omnibus test of model coefficients	17.841	6	0.007	Model is an improvement from the baseline
Hosmer and Lemeshow	12.956	8	0.113	Model is a good fit for the data

Source: Author

The omnibus test of model coefficients determines whether adding the independent variables to the model has improved the quality of the model. This test's null hypothesis (assuming no relation exists between variables) may be rejected based on the *p*-value of less than 0.05, which indicates that the model fits the data [$\chi^2(6) = 17.841$, $p = 0.007$]. This also indicates that the accuracy of the model improves when the independent (explanatory) variables are added. Furthermore, the Hosmer and Lemeshow test indicates that estimates made by the model fit the data with a non-significant result, indicating a good model fit. For this test, the *p*-value was greater than the usual 0.05 [$\chi^2(8) = 12.956$, $p = 0.113$] which can be accepted (Battle & Rakow 1993:77). Thus, this test's null hypothesis may not be rejected, and one can conclude that the model has a good fit.

Table 4.12: Pseudo R^2 values

−2 Log likelihood	Cox and Snell R squared	Nagelkerke R squared
37.610[a]	0.360	0.480

a. Estimation terminated at iteration number 5 because parameter estimates changed by less than.001.

Source: Author

Table 4.12 includes the Cox and Snell R squared (R^2) and Nagelkerke R squared (R^2) values. These R^2 values are often referred to as pseudo R^2 values and show

approximately how much variation in the dependent variable is explained by the model (Hasan 2020:23; Laerd Statistics 2018:1). Since little consensus exists concerning the best R^2 model to use (Allison 2013:1), values should not be referred to as definitive or exact values, but rather to an 'approximate percentage of variance accounted for' (Newsom 2019:6). It is notable that low R^2 values in logistic regression are the norm and may cause problems to an audience familiar with linear regression values (Hosmer & Lemeshow 2000:167).

Table 4.13: Classification table

Observed		Predicted		
		No	Yes	Percentage Correct [a]
Restatements	No	28	4	87.5
	Yes	7	1	12.5
Overall percentage				72.5

a. The cut value is.500.

Source: Author

Table 4.13 contains the results to illustrate that the binomial logistic regression model correctly classifies the absence and presence of restatements (dependent variable) for 72.5% of the cases.

Table 4.14: Odds ratios from the binomial logistic regression

Factor variables	B	SE	Wald	df	Sig. (*p*-value)	Exp(B)	95% confidence interval for Exp(B)	
							Lower	Upper
AC meeting interaction	0.055	0.398	0.019	1	0.891	1.056	0.484	2.305
AC regulatory role	0.375	0.508	0.545	1	0.460	1.455	0.538	3.937
AC sustainability reporting and combined assurance oversight	0.029	0.386	0.006	1	0.940	1.029	0.483	2.192
AC risk and reporting oversight	0.300	0.410	0.538	1	0.463	1.350	0.605	3.013
AC structure and responsibility	−0.678	0.323	4.409	1	0.036*	0.508	0.270	0.956

AC internal and external assurance oversight and consulting	−0.669	0.540	1.534	1	0.215	0.512	0.178	1.476

a. *p*-value considered significant, less than 0.05.

Source: Author

Table 4.14 provides the regression coefficient (B), the Wald statistic (to test the statistical significance) and the odds ratio (Exp (B) for each factor variable. For small samples, the *t*-values are not valid, and the Wald statistic should be used instead, as is the case for this study (Laerd Statistics 2018:1).

The *p*-values obtained from the Wald tests confirm that the only factor variable found to be statistically significant in influencing the odds of needing a restatement in the private sector is 'AC structure and responsibility' (*p*-value = 0.036 with an odds ratio of 0.508). The odds ratio (Exp (B)) reflects the multiplicative change in the odds of requiring a restatement for every unit increase on the independent factor variable, holding the remaining individual independent variables constant. An odds ratio that is larger than 1 (higher audit committee effectiveness) suggests a decreasing probability of requiring a restatement (higher financial reporting quality) since the value of the factor variable increases as more of the individual variables are disclosed, whereas a ratio less than 1 suggests an increasing probability for a restatement (lower financial reporting quality) as less of the variables are disclosed (lower audit committee effectiveness).

The ratio for 'AC structure and responsibility' indicates that the odds of requiring a restatement decreases by a factor of 0.508 for every additional disclosure from the three individual variables comprising 'AC structure and responsibility'. An increase in the factor variable 'AC structure and responsibility' requires an increase in the number of disclosures by the companies of the three individual independent variables subsumed in the factor variable. Thus, financial reporting quality increases and the presence of restatements in annual reports decreases, driven by the higher audit committee effectiveness.

The remaining factor variables are also interpreted using the odds ratio, despite them not being statistically significant predictors of restatements. For the 'AC regulatory role' and

the ‘AC risk and reporting oversight’, the odds of requiring a restatement increase by a factor of 1.455 and 1.350, respectively, for every additional disclosure of the subsumed individual independent variables by the companies. For ‘AC meeting interaction’ and ‘AC sustainability reporting and combined assurance oversight’, the odds of requiring a restatement increase by a factor of 1.056 and 1.029, respectively, for every additional disclosure of the subsumed individual independent variables by the companies. Given the values are close to 1, this implies little to no predicted change in the likelihood of requiring a restatement with more disclosures of the individual variables contained in these two factors.

Lastly, for ‘AC internal and external assurance oversight and consulting’, the odds of requiring a restatement decrease by a factor of 0.512 for every additional disclosure of the subsumed individual independent variables by the companies.

In this section, the results revealed that only one factor variable, ‘AC structure and responsibility’, statistically significantly predicts the requirement for restatements, implying a positive relation exists between greater disclosure and the absence of restatements. This outcome implies when more of the individual independent variables included in the ‘AC structure and responsibility’ are disclosed, fewer restatements occur, implying higher financial reporting quality. These individual independent variables are (1) AC consists of four or more members, (2) AC engages external auditors to provide assurance on the summarised financial information, (3) AC reviews the content of summarised information and (4) AC holds three or more meetings per annum.

4.4 CHAPTER SUMMARY

This chapter presented the two phases of data analysis and interpretation of the results. Phase 2 presented the results of the CATPCA and descriptive statistics on newly formed factor variables. Six factor variables were formed using CATPCA and a hypothesis developed for each. Most companies disclosed the majority of the individual variables subsumed in the ‘AC structure and responsibility’ factor variable. Phase 3 presented the results of binomial logistic regression analysis for testing the hypotheses developed during Phase 2. The results indicated that ‘AC structure and responsibility’ was the only

factor variable that had a statistically significant relation with the absence of restatements. The next chapter will provide the recommendations and conclusions of this study.

CHAPTER 5: CONCLUSION

5.1 INTRODUCTION

Chapter 4 presented the research results of Phase 2 and Phase 3 of the data analysis. This chapter includes an overview of the study, together with its key results and the contribution to practice (5.2), recommendations for future research going beyond the delimitations of the study (5.3) and a concluding note regarding the overall contribution of this study (5.4).

5.2 OVERVIEW OF STUDY, KEY RESULTS AND CONTRIBUTION TO PRACTICE

This section summaries the contribution of each chapter. Chapter 1 set the scene for the study. In the background, the definition of audit committee effectiveness highlights that despite the absence of a universally accepted definition, researchers' various definitions mostly overlap. Key aspects of the audit committee's oversight role captured in these definitions are the audit committee's role in overseeing management decisions and performance, influencing risks and internal controls and reporting, as well as of internal and external assurance providers. The various definitions also emphasise the audit committee's attributes of competency and independence. The relation between audit committee effectiveness and financial reporting quality is also motivated in Chapter 1, before describing international and South African developments concerning audit committees. The background then points out how international and South African audit committee failures have contributed to poor financial reporting quality and explains the use of restatements as proxy for financial reporting quality. The background concludes by stating that a knowledge gap exists because, to date, no South African study has directly focused on the relation between audit committee effectiveness variables and financial reporting quality proxied by restatements in the private sector. After highlighting the findings of South African data pointing to audit committee ineffectiveness, the consequent problem was described as follows: *Audit committee ineffectiveness undermines financial reporting quality in JSE-listed companies.*

Considering the gap in knowledge and the problem of this study, the aim was set to investigate the relation between audit committee effectiveness and financial reporting quality proxied by restatements in JSE-listed companies.

Chapter 2 provides the theoretical underpinning of this study. The role of the audit committee within the corporate governance of a company was described, using agency theory and related agency problems. Then, financial reporting quality was defined and the use of two common proxies was described, namely, earnings management and restatements. The last part of Chapter 2 provides a detailed review of audit committee effectiveness variables based on international and South African governance and regulatory pronouncements. The relevance of each variable is grounded in the literature, showing its relation to financial reporting quality. Throughout this review, audit committee effectiveness variables in King III and King IV™ are compared and contrasted.

Chapter 3 describes and justifies how and why a positivist quantitative research design was adopted. It deals with the quasi-experimental purposive sampling of disclosures in annual and other reports on websites of the top 20 companies as well as companies 81 to 100 of JSE-listed companies as at 9 November 2015. These 40 companies represented 94% of the market capitalisation of the top 100 JSE-listed companies on that date. The chapter also explains how 51 audit committee effectiveness variables were identified in the recommended practices for audit committees contained in King III (applicable at the time of data analysis) and how data were analysed in three phases. From Phase 1, the chapter presents descriptive statistics identifying 23 individual independent variables with sufficient variability across the companies based on frequencies, allowing further descriptive analysis. It also presents a methodological explanation of Phases 2 and 3 of data analysis and justifies the reliability and validity of the data and results of this study. Lastly, the chapter presents the ethical considerations and the limitations inherent in the use of secondary data as well as the scope and timing of the study.

Chapter 4 presents the data analysis results of Phases 2 and 3. In the first part of Phase 2, CATPCA indicated that six factor variables accounted for 61.122% of the

variance of all factor variables. These factor variables were labelled as (1) audit committee meeting interaction (three variables), (2) audit committee regulatory responsibilities (five variables), (3) audit committee sustainability reporting and combined assurance oversight (five variables), (4) audit committee reporting and performance oversight (four variables), (5) audit committee structure and role (four variables) and (6) audit committee internal and external assurance oversight and consulting (four variables).

Then, the factor loading of each variable was used to determine the correlation between each of the 23 variables from Phase 1 and each of the six factor variables from Phase 2. In Phase 3, binomial logistic regression was used to test the relation between audit committee effectiveness variables and the absence or presence of restatements for each of the factor variables.

This study concludes that four audit committee effectiveness variables statistically significantly predict the need for restatements, namely, (1) AC consists of four or more members, (2) AC engages external auditors to provide assurance on the summarised financial information, (3) AC reviews the content of summarised information and (4) AC holds three or more meetings per annum.

Organisational management and audit committees both in South Africa and internationally should prioritise these four variables if they wish to improve financial reporting quality. Financial reporting regulators and professional bodies concerned with audit committees (e.g. IoDSA and SAICA) should likewise prioritise these four variables when designing training and guidance interventions aimed at improving audit committee effectiveness.

5.3 RECOMMENDATIONS FOR FUTURE RESEARCH

Future studies could focus on the following elements. First and foremost, future studies could go beyond the delimitation to the King III recommended practices on audit committees by using more recent governance and regulatory pronouncements as audit committee effectiveness variables. Second, in combination with the first recommendation, future studies could go beyond the delimitation of this study to audit committees of public

companies listed on the JSE by including the public sector in South Africa. Third, in combination with the first recommendation, future studies could go beyond the delimitation to 40 JSE-listed companies by including all JSE-listed companies. This is particularly relevant considering the decreasing number of JSE-listed companies.

5.4 CONCLUDING NOTE ON THE CONTRIBUTION OF THE STUDY

The results of this study contribute new insights to the corporate governance literature on enhancing financial reporting quality by improving audit committee effectiveness. These results also contribute to practice by providing practical insights for boards and regulators. If implemented, these insights would assist in improving audit committee effectiveness, thus promoting greater user trust in financial reporting quality. This contribution is likely to benefit society's investments in the capital markets.

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APPENDICES

APPENDIX A: King III audit committee effectiveness variables coded during content analysis of audit committee disclosures

No	King III Code: Recommended practices	Recommended practice number	Aspect coded during the content analysis of annual reports
Principle 3.1 The audit committee: Terms of reference and meetings			
1.	Listed and state-owned companies must establish an audit committee	3.1.1	Existence of the audit committee
2.	All other companies should establish an audit committee and define its composition, purpose and duties in the memorandum of incorporation	3.1.2	Existence of the audit committee
3.	The board should approve the terms of reference (charter) of the audit committee	3.1.3	Approval of terms of reference by the board (charter)
4.	The audit committee should meet as often as is necessary to fulfil its functions but at least twice a year	3.1.4	Minimum number of two audit committee meetings per year
5.	The audit committee had more than two meetings during the year	Additional variable created	Attended more than two audit committee meetings per year
6.	The audit committee should meet with internal auditors at least once a year without management being present	3.1.5	Meetings held between the audit committee and internal audit without management
7.	The audit committee should meet with external auditor at least once a year without management being present	3.1.5	Meetings held between the audit committee and external auditor without management
Principle 3.2 Audit committee membership, size and expertise			
8.	All the members of the audit committee should be independent non-executive directors	3.2.1	Independent status of audit committee members stated in annual reports
9.	The audit committee should consist of at least three members	3.2.2	Number of audit committee members
10.	The audit committee consists of more than three members	Additional variable created	Number of audit committee members
11.	The chairman of the board should not be the chairman or member of the audit committee	3.2.3	Board chairman is not included in list of audit committee members

12.	The audit committee collectively should have sufficient qualifications and experience to fulfil its duties	3.2.4	Composition of audit committee members indicate sufficient professional accounting qualification and experience
13.	The audit committee members should keep up to date with the developments affecting the required skill set	3.2.5	Audit committees attended workshops, seminars and training. Their professional designations imply they keep up to date through continuing professional development requirements
14.	The audit committee should be permitted to consult with the specialist or consultants subject to a board approval process	3.2.6	Statement to specify consultation/ outsourcing by audit committee
15.	The board must fill any vacancies on the audit committee	3.2.7	Statement that the board filled vacancies on the audit committee
Principle 3.3 The audit committee chair			
16.	The board should elect the chairman of the audit committee	3.3.1	Statement that the board appointed the chairman of the audit committee
17.	The chairman of the audit committee should participate in setting and agreeing on the agenda of the committee	3.3.2	Statement that the audit committee chairman is involved in setting the agenda of audit committee meetings
18.	The chairman of the audit committee should be present at the annual general meeting	3.3.3	Statement that audit committee chairman attended the annual general meeting
Principle 3.4 Financial reporting oversight			
19.	The audit committee should have regard to all factors and risks that may impact on the integrity of the integrated report	3.4.1	Statement that the audit committee reviewed risks, controls and governance processes
20.	The audit committee should review and comment on the financial statements included in the integrated report	3.4.2	Statement that the audit committee reviewed / evaluated / commented on the annual report

21.	The audit committee should review the disclosure of sustainability issues in the integrated report to ensure that it is reliable and does not conflict with the financial information	3.4.3	Statement that the audit committee reviewed / evaluated / commented on the sustainability issues in the annual report
22.	The audit committee should recommend to the board to engage an external assurance provider on material sustainability issues	3.4.4	Statement that the audit committee recommended to engage external assurance on sustainability issues
23.	The audit committee should consider the need to issue interim results	3.4.5	Audit committee considered/evaluated the need for interim results
24.	The audit committee should review the content of the summarised information	3.4.6	Audit committee reviewed summarised content in annual reports
25.	The audit committee should engage the external auditors to provide assurance on the summarised information	3.4.7	Audit committee ensured that external auditors provide assurance on summarised content in annual reports
Principle 3.5 Combined assurance oversight			
26.	The audit committee should ensure that the combined assurance received is appropriate to address all the significant risks facing the company	3.5.1	Audit committee ensured adequate combined assurance applied that addresses significant risks
27.	The relationship between the external assurance providers and the company should be monitored by the audit committee	3.5.2	Audit committee monitored the relationship between external assurance providers and the company
Principle 3.6 Finance function oversight			
28.	Every year a review of the finance function should be performed by the audit committee	3.6.1	Audit committee performed an annual review of the finance function

29.	The results of the audit committee review of the finance function should be disclosed in the integrated report	3.6.2	Results of the finance function review are disclosed in annual reports
Principle 3.7 Internal audit oversight			
30.	The audit committee is responsible for the appointment and/or dismissal of the chief audit executive	3.7.1	Statement explaining that the audit committee appointed/dismissed the chief audit executive / internal audit head
31.	The audit committee is responsible for the performance assessment of the chief audit executive	3.7.1	Statement explaining that the audit committee assessed the performance of the chief audit executive / internal audit head
32.	The audit committee should approve the internal audit plan	3.7.2	Statement explaining that the audit committee approved the internal audit plan
33.	The audit committee ensures that the internal audit function is subject to independent quality review as and when the committee determines it appropriate	3.7.3	Statement explaining that the audit committee considered an independent quality review of the internal audit function
Principle 3.8 Risk oversight			
34.	The charter of the audit committee should set out its responsibility regarding risk management	3.8.1	Statement explaining the audit committee's risk management oversight
35.	The audit committee should specifically have oversight of financial reporting risks	3.8.2.1	Statement explaining the audit committee's financial reporting risk oversight
36.	The audit committee should specifically have oversight of internal financial controls	3.8.2.2	Statement explaining the audit committee's internal financial controls oversight
37.	The audit committee should specifically have oversight of fraud risks as it relates to financial reporting	3.8.2.3	Statement explaining the audit committee's fraud risks pertaining to financial reporting oversight
38.	The audit committee should specifically have oversight of information technology risks as it relates to financial reporting	3.8.2.4	Statement explaining the audit committee's information technology risks, affecting financial reporting oversight

Principle 3.9 External audit oversight			
39.	The audit committee must nominate the external auditor for appointment	3.9.1	Statement explaining that audit committee nominated external auditor for appointment
40.	The audit committee must approve the terms of engagement and remuneration for the external audit engagement	3.9.2	Statement explaining that audit committee approved terms of engagement and remuneration of external audit
41.	The audit committee must monitor and report on independence of the external auditor	3.9.3	Statement explaining that audit committee monitored and reported on the independence of the external auditors
42.	The audit committee must define a policy for non-audit services by the external auditors and must approve the contracts for non-audit services	3.9.4	Statement explaining that the audit committee defined a policy for non-audit services by external auditors and approved contracts for non-audit services
43.	The audit committee should be informed of reportable irregularities identified and reported by the external auditor	3.9.5	Statement explaining that the external auditors report reportable irregularities to the audit committee
44.	The audit committee should review the quality and effectiveness of external audit process	3.9.6	Statement explaining that the audit committee reviews the external audit process and quality
Principle 3.10 Audit committee disclosures			
45.	The audit committee should report to the board on its statutory duties and duties assigned to it by the board	3.10.1	Statement explaining that the audit committee reports to the board on its duties
46.	The audit committee must report to the shareholders on its statutory duties: how its duties were carried out	3.10.2.1	Statement in the annual report explaining the audit committee's duties
47.	The audit committee should report to the shareholders on its statutory duties: if the committee is satisfied with the independence of the external auditor	3.10.2.2	Statement in the annual report explaining the audit committee's satisfaction with the independence of the external auditors

48.	The audit committee should report to the shareholders on its statutory duties: Audit committee's view on financial statements and accounting practices	3.10.2.3	Statement in the annual report explaining the audit committee's view on financial statements and accounting practices
49.	The audit committee should report to the shareholders on its statutory duties: whether internal financial controls are effective	3.10.2.4	Statement in the annual report explaining the audit committee's view on the effectiveness of internal financial controls
50.	The audit committee provides a summary of its role and details on its composition, number of meetings and activities in the integrated report	3.10.3	Details of audit committee members, their qualifications, number of meetings and attendance thereof by each member included in annual reports
51.	The audit committee should recommend the integrated report for approval by the board	3.10.4	Statement that the audit committee recommended the annual report for board approval

Source: Adapted from IoDSA 2009a:31-35

APPENDIX B: Ethics approval letter

UNISA university of south africa

COLLEGE OF ACCOUNTING SCIENCES
RESEARCH ETHICS REVIEW COMMITTEE

Date: 8 June 2016 **(re-issued 15 July 2018 to correct omission)**

Ref: 2016_CAS_028
Name of applicant:
Prof P Coetzee
Student/Staff #: 90249100

Dear Prof P Coetzee

Decision: Ethics Approval

Name: Prof P Coetzee
coetzgp@unisa.ac.za

Title of research project:
Optimising the oversight role and value of audit committees in South Africa.

Purpose: Journal articles and postgraduate studies

Postgraduate students:	**Supervisors:**
Colin Thabo Matsimela	Prof Philna Coetzee
Clara Manamela	Prof Lourens Erasmus
Adéle du Preez	Prof Marianne van Staden
Marx Moabelo	
Shan Malan	
Mangakane Pududu	
Audrey Legodi	
Aveen Rampershad	

Thank you for the application for research ethics clearance by the College of Accounting Sciences Research Ethics Review Committee for the above mentioned research. Final approval is granted for the completion of the research.

For full approval: *The secondary data research application was reviewed in compliance with the Unisa Policy on Research Ethics by the College of Accounting Sciences Research Ethics Review Committee on 7 June 2016.*

The proposed research may now commence with the provision that:

1) *The researcher/s will ensure that the research project adheres to the values and principles expressed in the UNISA Policy on Research Ethics.*

2) *Any adverse circumstance arising in the undertaking of the research project that is relevant to the ethicality of the study, as well as changes in the methodology, should be communicated in writing to the College of Accounting Sciences Research Ethics Review Committee . An amended application could be requested if there are substantial changes from the existing proposal, especially if those changes affect any of the study-related risks for the research participants.*
3) *The researcher will ensure that the research project adheres to any applicable national legislation, professional codes of conduct, institutional guidelines and scientific standards relevant to the specific field of study.*

Note:
The reference number [top right corner of this communiqué] should be clearly indicated on all forms of communication [e.g. Webmail, E-mail messages, letters] with the intended research participants, as well as with the College of Accounting Sciences RERC.

Kind regards,

Prof L J Erasmus
(Chairperson of CAS RERC)
e-mail: erasmlj1@unisa.ac.za
Tel: (012) 429 8844

Prof L Nstalaze
(Acting Executive Dean of CAS)