External Auditor Perceptions on Audit Committees Effectiveness: a qualitative study in Polish public corporations

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Abstract

The paper examines auditor's experiences with corporate governance in the setting of a Polish two-tier board system and a capital market characterized by high ownership concentration and therefore it extends research on corporate governance practices of an economy outside of the well research Anglo-American model.
The auditors indicate that the corporate governance environment has changed to some degree in the recent years. At the same time, auditors report only some reliance on corporate governance information in the planning phase and no reliance in the field-testing or review phases. The findings differ from those of prior studies, in which auditors reported far greater reliance on corporate governance in all phases of the audit process. The two possible reasons for this difference in findings could be the different stages of the development of the respective capital markets and/or the different corporate governance systems.

Keywords: audit committee, external auditors, corporate governance reforms, audit, Poland

1. Introduction

The integrity of financial reporting has been on the agenda of regulators, accounting professionals and researchers for many years. The debate has been intensified as corporate scandals have been revealed. As a consequence, regulators and professionals are trying to design new social structures, or improve existing ones, in order to enhance control over the corporations' actions and restore and increase the trust in the information provided to market participants. The two elements considered to be important in the process of restoring confidence in the capital market and corporations are corporate governance (CG) and auditing. For instance, the Sarbanes-Oxley Act of 2002 (SOX) represented an attempt to reform the CG system by prescribing a set of measures to enhance the effectiveness of CG mechanisms. Among these is the mandatory requirement to establish an audit committee (AC) to monitor external auditors. On the other hand, the external auditor plays a crucial role in helping to promote financial reporting quality by curtailing excessive earnings management practices and serves as an effective monitor of managerial aggression. In the European context, in February 2005, the European Commission recommended the establishment of an AC for all listed companies. The European Parliament and Council amended the Eights Directive on Company Law in 2006, requiring entities operating in the public interest to establish an AC through changes to laws or through CG codes based upon the "comply or explain" principle. The EU Eights Directive highlights that ACs have evolved from a purely voluntary initiative, into an essential and mandatory element in the continental European system of corporate governance (Bohm et al, 2013.). The objective of reforms is to increase the visibility and credibility of the information releases by companies, which has become an important issue in the post-Enron era. The credibility and relevance of financial statements information is evaluated by the AC in collaboration with both internal auditors and external auditors (Piot, Janin, 2007; DeVlaminck and Sarens, 2015).

External auditors are considered an important element of the CG mosaic (Cohen, et al, 2004). In particular, external auditors play an important role in the mitigation of earnings management by the corporate management. Therefore, they play a key role in ensuring the quality of corporate financial reporting. Recent CG reforms increased the responsibilities of auditors in the effective governance system. To ensure the integrity of financial reporting, auditors should not only present their opinions on the quality of financial reporting but also actively participate in the dialogue on the quality of financial reporting with the ACs, internal controllers and company management

The objective of this paper is to explore auditors' perceptions of the performance of AC in particular, and CG reforms in general. In that sense the paper build on prior research (Cohen et al, 2002 and Cohen et al, 2010). The two papers examined auditor's experiences in working with CG actors in the pre- and post- Sarbanes Oxley era based on the interviews conducted with external auditors providing services on the American market. The results of the study (Cohen et al, 2010) shows that the auditors find the CG environment significantly improved and the ACs being substantially more active and diligent and the same time having more resources to perform their responsibilities, as compared to the findings in 2002 (Cohen et al, 2002). This paper explores the experiences of the external auditors working in a different economics and business environment of a country with just above twenty five years of experience with the free market economy as well as with still evolving capital market and the CG system, which can be classified as following the Continental model of CG. Poland has a governance system characterized by a high concentration of ownership. The background for the development of a free-market economy consists of the establishment of capital markets and effective capital market institutions. In Polish CG, these specific developmental features are associated with the manner in which privatization was executed during the transition from a centrally planned economy to a market-based economy, leading to a capital market characterized by a significant concentration of ownership. The structure of shareholding has changed over time, with the average shareholdings of the largest owners in privatized firms at 34% in 1996 and 50% in 2000. The highest ownership concentrations (up to 75%) are observed in firms that have been bought by foreign investors (Grosfeld and Hashi, 2007). Another reason for choosing Poland as a research site for the present study was that Poland, which entered the EU in 2004 after a rapid economic transformation, has a relatively young capital market and is representative of countries of the so-called "New (enlarged) Europe." Although there has been some global convergence in CG practices, the effectiveness of CG in transition economies may be limited due to such factors as business history, culture, and the origin of financial institutions.

This study adopts a qualitative research approach, using interview data from 15 interviews in large publicly listed companies in Poland, to examine the relationship between auditors and ACs and CG. We aim to enrich the scant knowledge about auditors' perceptions of their interactions with AC and CG reform in general. The paper examines also one of the aspects of macro-level analysis; specifically, specifically what elements of CG systems are important to auditing at different stages of audit assignment. Thus, the paper contributes to the understanding of auditors' use of the macro-level factors, as the professional literature, auditing regulations and prior research all highlight the importance of such factors in the planning and execution of audits by audit firms.

In sum, based on the preceding discussion, the main research problem addressed by this study focuses on the emerging practices in auditing in respect to CG in Polish firms. More specifically, the three sets of research questions for the study are:

1. How do auditors define and assess the role of AC and CG reforms in general? How do auditors describe the scope and nature of their interactions with the company and the ACs in particular?
2. How do auditors consider CG factors in the planning and conduct of an audit?
3. From the perspective of auditors, how important is the AC and other CG mechanisms in an audit engagement, and how effective are the existing CG practices?

The present study aims to extend current research in three ways. First, the paper is a direct response to a call made by Carcello, Hermanson and Ye (2011) to explore the relation between CG and auditing in other countries and settings, specifically those that do not follow the Anglo-American governance model as well as in the more regulated, post-SOX environment. Also Bedard and Compernolle (2014) call for more research leading to better understanding the relationships and communication between AC, management and external auditors. Poland is characterized by the continental model of CG with a two-tier system. Another feature distinguishing the Polish CG model from the Anglo-American setting is the high concentration of ownership and the weak investor protections (Aluchna and Koładkiewicz, 2010; Dobija, 2015). Poland is also an example of a country in a fast transition, where CG standards are developing simultaneously with the development of the capital market (Dobija and Klimczak, 2010).

Carcello, Hermanson and Ye (2011) also point out the need to use diverse research methods and approaches. Among the suggested methods and approaches are qualitative studies using interviews as a main source of primary data and studies using explorative and critical approaches to the data analysis.

We aim to enrich the scant knowledge about auditors' perceptions of their interactions with AC and CG reform in general. The paper examines also one of the aspects of macro-level analysis; specifically, specifically what elements of CG systems are important to auditing at different stages of audit assignment. Thus, the paper contributes to the understanding of auditors' use of the macro-level factors, as the professional literature, auditing regulations and prior research all highlight the importance of such factors in the planning and execution of audits by audit firms.

Finally, the paper also offers additional insight into auditing and CG in Poland, an example of an economy in Europe. EU does not have a uniformed CG system.

The reminder of the paper is decided into 4 sections. Section 2 provides an overview of existing literature and theoretical frameworks. Section 3 provides some insights into the context of the Polish CG system. Section 4 describes the method of research implemented for the purpose of this research project.. The following section 5 provides an overview of main findings. The paper ends with a discussion of the results and summary.

2. Literature review and interpretive framework

The review of literature reveals that researchers have examined whether AC are effective in terms of oversight over the financial reporting and external audit quality. There is a vast body of literature examining the AC impact on audit quality. However a smaller number of papers deal with the interactions between external auditors and AC. The subsequent section summaries the main findings of prior research. Subsection 2.2

gives an overview of main theoretical frameworks used to interpret the results of various studies.

2.1. Prior studies on the relationships between AC and external auditing

A vast body of literature analyzes the effectiveness of ACs. DeZoot et al. (2002) presented a meta-analysis of AC research during the period of 1981-2002 using a framework comprising the four fundamental determinants of AC effectiveness: composition, authority, resources, and diligence. Turtley and Zaman (2004) provided an overview of AC literature through 2002, with an emphasis on international differences. The most recent meta-analysis, presented by Bedard and Gendrom (2010), spans the years 1994-2008. All of these papers use a similar framework for the analysis, considering the main elements determining AC quality. Bedard and Gendrom include additional elements associated with the various actors who affect the effectiveness of the ACs and thus CG. The two main types of actors are internal auditors (internal control) and statutory auditors (external control). These two types of actors are considered to have a substantial influence on financial reporting quality and therefore can positively or negatively affect the investors' perception of the firm's financial information and reports and the functioning of financial markets. Cohen et al. (2004) used a similar model to present a CG mosaic and the effects of various actors on financial reporting quality. One of the main responsibilities of the AC is to oversee the selection, compensation, scope of work, and level of independence of the external auditors.

Literature on the relationship between the external auditors and CG deals specifically with auditors' selection and acceptance by the client, audit fees and quality, and the audit process and opinions (Bedard and Gendron, 2010; Cohen et al., 2004; DeZoot et al., 2002; He et al., 2009; Lin and Hwang, 2010). However, little qualitative research has been conducted on how auditors perceive governance factors in their work. In general, there are two types of studies: experimental studies and interpretive studies. In the latter case, data are collected through direct interviews with auditors. The first study on this topic, by Cohen and Hanoo (2000), dealt with a specific case of acceptance of a small number of clients. In their experiment, the researchers asked audit partners and managers to make a client acceptance recommendation. The study shows that both the organization's management control philosophy and the strength of its CG structure significantly influence client's acceptance recommendations, control risk assessments and the extent of substantive testing.

Cohen et al. (2002) conducted interviews with 36 auditors of the Big 5 audit firms in the pre-SOX period. They found that the auditors generally considered clients' ACs to be ineffective in monitoring the financial reporting process, and to lack the power and financial expertise necessary to effectively confront management.

Cohen et al. (2007), in an experimental study, examined the effect of different board roles on the audit process. Specifically, they considered the roles of agency, which focuses on monitoring management, and resource dependence, in which the board proactively assists management in setting up the corporate strategy and actively helps to search for external finance. The results of the experiment show that both roles have an influence on the auditor's risk assessment and decisions about the extent of testing in the audit planning phase.

In their most recent study, Cohen et al. (2010) interviewed 30 audit partners and managers from three of the Big 4 firms. In the study, auditors indicated that the CG environment has significantly improved in recent years, with ACs that are substantially more active and diligent and possess greater expertise and power to fulfill their responsibilities. As a result, the auditors rely more on CG information in planning and performing the engagement. The researchers also reported that management continues to be seen as a major actor in the governance mosaic.

Another study, based on a Canadian case sheds light on the audit appointment and removal processes (Fiolleau et al, 2013). The findings of the paper show that management was in charge of process and that the AC oversee the process. These findings are consistent with the results obtained in a different results (Dobija, 2015)

2.2. Interpretive frameworks

Rigor and openness are considered as the two characteristics of a qualitative study, but keeping a balance between them is not an easy task for a researcher (Ahrens and Chapman 2006). Patton (1990) stressed that the researcher is not required to be locked into rigid methodological designs that eliminate responsiveness. One should be ready to accept some methodological flexibility. Methodological flexibility allows for the adoption of data collection and analysis according to the emergence of important trends and patterns from the data Gendron (2009:127). At the same time, multivocality in the interpretive studies, relates to the belief that diverse theories can be simultaneously descriptive of a reality, as no single theory, perspective of analysis, or method of producing knowledge can account for the complexity of human behavior (Gendron 2009:127).

As suggested by Gendron (2009: 128), diverse theories can be employed simultaneously to describe a given reality. The literature reveals that researchers have utilized a number of theoretical approaches to study and explain AC practices, such as traditional agency theory, institutional theory, resource dependence, managerial hegemony, and efficiency perspectives (Cohen, Krishnamoorthy and Wright 2010; Beasley, Carcello, Hermanson and Neal 2009; Spira 1999). A different approach used in other studies was connected with the application of sociological perspectives to study CG and AC practices in particular (Gendron and Bedard 1994).

The view of governance commonly held in the accounting domain relies heavely on agency theory. Due to separation of ownership and control, agency theory views managers as self-interested actors who could engage in opportunistic behavior. Various contractual mechanisms, including CG, are supposed to reduce the agency costs, resulting from information asymmetry between managers and owners. A common contractual means for reducing these agency costs is the provision for an independent party to monitor the agent, while reporting back to the owner. According to agency theory, the supervisory board and therefore the AC is an independent monitor of management. Without a monitor, management may act in their best personal interests and not in the interests of the principals (shareholders) (Jensen and Meckling 1976). Thus, the role of the supervisory board and its sub-committees (including an AC) is to independently monitor management to prevent possible opportunistic behavior.

The institutional theory considers a comprehensive set of organizational dynamics including institutional environments, and the ceremonial structures which actors within this dynamic display. The institutional theory looks at changes in organizational processes over time (Cohen at al. 2002, 2007) and how existing structures fulfill ritualistic roles to help legitimize the interaction among various participants of the organization. DiMaggio and Powell (1983) argue that institutions become similar over time through the process of institutional isomorphism as organizations adapt to become more similar to those around them. Isomorphism arises through three avenues: coercive, normative, and mimetic. Coercive isomorphism comes about as the results of external regulatory-type pressures for organizational convergence. An example of coercive isomorphism is the obligatory existence of an AC as an element of a governance structure. Normative isomorphism suggests convergence through socialization. Mimetic isomorphism is a functions of significant environmental uncertainty that leads organizations to “follow the leader” regardless of whether or not there is evidence that the leader’s practices are effective. In this view, ACs may be coerced into becoming similar through regulation, following the best practice model or by simply mimicking other organizations to enhance their legitimacy (DiMaggio and Powell, 1983; Cohen et al, 2010). One implication institutional theory holds for understanding CG is that in periods of ambiguous and uncertain environments the boards and AC may emphasize ceremonial and symbolic roles. The practices of AC may be more ceremonial in nature, with a focus on providing symbolic legitimacy but not necessarily vigilant monitoring (Spira, 1999). When the AC plays a more ceremonial role, the external auditor bears a greater responsibility for reliable financial reporting. Institutional theory also suggests that there is a tendency to attract homogeneous individuals into institutions (Tuttle and Dillard, 2007), therefore it is important to consider the relevance of social culture and environment on the practice of accounting and the use of accounting practices to rationalize and maintain legitimacy. Institutional theory emphasizes how governance mechanisms fulfill ritualistic roles that help legitimize the interactions among the various actors within the CG mosaic (Cohen et al, 2008).

Resource dependence theory (Pfeffer and Salancik, 1979; Boyd, 1990) suggests that stockholders and managers may rely on the board as a means to access and manage scarce resources and help set the strategy of the firm (Williamson, 1999). The primary role of the board is less that of a monitor than a partner to management, and one that helps set effective policies and strategies for the firm. Dalton and Daity (1999) argue that a resource dependence perspective enhances a company’s long-term success as board members’ connections confer access to necessary strategic resources, networking, and information. Because of this focus on business strategy, valuable attributes of a board member include industry expertise, knowledge in helping set corporate strategy, and providing access to external resources (Boyd, 1990). In line with the resource dependence theory, the AC members with industry expertise, are likely to have a superior ability to understand, interpret, and assess the quality of financial reports than members with no industry expertise, but are completely independent.

Managerial hegemony perspective suggests that senior management selects cronies and colleagues who will not curtail their actions (Patton and Baker, 1987) and are willing to be passive participants in the governance process, and are dependent on the company management for information and insights about the firm and its industry (Wolfson, 1984). This approach can be viewed as more symbolic rather than an effective oversight of management and a tool to effect organizational change.

Efficiency theory considers organizations as rational actors and points to the gains in effectiveness or efficiency following the adoption of a new practice (Böhm et al. 2012).

3. Setting up the context

3.1. CG and ACs in Poland

The CG system in Poland is an example of a continental model with a two-tiered board structure. In such a model, the supervisory and management board are kept separate. Unlike in mature markets, where strong CG mechanisms are considered to be a precondition of the effectively functioning capital market, in an emerging economy, CG and the capital market develop simultaneously (Dobija and Klimczak, 2010).

With the introduction of the market-based economy, Poland has started a mass privatisation program. From the beginning of this transition, the Polish authorities were concerned with the proper development of the financial market and focused on the creation of a well-established legal system and enforceable laws. The main concern of the regulators was to avoid excessive dispersion of ownership and to provide companies with owners who would be able to restructure them. However, the promoters of the mass privatisation program were also concerned with the potential dangers associated with the private benefits of control; thus, they imposed a limit of 33 per cent on the lead fund's holdings in each company (Grosfeld and Hashi, 2007).

This privatisation program design led to a capital market characterized by a significant ownership concentration. The shareholding structure has changed over time, with the overage shareholding of the largest owner in the privatised firms averaging 34% in 1996 and 50% in 2000. The highest ownership concentration, up to 75%, can be observed in firms bought by foreign investors (Grosfeld and Hashi, 2007). According to Aluchna (2007), on average, the dominant stakeholder's stake in 2008 was around 41%, with the top management of the company being the most frequent dominant shareholders. Many domestic companies are subsidiaries of larger companies and thus are also controlled by the executives of the parent company. Therefore, as Aluchna (2007) points out, the dominance of the executives in ownership is even higher than the identified 41% as a result of the pyramid formation. This high concentration of ownership affects how the minority investors' rights are protected. Aluchna and Koładkiewicz (2010) argue that weak investors have weak protections.

Poland's first CG code was written and adopted by the public companies in 2002; however, the enforceability of its external monitoring mechanisms and transparency rules is considered to be low (Kuchenbeker 2008).[2] Figure 1 presents a timeline for the introduction of CG regulations in Poland.

Insert Figure 1 about here

Initially, Poland chose to voluntarily adopt the CG code through self-regulation. The 2002 CG code contained a recommendation about the presence of an independent supervisory board member when selecting an external auditor. The second version of the CG code issued in 2005, set a direct recommendation to create an AC and a remuneration committee. It also recommended that all members of an AC be independent and that external auditors be rotated every five years. However, the independence criteria were determined to be too strong, thus too difficult to meet for an emerging CG system characterized by a high concentration of ownership; thus, after three years of experience with the CGC, a new version of the code was adopted that loosened the requirements regarding committees and their membership. The 2008 CGC recommended at least two independent board members and abolished the recommendation for a remuneration committee (Dobija et al., 2011).

The 2008 CGC still recommended the creation of an AC, with at least one independent member possessing competence in the area of accounting and finance. For the independence criteria, as well as for a detailed description of the responsibilities of the AC, the CGC recommended the use of the EU recommendations (EU., 2005).

Poland adopted the Eight EU Company Law Directive to its legal system in 2009. The Eight EU Company Law Directive defines statutory auditing standards for EU Member States and is considered by the EU as an important element of the establishment of a single European capital market. Braiotta and Zhou (2008, 269) stress that the Eight EU Company Law Directive affects 7,000 listed companies and requires the improvement and harmonisation of approximately two million statutory audits conducted annually in the EU.

As a response to the change in the EU Eight Directive, Poland had issued a new legislation regulating the existence and the role of AC through a parliamentary act on certified auditors, their self-government, and entities authorized to audit financial statements and public supervision (The Act 2009). The establishment of the AC within a supervisory board is requested in the legislation, and the responsibilities of the AC are set on a mandatory basis. These responsibilities, as listed in the legislation, include overseeing financial reporting, overseeing internal control systems, internal audits and risk management, overseeing external audits, and checking the independence of the auditor. The Act also specifies that the AC should recommend an audit firm. According to the regulation, the AC should have at least three members, at least one of whom should be independent and should have qualifications in accounting or financial auditing.

3.2. Statutory auditors in Poland

The audit requirement in Poland dates back to 1928, when the Polish President issued a resolution requiring audits of joint stock companies' annual financial statements and founders' statements. This requirement was subsequently implemented in the Commercial Code of 1934 (Krzywda, 2012, Plaff, 2007). In the period of 1945–1991, the audit function was preserved. The annual audit of financial statements was required, and "state-authorized accountants" were granted the right to perform the audits and were charged with control functions similar to those exercised by today's statutory auditors (Jaruga, 1993; Schroeder, 2007).

With the transition to a market-based economy, a modern model of auditing emerged. In 1992, the first Audit Act was introduced. As a result, the National Chamber of Chartered Accountants was established, and temporary auditing standards were issued. The next important step in the development of accounting and auditing was the implementation of the Act of Accountancy in 1994. This Act regulated accounting rules as well as fundamentals of auditing, which led to the creation of new and more stable auditing standards in 1996. Additional changes in auditing standards in Poland took place in 2002 and 2010 and were mainly related to adaptation to the global professional standards and EU regulations. A number of papers outline the early development of the statutory audit in Poland (Jaruga, 1976; Jaruga, 1993; Kosmala MacLullich and Sucher, 2004; Krzywda Schroeder, 1998, Schoreder, 1999).

In Poland, there are presently 7311 auditors registered with the National Chamber of Statutory Auditors (NCSA), and 9661 others are in the process of obtaining professional qualifications. The audit market in 2011 was worth 728.5 m. PLN. Until June 5, 2009, a formal supervision of the profession and auditors was conducted by the Ministry of Finance. Currently, following the introduction of a new regulation in the Auditing Act (2009), the supervision of the auditors is in hands of the National Chamber of Statutory Auditors and in the hands of the Audit Oversight Board (AOB). The NCSA maintains a registry of statutory auditors and a list of entities entitled to conduct statutory audit and prepares various resolutions related to the operations of the auditors and the audit firms. The role of AOB is to perform public oversight over: (1) the practices of professional statutory auditors, (2) the operations of entities entitled to audit financial statements, and (3) the operation of the NCSA. Among others, the AOB's tasks include (a) approval of annual control plans prepared by the National Supervisory Commission regarding (1) and (2) above and (2) conducting controls and approval of controllers conducting controls.

4. Research method

As discussed earlier, our objective is to determine the opinions of auditors regarding the form and content of the audit report. Qualitative studies, in general, are more accurate when exploring and examining issues that are difficult to investigate using the quantitative and archival research methods. Qualitative methods facilitate a better description of the phenomenon, as they permit the inclusion of details that are naturally suppressed in studies of large samples (Silverman, 1985; Patton, 2002). We selected the semi-structured interview method, since it enabled us to gain in-depth knowledge of the research subjects' perception of the existence and extent of the information gap in auditing, as well as possible improvements.

The primary research was conducted in September and October 2012. The subjects of study the statutory auditors with experience in auditing the accounts of public interest entities listed on the Warsaw Stock Exchange.

Semi-structured, in-depth interviews were conducted. To ensure construct validity the questions were designed to reflect the key theoretical constructs of the study (Silverman, 1995; Patton, 2002): specifically, the auditors' experiences with CG and the use of CG in the audit process. The research instrument included a set of 14 questions divided into 2 groups (Appendix A). In accordance with the standard practices of qualitative research, the interview questions were refined during the fieldwork period based on the existing professional and academic literature, proposals for regulations and discussion papers (Yin, 2003). Prior to the interview, the respondents were informed that the interview's purpose was to collect their own experiences and that, therefore, they should not be concerned about providing "wrong" answers to the questions. The auditors interviewed were assured that their responses would be used in strict confidence. They were also asked permission for the interview to be recorded. In order to provide a reasonable comfort level related to sensitive data, the interviewees who allowed recording of the session were also instructed that, in the event of disclosure of sensitive information, they would be permitted to ask the interviewer to switch off the recording device temporarily at any time. When such a request was made, the interviewer took notes and recorded a report on the unrecorded portion following the interview.

In total, 15 interviews were conducted. Most interviews were recorded and transcribed. A draft report was presented to the interviewees to allow for comments on the reliability, validity and overall credibility of the observations and conclusions (Patton, 2002).

Insert Table 1 about here

Once the data had been collected, collated and transcribed for each stage, they were manually coded using the key theoretical constructs: definition of CG, interactions with AC, interaction with management/supervisory board/internal auditors, Decision of audit appointment, nature and extend of the use of CG information in the audit process and importance of CG mechanisms in audit engagements. (Ahrens and Dent, 1998). Patterns and exceptions in the coded data were identified (Ahrens and Dent, 1998). Two independent coders read all materials independently, coded them into the same summary table, and then discussed and resolved any coding differences. The patterns that emerged from the data were then compared to prior research on the auditors and CG. The results were documented once this process was completed. This process is consistent with the pattern matching process described by Ahrens and Dent (1998). The following section discusses the elements coded in this table.

5. Findings

5.1. External auditors experiences with AC and CG in general

After the financial scandals at the beginning of the century, both businesses and academics stressed the importance of CG. However, after a long debate, there are still no widely accepted definitions of CG and good governance practices. Similar to the findings of Cohen et al. (2010), the interviewed auditors in this study, when asked about the most important agents of CG, identified management, ACs and supervisory boards; only one respondent mentioned shareholders and stakeholders in general. The respondents provided mixed responses when asked about their own definition of CG. However, all the definitions given shared one common feature: in all cases, the respondents understood CG in a narrow sense as internal regulations (procedures or rules) in place to help organizations conduct business. The following are some examples of definitions given by auditors in both large and small firms.

An auditor in one of the big audit firms defined CG as:

> *[A] certain way of managing an organization, which is focusing on the matters related to the relations with shareholders and the protection of the owners and shareholders.*

A different auditor in an international audit firm defined CG as:

> *[A] set of internal procedures related to internal control. CG means the existence of an AC and a set of external procedures that help to enforce the application of all of the requirements and rules set forth to be used by a company.*

An auditor in a local audit firm provided a similar definition:

> *CG means certain structures and procedures that help to maintain a corporate order*.

One of the most important features of CG is the existence of ACs. CG regulations around the world place more and more responsibilities on the AC to oversee financial reporting, the audit process and internal controls. One of the hallmarks of an AC's effectiveness in its independence, as well as the requirement that at least one member of the committee have financial expertise. Gendron et al. (2004) provide evidence that effective AC meetings have value beyond symbolism and that AC members ask diligent questions to establish their perceived effectiveness. Beasley et al. (2007) show that AC members perceive that they take an active role in monitoring the financial reporting process and the external auditors. Prior research on ACs shows that their role has changed over time in the Anglo-American context – from only nominal oversight at the beginning of the Century to more substantial oversight 10 years after the introduction of SOX. However, prior research on the effectiveness of ACs from the perspective of auditors has shown a gloomier picture; for example, the auditors' experience was negative as reported by Cohen et al. (2010).

In the Polish context, it is interesting to observe that, despite the auditors' agreement that the AC is an important element of CG, the auditors also report that interaction with the AC does not have an impact on the way they conduct audits and the audit process. The auditors in our study described the competencies of ACs as ranging from professional to very weak; however, all respondents noted that the effectiveness of ACs has increased with time. The competencies of the AC members representing investment funds (one of the majority shareholders on the Polish capital market) are usually assessed as very high. At the same time, the assessment of the power of the AC was somewhat weaker. One of the reasons for this disparity could be the fact that concentrated ownership characterizes the Polish capital market, where the major owners still have much influence on the company and, very often, on the supervisory board activities as well.

As one of the auditors observed:

I think the competencies of ACs, if they exist, are getting better and better. It is difficult to assess the power of the committees, but those committees with independent member are much more competent. First of all, they can read financial statements. They can ask relevant questions, and very often they ask about matters not included in the financial statements or in the notes. They simply want to ask about additional information to form a full picture of the company's situation. One may think those questions are mean, but they are not… they are just inquisitive. It is clear that those people know what they are doing.

The frequency of meetings varies depending on the size of the company. For companies listed on various indexes on the Warsaw Stock Exchange, the most frequently provided number of meetings is 4. For smaller companies the number of reported meetings is smaller and varies from 0 to 2. The auditors also reported that some supervisory boards had not established an AC. Cohen et al. (2010) report an increased number of meetings in the post-SOX era in the American context. The numbers reported in this study are more in line with the results of Cohen et al.'s (2002) study of auditors' experiences at an early stage of the development of CG – before the introduction of SOX. Also, what is striking in the Polish context is a discrepancy in the number of meetings identified by the auditors and the number of meetings identified by AC members in another study (Dobija, 2015), where the AC members reported meeting with the auditor on average at least 4 times a year.

One of the auditors described the interaction with the AC and the management as follows:

In the cases where AC does not exist we only meet with the management. In a case where an AC exists. the most frequent reason for a meeting is the selection of a new auditor at the time of the presentation of our offer for audit services. The other meetings depend on our needs. In some cases, we do not meet with the ACs at all; in other cases, we meet about twice a year.

When contrasted with the regular and frequent meetings of auditors with the company management, to whom the auditors reported experiencing easy and constant access, the effectiveness of ACs in the oversight of external auditors seems to be limited.

This can be also confirmed by analysis of the issues discussed with the ACs. In general, the auditors characterized their meetings with the ACs as passive where they would merely report significant audit issues, rather than as active or proactive interactions. The auditors reported that the most frequently discussed matters during meetings with ACs were related to internal control weaknesses, risks related to financial statements and the impact of important accounting transactions on the financial statements. However, the meetings were described primarily as informative meetings, where a discussion of specific issues was limited.

When asked a more general question regarding factors affecting the efficiency of contacts with the ACs, all auditors stressed communication as the most important factor; another factor often mentioned was the availability of people interested in what the auditors had to say and the professional attitude characterized by a lack of emotions in discussions with the auditor.

As one of the auditors described it:

> *The availability of people is the most critical, but also their willingness to solve problems and their curiosity – their interest about the situation of the company. It would be great if it were not a one-sided game. It is very often the case that an auditor expects some action from an AC or the supervisory board, asks for additional information or additional data, and receives no feedback…. So availability is important but also an understanding of what the auditor is trying to say, a proactive attitude, and a certain discussion around the issues raised by the auditor.*

One of the important responsibilities of ACs is the authority to appoint and terminate external auditors and to determine auditor compensation. prior studies indicate that the management of the company still plays the most important role in the auditors' retention (Gendron & Bedard, 2006; Cohen et al., 2010; Fiolleau et al., 2013), while the AC takes a more distant or nominal role. The data collected in the study show a similar trend. We asked auditors to provide information on their experience and perception regarding those parties that have the greatest influence on external auditor appointment decisions. Consistent with studies in the Anglo-Saxon context, the respondents mentioned two parties involved in the decisions: company management and the supervisory board (AC). However, in the context of concentrated ownership, the auditors mentioned a third party: a dominant shareholder. Unsurprisingly, when asked to provide their assessments of the various parties' influence on the appointment decisions, on average, management was identified as most influential (70%, ranging from 80-60%) and the supervisory board (AC) was regarded as less influential (30%, ranging from 20-40%); however, the assessment depended largely on the role of the dominant shareholder.

One of the auditors described the most influential parties as follows:

> *The owners. Of course, formally it is always the supervisory board, but very often it is actually the management of the company. The management of the company initiates the process, sends the call for bids, collects the bids and prepares a shortlist of auditors, and recommends the auditor to the supervisory board. In some cases, the process is also initiated by the supervisory board; in this case, the decision depends greatly on the dominant shareholder. It is very often the case that the dominant shareholder is a bank or an investment fund. The representatives of the bank or the investment fund play an important role in the supervisory board, and they very often convince the other members that a certain auditor should be appointed*.

Another auditor, when asked to assigned percentages, said:

> *There are different cases. There are cases in which a dominant shareholder sits on the management board. I would say that major voice is that of the (dominant) owner. On the other hand, the dominant owner can sit on the supervisory board rather than the management board. So, in fact, it is difficult to give percentages. The decision will be made where the owner has a major voice. There are also cases where the owner is not really interested in the financial matters. Then the decision is put in hands of management with the following words on his mind: "if you have good working relationship with this auditor, you can hire the one you like".*

5.2. CG considerations in the audit process

The most recent study in the Anglo-Saxon context (Cohen et al., 2010) reported that 97% and 59% of auditors, respectively, indicated that the planning and field-testing phases of the audit process had changed in the last five years in terms of the use of CG information. The auditors also identified changes at the level of manager's or partner's review to the use of CG information. Similarly, in a different study (Cohen et al., 2010), the auditors' control risk assessments were higher when the board was considered weaker in terms of its agency and resource dependence roles.

In this study, we asked auditors about the nature and extent of the use of CG in the various phases of the audit process (planning, field-testing and review). Most of the interviewed auditors confirmed that CG material is analyzed and used in the planning phase, but none of the auditors reported the same material is used in the field-testing and review stages.

One auditor asked whether CG information was used at various phases answered as follows:

> *No. I personally look at those matters, but this is not what is being considered in general. I think my "no" was said too fast. We consider the general assembly minutes, the supervisory board minutes or the minutes of the management board meetings. But we do not assess those documents from the perspective of CG effectiveness. Instead, we use them to look for potential problems or issues that need to be considered, as well as to see whether those issues are reflected in the financial statements. We check if a supervisory board, for instance, paid attention to the difficult management issues such as: investment expenditures or special transactions. Those considerations may give us some hints about how to approach the audit.*

Another auditor described the same issue as follows:

> *In general, we assess various risks at the stage of planning, and the fact that a company has an active AC or effective control influences the level of risk. If, for instance, we see that the management frequently communicates with the supervisory board, that the supervisory board is an active monitoring agent, and that the procedures are verifiable because there is an active internal control, then this information will be reflected in the way we assess the risk and plan the other stages of the audit.*

All the auditors confirmed that they consider internal control issues in the planning process. The auditors' assessments of the effectiveness of the internal controls influence their decision about the level of risk. In fact, the auditors consider corporate control to be the most important part of this stage of the audit, as later actions will depend on the result of this assessment. The auditors mentioned having noticed improvements in the effectiveness of corporate control and having seen changes in the quality of the control systems, especially in the bigger organizations with international capital. In the local companies, according to the auditors, the control systems are not as developed as those in the bigger companies.

The auditors were also asked to assess the use of CG information across different engagements in order to give the researchers a sense of the nature of the use of CG information and how it affects the audit process. The responses suggested that larger companies with international capital have more effective CG mechanisms, while the application of those mechanisms becomes more problematic in smaller, local companies. As one of the auditors explained:

> *There are two types of companies: international companies and smaller, local companies. The international companies have already introduced rules and procedures. These are not only on paper but are also applied in practice. In such cases, the companies want to be seen as transparent, and the management board appreciates the role of CG. In the case of smaller companies, corporate procedures are not always applied, and some are only written on paper and not used at all in practice. So, to sum it up, the size of the company has a great impact on the CG of the company."*

One of the auditors also pointed out that the financial sector is characterized by effective CG mechanisms due to the special supervision of the Financial Supervision Commission.

5.3. Importance and effectiveness of AC Perspective of auditors

In addition to their the interaction with management and ACs as well as the use of CG information in their work, we were also interested in the auditors' experiences with other CG mechanisms, their assessment of the changes in CG in the last five years, and their perspectives on future development. Among different CG mechanisms, we asked about the certification of financial statements by the management, the impact of the supervisory board independent members, whistleblowing procedures and the implementation of codes of ethics.

One of the important elements of CG mechanisms is the certification of financial statements by the management as well as the supervisory board. The efficiency of this mechanism is still being debated, and the evidence on its effectiveness is mixed. In a study by Cohen et al., (2010) a majority of auditors confirmed a positive impact on financial reporting quality, while only a fifth of the auditors stated that this mechanism had an impact on their work.

In this study, the auditors also confirm that the certification of financial statements has a positive impact on the financial statements' quality and reduces manipulation risk. Some auditors see the certification process as a clear message to the management and the supervisory board about their ultimate responsibility for the preparation of financial statements. One of the auditors said:

> *A person who signs a document is more careful about the content of the financial statements. For instance, the requirement of signing of the internal affirmation letter stating that the content of the financial statements is free from misstatements and omissions and so on for the purpose of an audit is very often the subject of discussion with an auditor. When the letter contains phrases like "the management confirms that there is no case of fraud" or "the internal control system protects the company from all fraud," the management does not want to sign it. Even if it is explained that the letter is the result of procedures introduced by them to avoid fraud, the management is still resistant to sign such a document. So a requirement of certification makes people to think twice about their responsibility for the signed document.*

The auditors see the importance of codes of ethics and whistleblowing procedures for the functioning of the efficient CG system. If they are efficiently implemented, the auditors see these as tools for risk reduction in the planning stage. However, in practice, companies rarely develop such procedures, and even if they are written on paper they are not typically used in practice. In most cases, codes of ethics and whistleblowing procedures are used more as PR tools than as effective governance mechanisms.

We also asked auditors about their opinions on the impact of the independent member on the effectiveness of CG and the effective monitoring of financial reporting quality. Most of their assessments were positive, and most of their assessments were positive. An independent member is considered to be more inquisitive and less afraid to ask difficult and challenging questions. The auditors pointed out that, in practice, real independence is difficult to achieve, but an independent member very often provides an additional impetus in the discussion of difficult matters and can direct the other members of the committee to see a given problem from a different perspective. Independent members on the ACs are also considered to be more knowledgeable and skillful in finance and thus better prepared for financial reporting oversight.

In general, the auditors assessed CG reforms as positive. They see the last five years as a period of significant changes in this area, during which CG has in fact been created in Poland. The change they identified as most important was the formal requirement to establish ACs. At the time of the "comply and explain" rules when the applications of the rules was not compulsory only few companies were experiencing with the AC. At present, many companies have positive experience with ACs and one can expect the increase in this experience and thus the quality oversight.

6. Discussion of results and summary

Auditors are considered important actors in CG, in addition to the AC, supervisory board and the management board. All of these actors influence the quality of financial reporting. Several previous studies have reported auditors' experience with CG. In one of the first studies on this issue, Cohen et al. (2002) collected experiences of auditors in 1999-2000. This study reported that the auditors included the quality and efforts of CG in their risk assessments and program planning. However, the auditors generally considered ACs to be inefficient.

In a study of auditors' experiences with CG in the post-SOX era, Cohen et al. (2010) found a significant change in the CG environment since the introduction of SOX. In the post-SOX context, the auditors consider the boards as well as the AC to be important actors in the governance structure, despite the still-significant role of management in the appointment of an auditor. The auditors considered the knowledge and skills of ACs to be sufficient for the successful monitoring of financial reporting quality. They also found the ACs to be more active and diligent than in the previous study.

The evidence collected in this study allows us to create a picture of the use of CG information in the audit process in Poland – a country with a different CG model than the US. The results of this study show that external auditors notice some changes in the CG system in Poland, at the same time indicate management boards, supervisory boards but also owners of the companies as the main actors of the CG system. Inclusion of owners as one of the main actors in the CG mosaic constitute the major difference between the US and the Polish data, yet surprising on. The difference results from a dominating concentrated ownership structure on the Polish capital market, when it is the dominating owner who has the strongest and direct influence on the company's activities.

Another difference in the findings as compared with the US data (Cohen et al, 2010) is that the external auditors providing services on the Polish market do not perceive ACs as an important actor in the CG mosaic, even if they consider the ACs as an important CG mechanism. The US CG system has a long tradition of the AC existence, while in Poland audit committee seems to be a relatively new concept. Despite the fact that the existence of the audit committee was included the Codes of Best Practices for Warsaw Stock Listed companies form the first Code's inception, the rule was most frequently broken by the companies. The requirement of the AC existence was introduced formally with the new Auditing Act as of 2009, but even then the most common reaction was the reduction of the size of the supervisory board to five members in order not to avoid the formulation of the AC.

When defining CG, the auditors focused primarily on control issues; at the same time, they rarely interact with the internal controller. This finding is also somewhat different from the findings of the study in the US context where auditors also considered the board, management and corporate culture. The use of CG information in the audit process in the Polish context is limited to the planning phase, where mainly internal controls are assessed as a part of the risk assessment. Contrary to the US findings where the use of CG info as described by the authors of the study as moderate (Cohen et al, 2010), the external auditors in Poland auditors did not report the use of CG information in the field-testing phase or in the review phase.

When it comes to the to the assessment of accounting and finance level of expertise of the AC members done by the external auditors, the evaluations are not consistent in case of the Polish data – they vary from very weak to very good, at the same time the finance and accounting competences of the AC members representing investment funds highly appreciated. Cohen et al, 2010) evidence that the experience in accounting and finance of the AC members in the eyes of the US auditors increased and could be described as efficient, with differences among industry and size of the company (Cohen et al, 2010).

The assessment of the paper of the AC to confront managers as well as the effectiveness of the oversight of financial reporting also differs in case of the evaluation by the Polish and US auditors. In case of Poland the ability to confront the management of the company depends on the ownership structure of the company, while the US auditors focused more among differences between industries. The US auditors perceive ACs as more effective and more diligent then before (Cohen et al, 2010), while the Polish auditors' evaluation of the AC effectiveness in not so consistent and varies from AC being passive to AC being effective when it comes to the oversight of the financial reporting. The Polish auditors also observed that the management or the majority owner (who may sit on of the supervisory board or on the management board) plays the major role in the auditor's appointment.

The findings of the current study seems to be consistent with the experiences of auditors in the US context some 14 years ago, before the occurrence of the global CG scandals and the enactment of the SOX as described by Cohen et al (2002). A preliminary explanation of this situation could be that Poland's CG system is not as developed as those of the more developed market economies and that one can expect the practices to converge in the near practice. However, a closer look at the issue may lead us to ask the deeper questions of why there are differences in these practices and whether it is reasonable to expect that the practices will converge in the future. If the CG system is supposed to balance the expectations and self-interest of organizations' various participants (Sunder, 2008), any change in the expectations or in the behavior of the participants will put the system into a state of inequilibrium. In order to balance the expectations of the participants, one needs to find the appropriate balance between the legal regulations, market forces and social norms of a given society. In that sense, the CG system is a dynamic system. Seeing a CG system as a dynamic one leads to a conclusion that there is no a single effective CG system and, thus, the equilibrium will have to be modified with time as a result of changes in the development of the market, legal regulations, acceptable social norms, and the interests of the CG agents.

As suggested by Gendron (2009: 128) agency theory is not the only one, which can be used to interpret the collected material. Consistent with the prior literature (Cohen et al. 2010; Beasley et al. 2009; Spira 1999) institutional theory, resource dependence theory and managerial hegemony theories can be simultaneously used to describe CG reality in the studied case

According to agency theory, CG is a contractual mechanism aimed to reduce the agency costs. The agency costs arise because of the existence of the information asymmetry between managers and owners of the business (Jensen and Meckling 1976; Fama and Jensen 1983) and assumes that supervisory board re effective monitors of the managerial actions. Institutional theory, on the other hand, stresses the scope of interaction between the CG participants. Spira (1999) for instance provide evidence that practices related to AC may not necessarily be providing vigilant monitoring but may be more providing symbolic legitimacy and therefore may be more ceremonial in nature.

The evidence provided in this research can be used to support both the agency and the institutional theory. The primary findings of this study in the context of the Polish CG indicate that the auditors see some changes in the CG environment and see the management and the supervisory board as the main actors of the governance system. It is striking that none of the auditors mentioned ACs in their own definition, perhaps because auditors still see ACs in general as a weak CG mechanism. However, the auditors indicated that they see some changes in this respect, particularly noting the presence of effective ACs in larger companies with international capital. This means that there exist cases on the Polish CG scene, which could support either the agency theory or the institutional theory. The support for the agency theory would be most frequently found in case of larger companies and international ownership, while cases of smaller, local companies would be more likely to support the legitimacy theory.

One of the contributions of the present study is that it presents auditors' perceptions on CG in a setting that differs from the Anglo-American model. This is in line with a call made by Carcello et al. (2011) to explore the relation between CG and auditing in countries that do not follow the Anglo-American governance model. Additionally the paper evidence differences in the perception of CG and AC by the external auditors providing audit services on the Polish market to as compared to the US external auditors (Cohen at al, 2002 and Cohen et al, 2010). The third contribution of the paper was to offer an additional insight into auditing and CG practices in Poland.

Additional research into AC practices might shed more light on the development of these practices over time. There are a number of issues worth investigating in more depth. These include the influences and interactions among various actors of CG. We still need to know more on the processes, relationships and communications especially among AC, management and external auditors Bedard, Compernolle, 2014). Specific issues which are still worth investigating include: the process of external auditor selection, the process of reaching a consensus on a disagreement between an external auditor and management and AC, the process of communication among external auditor, AC and management.

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Appendix 1: Interview questions

1. How would you define CG (CG)?
2. How do you evaluate the role of ACs in ensuring the effectiveness of CG systems?
3. Could you describe your interaction with ACs?
4. What is your opinion of the level of expertise and knowledge of AC members?
5. How would you describe the nature and extent of your interactions with:
   5.1. Management board?
   5.2. Supervisory board?
   5.3. Internal auditors?
6. How often do you meet with the management board/supervisory board/internal auditors
7. Who has, in your opinion, the most influence in hiring/firing auditors? Specifically:
   7.1. Who has *the real* and *the most* influence?
   7.2. What is the percentage of influence of various agents (managers/supervisory board/ ACs)?
8. What factors influence your interaction with:
   8.1. Management board?
   8.2. Supervisory board?
   8.3. Internal auditors?
9. How do you assess the impact of financial statement certification requirements on management behavior?
10. How do you assess the new trends in CG and its likely influence on your work in the future?
11. How would you describe the role of CG in the audit process?
12. Do you consider CG issues in planning and conducting audits? What is the nature and extent of these considerations in:
    12.1. Audit planning?
    12.2. Field testing?
    12.3. Review?
13. In your opinion, how important is the existence of a corporate code of ethics and whistleblowing procedures in planning and conducting an audit?
14. Has the scope of those considerations changed over last 5 years? Is it likely to change in the next 5 years? If so, how?
15. Describe any differences in your consideration of CG aspects with regard to the following:
    15.1. Different risk profile clients
    15.2. National and international clients
    15.3. IPO and long-standing public companies
    15.4. Across industries
16. What is the nature and extent of your reliance on the work of internal auditors?

Figure 1. Timeline for the implementation of CG reforms

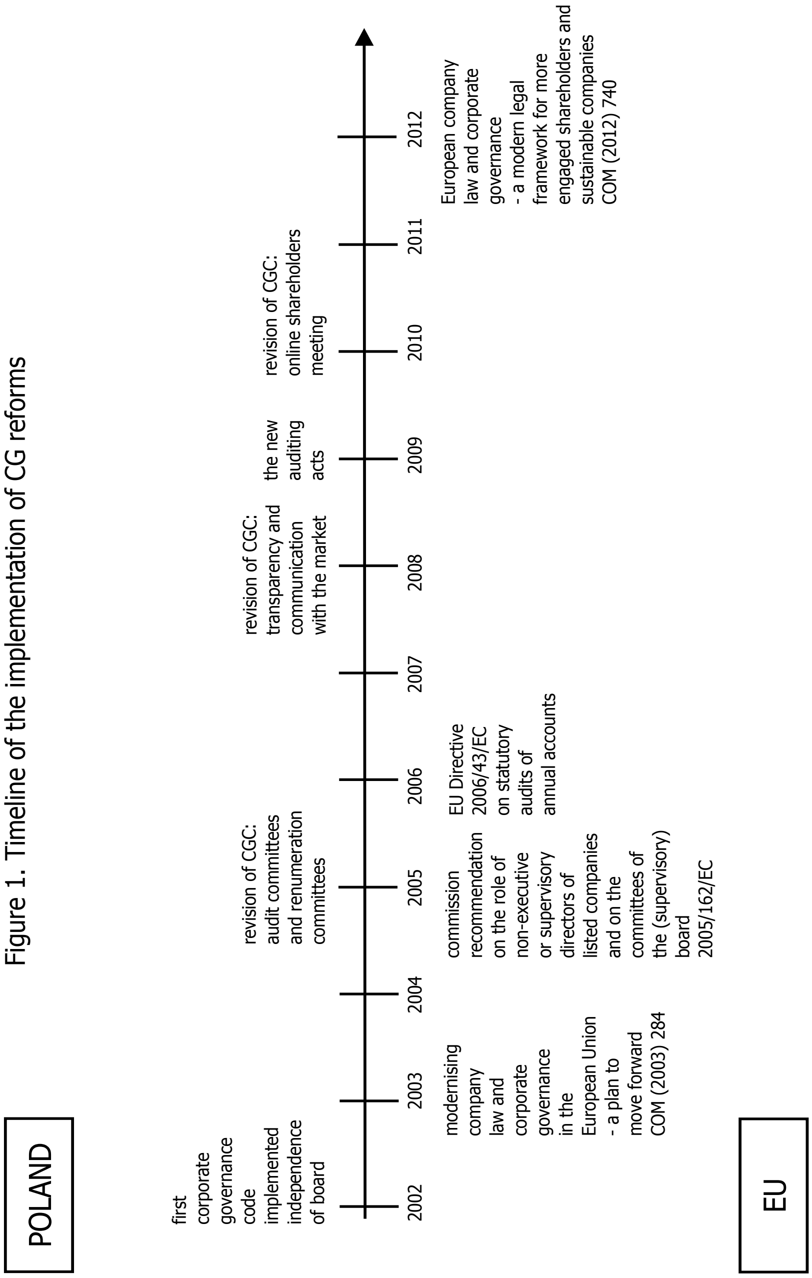

Table.1. Summary of interviews conducted

Participant	P1	P2	P3	P4	P5	P6	P7	P8	P9	P10	P11	P12	P13	P14	P15
Gender	Female	Female	Male	Male	Male	Female	Female	Female	Male	Male	Male	Male	Male	Male	Male
Age group	40-50	50-60	40-50	40-50	50-60	40-50	40-50	40-50	30-40	40-50	40-50	40-50	40-50	40-50	30-40
Date	September 2012	September 2012	September 2012 September 2012	September 2012	September 2012	October 2012	October 2012	October 2012	October 2012	October 2012	October 2012	October 2012	Novemver 2012	December 2012	January 2012
Duration (h)	2	2	1.5	1	1	0.75	0.75	1	1.75	.75	1	1	1	1	1
Method of recording	Notes, partial transcription	Notes, partial transcription	Notes, partial transcription	Notes, partial transcription	Notes, t partial transcription	Notes, notes	Notes, notes	Notes, partial transcription	Notes, partial transcription	Notes, =	Notes, partial transcription	Notes, partial transcription	Notes,	Notes, t	Notes, t