

The Effectiveness of Audit Committees in Jordanian Public Shareholding Companies and Potential Company Characteristics Affecting It: Perceptions from Auditors in Jordan

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ABSTRACT

This study aimed at exploring the effectiveness of audit committees in Jordan and potential factors affecting it. This includes audit committees' performance of their assigned responsibilities, their achievements of certain other benefits, limitations on their effectiveness, and the effects of certain factors, such as company size, debt, and formation of board of directors on their effectiveness. In order to do so, the study used a questionnaire to survey the views of Jordanian auditors who work for audit firms involved in auditing Jordanian companies that are legally required to have audit committees.

The results of the study generally show that audit committees in Jordan are only slightly effective. Auditors perceived that audit committees in Jordan only slightly perform their legally required duties, and that some of the potential benefits covered in the questionnaire are achieved, but only to a limited degree. Factors of company size and debt were generally found not to have an effect on audit committee effectiveness, but the composition of the board of directors factor was perceived as having a slightly significant effect.

Keywords: Audit committees, effectiveness, auditors, corporate governance.

1. INTRODUCTION

The audit committee has recently become of prominent importance in corporate governance. It is usually formed as a subcommittee of the board of directors that includes independent, outside directors (Rittenberg and Shweiger, 2001). Its main role is to liaise effectively between auditors and directors of the audited company. Therefore, it is mainly composed of non-executive directors (Woolf, 1994). In order to do this, its main duties include oversight responsibility for external financial reporting, risk-monitoring and control processes, and the internal and external audit (Rittenberg and Shweiger, 2001). This enables it to be effective at overseeing the quality of the financial reports, and at acting as a deterrent to management override of controls and management fraud (Whittington and Pany, 2003).

Reviewing the various definitions of audit committees

and their general duties, Spira (1998) considered that the main issues raised in these definitions are that an audit committee is a board subcommittee formed predominantly from non-executive directors and concerned with audit, internal control, and financial reporting matters. Therefore, where the role of management is preparing the financial statements and the role of the auditor is to audit the financial statements and evaluate internal control, the role of the audit committee is to oversee the entire process (Blue Ribbon Committee, 1999).

Audit committees began to appear and be adopted in the USA during the late 1970s and early 1980s, due mainly to efforts of the Securities and Exchange Commission (SEC) and the New York Stock Exchange (NYSE) (Knapp, 1987). The two main boards to issue recommendations on the adoption of audit committees in the USA were the Cohen Commission (AICPA, 1978) and the Treadway Commission (1987). In the wake of recent financial and audit failures, the Sarbanes-Oxley Act was enacted in 2002, and added additional requirements regarding the work of audit committees. In the UK, the audit committee became a key element in the

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corporate governance structure mainly after the Cadbury Report (1992), and since then most public limited companies in the UK have one (Higson, 2003).

In Jordan, establishing audit committees became mandatory in 1998 for companies filing with the Jordan Securities Commission (JSC). Given the fact that audit committees are still a recent form of corporate governance to be employed in Jordan, this study aims to explore views of auditors in Jordan about the effectiveness of audit committees in Jordan in performing their responsibilities as stated in Jordanian regulations, and other potential roles they may have.

Importance of this Study

The importance of this study is that it explores the effectiveness of audit committees in Jordan in achieving their roles in the corporate governance process. This is important given the significant role audit committees are expected to perform in Jordanian public shareholding companies, especially that audit committee establishment has just recently (1998) become mandatory in Jordan.

This study is, to the researcher's best knowledge, the first study in Jordan to emphasize audit committees and their effectiveness in such extensive detail¹. Its results will therefore fill a gap in the current body of literature on auditing and corporate governance in Jordan and provide valuable information to internal and external auditors, managers and members of boards of directors in public shareholding companies, preparers of financial statements, users of financial statements, and regulators.

Research Problem and Objectives

The Jordanian government mandated the establishment of audit committees in Jordanian public shareholding companies in 1998, in an attempt to improve corporate governance in Jordan. This was partly due to some local corporate failures and partly due to Jordan's willingness to increase its involvement in international trade and attract foreign capital. However, although audit committees have been established by law, our knowledge of their actual performance and effectiveness is very limited, due to the lack of sufficient published information about them and the lack of sufficient local research on them. Given that, this study seeks to contribute to our knowledge about audit committee effectiveness by surveying views about their actual performance and effectiveness in the Jordanian context. In doing so, this study utilized the main results of

existing literature and local and selected international regulations on audit committees, modifying them when necessary to become suitable to the Jordanian context, in order to identify the main issues to enquire about in the questionnaire used to explore how effective audit committees in Jordan are.

This study is an exploratory study which seeks to respond to the general question of how effective audit committees in Jordan are (in achieving their assigned responsibilities as per Jordanian laws and regulations, and in achieving certain potential benefits reported in theory and literature from other countries), and what factors might affect their effectiveness. In more detail, this study seeks to respond to the following questions:

- 1- How effective are audit committees in Jordan in fulfilling their assigned responsibilities as per Jordanian regulations?
- 2- How effective are audit committees in Jordan in achieving potential benefits regarding improving corporate governance and better serving stakeholders' interests?
- 3- How do some possible limitations on the role of audit committees in Jordan affect their effectiveness?
- 4- Do factors of company size, debt, and composition of the board of directors affect audit committees' effectiveness in Jordan?
- 5- Do respondents' personal background characteristics have a significant relation to their responses to the previous questions?

2. THEORETICAL FRAMEWORK

Audit committees have been globally adopted during the last quarter century (Morse and Keegan, 1999). They have been seen to provide many benefits to boards of directors, non-executive directors, external auditors, internal auditors, and shareholders and other users of financial statements (Collier, 1997). Turley and Zaman (2004) provide a theoretical model for audit committees, where they conclude that potential benefits of audit committees can be divided into structural incentives (such as size, leverage, and other agency factors), effects on the audit function (such as auditor selection, remuneration, and independence, and audit reporting and internal control), effects on financial reporting (such as the role of audit committees in affecting financial reporting quality and reducing financial statement fraud), and effects on

corporate performance (including its potential role in improving corporate governance).

In order to achieve these benefits, several guidelines have been suggested to govern audit committees. Among others, the Blue Ribbon Committee (1999) in the USA suggested that an audit committee should be composed of only non-executive directors who are financially literate. It should also have a written charter, issue a statement on how it undertook its responsibilities, have authority in appointing or replacing external auditors, and hold discussions with external auditors about the latter's independence and the quality of the company's financial reporting. In addition, the Cadbury Committee (1992) in the UK has recommended that the audit committee meet at least twice a year, and at least once a year with the external auditors without the presence of the executive directors. The Sarbanes-Oxley Act of 2002 in the USA added significant roles to the audit committee, such as making decisions on hiring and dismissing auditors, approving all payments made to external auditors for audit and nonaudit services, and dealing with disagreements between the auditor and management about accounting matters (see Tackett, 2004).

Although the idea of audit committees has been generally acceptable, their effectiveness in fulfilling their role has not been without criticism. Collier (1997) suggests the following reasons for possible weak effectiveness of audit committees:

- 1- Audit committees may be formed merely to provide an appearance of monitoring in order to satisfy parties such as shareholders and regulators.
- 2- The true independence of non-executive directors is questionable. On this issue, Abdel-Khalik (2002) suggests that some of the audit committee members be appointed by a shareholders' board of trustees which is independent from the board of directors of the company.
- 3- Audit committees may have deficiencies in their operations.
- 4- The whole concept may be flawed.

In addition, there may be too many undue expectations for the role of audit committees, especially when the same regulations apply to all companies of different sizes (Zaman, 2001).

Audit Committees in Jordan

Audit committees have been introduced into the Jordanian laws in 1998. Regulations issued by the Jordan

Securities Commission (JSC) (1998) required that listed companies establish an audit committee every year. The committee is to be answerable to the board of directors and is comprised of three non-executive members of the board of directors. The committee is to meet at least four times a year, and has the authority to seek information and advice from any internal or external source.

According to the above mentioned regulations, the audit committee is responsible for studying and discussing the work of the internal and external auditors, including the external auditor's reports on the financial statements (including any reservations) and on the internal control system. Also, the committee is responsible for studying and discussing the company's annual and interim financial statements, including the main accounting policies employed (and any changes in them) and compliance with any legal requirements. The revision of the 1998 regulations in 2004 included some extended detail on the above issues, but did not add any new roles or responsibilities to audit committees.

Audit committee regulations in Jordan were criticized by several writers for the lack of some important issues. For example, Jomaa (1998) argues that it is not suitable for the audit committee to be selected by the board of directors, not to have a compulsory written charter, and not to have its members' qualifications clearly stated in the law. Al-wardat (2003) argues that the lack of proper qualifications and business experience for the audit committee members may actually lead to negative effects such as increased bureaucracy and obstructing the external and internal auditors' work. He also argues for more detailed determination of audit committees' responsibilities. In addition, Dahmash et al (2003) argue for more supervision by regulatory authorities concerning actual compliance by companies with audit committee regulation.

According to the Jordanian Shareholding Companies Guide 2003, the number of Jordanian public shareholding companies is about 200, and they are all required to establish audit committees. These companies' financial statements are audited by 21 different Jordanian audit firms of different sizes, some with international affiliations. A recent enquiry by the researcher about the companies which have registered their audit committees with the JSC shows that their percentage from the total companies is about 85%. However, very little is known about the actual operations of the audit committees in these companies, which is something this study aims to explore.

3. PREVIOUS STUDIES

Due to the apparent benefits of audit committees, surveys in the UK (see for example Chambers and Snook, 1979) and in the USA (see for example Mautz and Neumann, 1977) have shown that a significant percentage of companies have adopted them even before they became mandatory. Results of research on voluntary formation of audit committees showed that it has been associated with several factors. For example, Pincus et al. (1989) studied a sample of companies listed on the NASDAQ stock exchange and found that voluntary formation of audit committees is associated with a lower portion of share capital owned by directors/managers, a higher level of financial leverage, a larger number of non-executive directors, a larger company size, and the external auditor being one of the top tier audit firms. In addition, Collier (1993) studied a sample of British companies which voluntarily formed an audit committee and a sample of other British companies which did not. His results were much similar to those of Pincus et al. (1989). A study by Bradbury (1990) on a sample of Canadian companies also found similar results, except for the cases of company size and financial leverage, where no significant association was found.

In several countries, research on the effectiveness of audit committees has produced mixed and inconclusive results. A survey by Teoh and Lim (1996) on accountants and auditors in Malaysia, and another survey by Beattie et al. (1999) on accountants and auditors in the UK, both found that audit committees are perceived to have a positive effect on auditor independence. Studies which found positive results about the effectiveness of audit committees include McMullen's (1996) study, based on a sample of US companies, which found audit committees to be

'associated with fewer shareholder lawsuits alleging fraud, fewer quarterly earnings restatements, fewer SEC enforcement actions, fewer illegal acts and fewer instances of auditor turnover when there is an auditor-client accounting disagreement' (McMullen, 1996: 101).

Similarly, DeFond and Jiambalvo (1991), who studied a sample of US companies which disclosed accounting errors and a sample of US companies which did not, found that public companies with overstated annual earnings are less likely to have an audit committee. This result was mirrored by that of Davidson et al. (2005),

who studied a sample of listed Australian firms and found that a majority of non-executive members on an audit committee is associated with a lower likelihood of earnings management. Findings of Beasley et al. (2000), based on a sample of companies from the 1980s and 1990s which experienced financial statement fraud, associate the existence of audit committees with less likelihood of experiencing fraud, while findings of Goodwin and Seow (2002), who surveyed views of a sample of auditors and directors in Singapore, associate the existence of strong audit committees with a positive effect on audit effectiveness and detection of fraud (although not necessarily prevention of fraud).

DeZoort and Salterio (2001) used a questionnaire that was administered to a sample of audit committee members in Canada. They found a positive association between both of the number of independent audit committee members and their audit reporting knowledge, and supporting auditors in an auditor-management dispute. They also found that when audit committee members are managers in the company they tend to give less support to the auditor and more support to management. Also, Beattie et al. (2000) studied the extent, nature, and outcome of discussions and negotiations between finance directors and audit engagement partners. By using a questionnaire administered to a UK sample from both groups, their findings included that audit committees are successful in reducing confrontational intensity of interaction between auditors and audit clients (increasing discussion and reducing negotiation). In addition, Scarborough et al. (1998) used a questionnaire that was administered to a sample of internal auditors in Canadian industrial companies. They found that audit committees with independent members are more likely to have frequent meetings with the chief internal auditor and to review the results of internal auditing and the internal audit program. Findings of Meng et al. (2005), based on data from top companies listed on the Australian Stock Exchange, supported the positive role of the audit committee by showing that a higher proportion of non-executive directors on an audit committee is associated with the selection of an industry specialist audit firm.

The previous studies generally reported favorable results about the effectiveness of audit committees. However, some studies have found unfavorable results about that. Menon and Williams (1994) studied a sample of US companies which voluntarily formed audit

committees. They found that the main deficiencies in the performance of audit committees are that many firms which have them do not actually rely on them, maintaining them only for the appearance of monitoring. They found that audit committees generally hold very few and infrequent meetings and that some audit committees are staffed by insiders. However, they found that the larger the company, the higher is the probability of having an active audit committee. They related this to economies of scale or to monitoring complexities.

Cohen et al. (2002) interviewed a sample of auditors based in the USA about audit committees and corporate governance. They found that audit committees are generally passive, ineffective, and not powerful enough. They also found that audit committees tend to be only concerned with monitoring rather than business strategies and risk, and that audit committee members often lack expertise (especially in financial matters) to effectively perform their job. In addition, Vicknair et al. (1993) studied proxy statements of 100 New York Stock Exchange firms. They reported that the control of audit committees by non-executive, but somewhat affiliated or financially interested, board members may limit the effectiveness of audit committees.

The majority of the above mentioned studies were performed using different types of econometric modeling to study specific phenomena related to audit committees. However, in one of the rare studies to use a case study approach to analyze the role of audit committees in a leading FTSE-listed company, Turley and Zaman (2003) found that the contributions of audit committees to corporate governance come to a large degree from informal processes. An important role of audit committees was found to be helping in mediating organizational solutions in certain nonroutine situations. Audit committees have also been found to have significant influence on power relations among relevant organizational participants. A key element in the impact of the audit committee was found to be the standing of the individuals who comprise the committee.

In one of the very few studies on audit committees in the Arab region, Al-Twajjry et al. (2002), used interviews with a small sample of internal and external auditors, found that audit committees in Saudi Arabia are seen as questionable in terms of independence and expertise of their members. They were seen to have failed in establishing close working relationships with internal auditors and external auditors. Joshi and Wakil (2004),

used a questionnaire covering the existence, composition and main functions of audit committees in Bahrain, found that the existence of an audit committee becomes more likely when the size of the company and the number of its foreign transactions are large, and when its financial statements are audited by a Big-Four audit firm. The study found that the independence of audit committee members is limited given that they come mainly from the boards of directors, some even being members of executive management. The study also found that audit committees do perform some overview over internal and external auditing, but that they do not report to shareholders about their findings.

In the only study in Jordan to cover audit committees, Al-Farah (2001) used questionnaires sent to small samples of internal auditors (company-specific questions) and external auditors (general questions), in order to assess the effectiveness of audit committees. In summary, his findings showed that external auditors perceive audit committees as ineffective. The areas where external auditors showed slight agreement on the effectiveness of audit committees were the discussion of company accounting policies and the external auditor's report on the internal control system, while the areas where they showed lowest agreement on that were audit committees' effectiveness in dealing with auditor appointment and fee determination and audit planning. Internal auditors, speaking about their company's own audit committee only, spoke more favorably about its effectiveness, especially in dealing with the internal auditor and discussing the company's financial statements.

Main Contributions of This Study

This study can be distinguished from previous developed countries' studies in that, by using a questionnaire survey, it explores a large number of issues related to audit committees, while most extant research uses econometric models to relate audit committees attribute to some other variable(s) such as fraud or type of audit firm. Even in the cases of two Arab studies cited earlier, these were limited in emphasis to issues such as independence and experience of audit committee members (Al-Twajjry et al., 2002) and the establishment and composition of audit committees (Joshi and Wakil, 2004). The broader coverage of this study is a major contribution.

As for Al-Farah's (2001) only study on audit committees' performance in Jordan, this study contributes

to its findings by covering significantly many more issues and in more detail, covering a much larger population of respondents (targeting auditors rather than audit firms), and being performed several years after the establishment of audit committees in Jordan. This may lead to different findings due to the fact that, in 2000, audit committees were very recently established and very few in number. Therefore, the findings of this study contribute a lot to our knowledge about audit committees' effectiveness in Jordan, and are therefore very useful to readers from several groups of the Jordanian business community.

Research Hypotheses

Based on the previous theoretical framework and literature, the following hypotheses were developed in order to be tested in this study:

- Ho1: Audit committees in Jordan are not effective in fulfilling their assigned responsibilities as per Jordanian regulations.
- Ho2: Audit committees in Jordan are not effective in achieving potential benefits regarding improving corporate governance and better serving stakeholders' interests.
- Ho3: There are no limitations negatively affecting the effectiveness of audit committees in Jordan.
- Ho4: Factors of company size, debt, and composition of company's board of directors do not affect audit committees' effectiveness (Each of these three factors will be tested alone as a sub-hypothesis)
- Ho5: The personal background characteristics of respondents to the questionnaire do not affect their responses to the questionnaire.

4. STUDY POPULATION AND RESEARCH METHOD

The population of this study is Jordanian licensed auditors who are involved in auditing public shareholding companies which are required to have an audit committee². This involved 21 audit firms of different sizes, only one of which declined to participate in the study. The survey covered all of the population, due to its relatively small size, with questionnaires ranging from 1 to 20 administered to each firm according to its size (number of auditors qualified to receive the questionnaire). These individuals were selected due to their experience in auditing public shareholding companies and dealing with corporate governance matters, particularly audit committees. Auditors have

broad experience with different sorts of companies, and are therefore the best source of information available to the researcher on the research issues covered in this study.

One limitation of this study that might be argued is that other potential groups were not covered in it. Reasons for that are that the shareholders group (assumed to be the main beneficiary of the audit committee function) is not involved in daily work of the companies and is therefore probably unable to provide reliable information on the effectiveness of audit committees. Other potential groups, such as internal auditors, members of audit committees and boards of directors were excluded due to the argument that their knowledge is in most cases limited to one single company only. This is because the subject of audit committees in Jordan is relatively recent, and their actual performance may vary widely among companies, and therefore the researcher included only external auditors since they are the group which has broader experience with many companies and can provide more reliable and generalizable findings.

The whole population, as defined above, was surveyed in this study. This included 108 questionnaires, which were administered and recollected in summer 2004. The questionnaires were mainly distributed and recollected personally by hand. The number of usable responses was 68, giving a usable response rate of 63%, a rate that is considered average for similar studies in Jordan.

The questionnaire covered the issues of:

- 1- Audit committees' responsibilities according to Jordanian regulations (Statements S1-S4).
- 2- Potential audit committees' benefits in the areas of improving corporate governance and better serving stakeholders' interests (Statements S5-S16).
- 3- Possible factors limiting audit committees' effectiveness (Statements S17-S21).
- 4- Effects of company size, debt, and board of directors' composition on audit committees' effectiveness. (Statements S22-S29).

In addition, the questionnaire included a section on the personal background of the respondent. Respondents were asked to fill in the questionnaire based on their knowledge about audit committees in Jordan particularly.

Apart from the personal background section, the other four sections included Lickert-scale questions with responses ranging from 1 (*strongly disagree*) to 7 (*strongly agree*). The questionnaire was pilot-tested by a sample of specialists and amended according to the feedback.

Table 1: Personal background of respondents to the questionnaire.

VARIABLE	FREQUENCY	PERCENTAGE
<i>Gender of respondent</i>		
Male	65	95.6
Female	3	4.4
Total	68	100
<i>Age of respondent</i>		
Below 25 years	17	25.0
25-30 years	28	41.1
31-40 years	14	20.6
41-50 years	5	7.4
Above 50 years	4	5.9
Total	68	100
<i>Respondent's auditing experience</i>		
Below 5 years	35	51.4
5-10 years	18	26.5
11-15 years	7	10.3
16-20 years	3	4.4
Above 20 years	5	7.4
Total	68	100
<i>Highest academic qualification of respondent</i>		
Secondary school certificate or lower	0	0
Community college diploma	3	4.4
First university degree	55	80.9
Postgraduate diploma	3	4.4
Master degree	7	10.3
Doctoral degree	0	0
Total	68	100
<i>Respondent possesses an international professional certificate in auditing</i>		
Yes	18	26.5
No	50	73.5
Total	68	100
<i>Audit firm where respondent works is linked with an international audit firm</i>		
Yes	40	58.8
No	28	41.2
Total	68	100
<i>Size of audit firm where respondent works</i>		
Large	44	64.7
Small	24	35.3
Total	68	100
<i>Respondent's has experience in auditing Jordanian companies that have established audit committees</i>		
Yes	51	76.1
No	16	23.9
Total	67	100

The reliability of the questionnaire was measured using the Cronbach's Alpha method, and the results were favorable. For the questionnaire as a whole (all questions except personal background ones) Cronbach's Alpha was 0.8871. This is significantly higher than 0.7, the value generally regarded as a minimum criterion for good reliability (Litwin, 1995). The same test was repeated for each of the four sections mentioned above alone. Results

were similarly favorable with high alpha values, except for the section on possible limitations on audit committee performance, where alpha was slightly lower than 0.7. This is relatively good anyway, since results of this section need not be as consistent as those of other sections (i.e. people may have different views on each question and still provide reliable answers).

Table 2: Views on audit committees' performance of their legal responsibilities.

Statement number	Statement text	Mean	Standard Deviation	P-Value for t-Test
S1	Audit committees in Jordanian public shareholding companies are generally effective in performing their duties	3.99	1.571	0.938
S2	Audit committees perform a detailed study of the company's financial statements, especially in the areas of accounting policies and estimates, and compliance with laws and accounting standards	4.96	1.296	0.000
S3	Audit committees perform a detailed study of the external auditor's reservations on the company's financial statements, and provide recommendations concerning that.	5.12	1.144	0.000
S4	Audit committees perform a detailed study of the company's internal control system.	4.70	1.435	0.000

Table 3: Views on audit committees' perceived benefits.

Statement number	Statement text	Mean	Standard Deviation	P-Value for t-Test
	The existence of an audit committee in a Jordanian public shareholding company leads to (statements S5 to S14):			
S5	Increasing the quality of the company's financial statements.	5.00	1.327	0.000
S6	Increasing the independence of the company's external auditor.	4.51	1.461	0.005
S7	Increasing the independence of the company's internal auditor.	4.42	1.343	0.015
S8	Improving the cooperation between the company's external and internal auditors.	4.85	1.280	0.000
S9	Increasing the probability of selecting an external auditor from the big audit firms.	4.75	1.470	0.000
S10	Increasing the probability of selecting an external auditor who is a specialist in the company's business area.	4.56	1.394	0.002
S11	Increasing the probability of detecting and preventing fraud, embezzlement, and weaknesses in the company's internal control system.	4.85	1.384	0.000
S12	Strengthening the position of the company's external auditor in the case of a dispute with the company's management over the financial statements.	4.97	1.555	0.000
S13	Giving a more positive role to non-executive members of the board of directors in the corporate governance process.	5.13	1.043	0.000
S14	Increasing the public's confidence in the reliability and objectivity of the company's financial statements.	5.07	1.297	0.000
S15	Audit committees play a big role in appointing and dismissing the company's external auditor.	3.66	1.822	0.128
S16	Audit committees play a big role in determining the fees of the company's external auditor.	3.49	2.010	0.043

Statistical Tests Used for Hypothesis Testing

The hypotheses of this study were tested using the following analysis:

- 1- Descriptive statistics (by analyzing means and standard deviations) for testing the first four hypotheses.
- 2- One-sample t-test (two-tailed, 5% significance level) (for analyzing whether mean responses for each question significantly differ from 4, which is the value assigned for neutral responses) for testing the first four hypotheses.
- 3- Kruskal-Wallis multiple-samples test (for analyzing the relation between respondents' background variables and their responses to each question).

Summary Characteristics of the Study Sample

68 usable questionnaires were returned to the researcher and used for the analysis of results. As is apparent from Table (1), the respondents were predominantly males. The sample varied among age and audit experience categories, with many respondents being from the small and medium age and experience categories. This can be related to the fact that audit firms which audit public shareholding companies in Jordan are generally the large audit firms. In such cases, the firms would normally have few partners and highly experienced individuals managing the firm and taking general responsibilities for the audits, while most individuals would be from lower ranks and with less experience. However, this fact is unlikely to threaten the quality and generalizability of the results of the study, since the sample of respondents resembles the total population as defined, and generally possesses ample knowledge needed to provide the requested information.

The vast majority of respondents had a first university degree as their highest academic achievement, while about 10% of them possessed a master degree. A significant minority of them possessed an international qualification in auditing, and a majority of them reported that they worked for a Jordanian audit firm linked to an international audit firm. In addition, the majority of the respondents reported that they worked for big audit firms³, while the rest came from small audit firms. These results are expected, given that the majority of public shareholding companies in Jordan are audited by the biggest audit firms in the country, many of which have international links.

Finally, most of the respondents reported that they

had actual experience in auditing Jordanian companies that have an audit committee. This is a positive fact, since this study emphasized auditors as the group that can provide the most reliable information about the performance of audit committees in Jordan, and therefore the respondents should generally have ample experience dealing with companies with audit committees.

Hypotheses Testing and Analysis of Results

Hypothesis 1:

Audit committees in Jordan are not effective in fulfilling their assigned responsibilities as per Jordanian regulations.

Statements S1 to S4 (see Table 2) deal with audit committees' responsibilities which can be derived from Jordanian regulations. Statement S1 is a general statement while the other three statements are more specialized. The information in Table (2) shows that auditors are generally neutral on the argument that audit committees do fulfill their required roles, and generally only slightly agree that audit committees apply their responsibilities as per Jordanian regulations. The lower agreement on the general effectiveness of audit committees may imply that auditors expect audit committees to perform more duties than those included in the current regulations. Responsibilities of thoroughly discussing the financial statements and auditors' reservations on them seem to be slightly more emphasized than those of studying the internal control system.

As for testing the hypothesis, Table (2) shows that mean values for statements S2, S3, and S4 are significantly different from the neutral value 4 (p-value is lower than 0.05). Therefore the null hypothesis is rejected regarding these statements and it can be concluded that auditors do perceive audit committees as somewhat effective in fulfilling their assigned responsibilities as per Jordanian regulations. However, the null hypothesis is not rejected in the case of S1 (p-value is higher than 0.05), where it can be concluded that auditors are neutral about the general effectiveness of audit committees in performing their duties.

Hypothesis 2:

Audit committees in Jordan are not effective in achieving potential benefits regarding improving corporate governance and better serving stakeholders' interests.

Statements S5 to S16 (see Table 3) cover some

potential benefits that may be associated with the existence of audit committees in Jordanian companies and which are assumed to improve corporate governance and better serve stakeholders' interests. These issues were selected after reviewing previous international studies. Findings of these studies associated the existence of audit committees with benefits such as improving the quality of the financial statements, improving auditor independence, improving internal control, and increasing the probability of detecting and preventing fraud. Such benefits are expected to limit the probability of company failure where reasons can be blamed on weak corporate governance. The fact that the existence of an audit committee was found to be associated with such benefits indicates the importance of its establishment and its effective performance. Therefore, this study attempts to explore to what extent the existence of audit committees in Jordanian companies can be associated with such benefits. In addition, the Sarbanes-Oxley Act of 2002 in the USA gave audit committees the right to appoint, dismiss, and determine fees of the external auditor. These issues were also considered as potential benefits in this study since they are expected to improve corporate governance.

From Table (3) we can observe that auditors tended to slightly agree on most of the statements. It can be concluded that auditors perceive that the potential benefits of audit committees discussed above do exist in Jordan, but only to a limited degree, witnessed by the relatively small degree of agreement on the statements. The exception was in the last two statements, where auditors generally tended to take neutral or slight disagreement views on the issues of audit committees playing significant roles in appointing, dismissing, and determining fees of external auditors. It seems that, in Jordan, this role is still effectively undertaken by management and the board of directors (on behalf of the shareholders). However, given the relatively high standard deviation for S15 and S16, it may be argued that audit committees in Jordan vary with respect to their roles among different Jordanian companies. In this area, they may have somewhat powerful roles in some companies, given the authority to deal with appointment and fee determination for external auditors, although they are not legally entitled to this role, while in other Jordanian companies audit committees may have no role at all in such functions.

Ranking the benefits according to auditors' views, it

seems that the biggest (although not very big) benefit from audit committees in Jordan is achieved in the area of giving a more positive role for non-executive members of the board of directors in the corporate governance process. In the Jordanian context, this is arguably a positive sign since it may limit the ability of executive members of the board of directors, who generally occupy the most senior management positions in the company, to get involved in fraud and other illegal acts to the detriment of the position of other shareholders, given the inclusion of non-executives in the corporate governance system. Other important factors reported were, respectively, increasing the public's confidence in the company's financial statements, increasing the quality of the company's financial statements, and strengthening the position of the external auditor in cases of dispute with the company's management over the financial statements. If audit committees in Jordan get increasingly effective in fulfilling such roles, this is expected to have a positive effect by improving the external auditor's power and independence from management, and therefore producing more reliable financial statements and enhancing accountability of managers.

As for testing the hypothesis, Table (3) shows that the mean values of all the statements (apart from statement S15) are significantly different from the neutral value 4 (p-values are less than 0.05). Results of statements S15 and S16 also show relatively high standard deviations, suggesting the lack of a general consensus among auditors on the role of audit committees on the issues covered in the two statements. Therefore, the null hypothesis is rejected regarding all of these statements (apart from S15, where the null hypothesis is not rejected), and it can be concluded that auditors do perceive that the existence of audit committees in Jordanian public shareholding companies does provide some benefits, but only to a limited degree. It can be also concluded that the majority (over 65%) of auditors hold neutral views or believe that audit committees in Jordan do not play a significant role in decisions regarding appointing, dismissing, and determining fees of external auditors, although there is a significant minority of auditors who believe that audit committees do effectively perform this role.

Hypothesis 3:

There are no limitations negatively affecting the effectiveness of audit committees in Jordan.

Statements S17 to S21 (see Table 4) deal with issues that are potential limitations to the performance of audit committees in Jordan. Main issues included in this section are audit committees being seen as a useless legal requirement, low reliance on audit committees by boards of directors, low encouragement from audit firms for the establishment of audit committees, insufficient legal regulations on audit committees, and undue high expectations from audit committees by the public. These issues were found to be significant in several international studies (e.g. Zaman, 2001; Cohen et al., 2002). In addition, while Abdullatif's (2003) study on auditing in Jordan found that Jordanian auditors argue that audit regulations as a whole are not sufficient and limit audit effectiveness and that undue demands are expected from Jordanian auditors. If such issues do apply to auditing, they may also apply to audit committees as well, since they are another type of assurance function.

Testing the hypothesis, Table (4) shows that the mean values of all the statements are significantly different from the neutral value 4 (p-values are less than 0.05). These results mean that the null hypothesis is rejected for all of the statements.

Auditors tended to only slightly agree on the statements. An analysis of such responses would suggest that audit firms in Jordan tend to a little degree to promote audit committee establishment, and that boards of directors of companies do use them for control purposes, albeit only to a little degree. Such results can be expected given the short time since the establishment of audit committees in Jordan. However, the results also show that a slight majority of auditors (given the 4.53 mean value and the relatively high standard deviation for statement S17) perceive that in the case of audit committees not existing, companies would generally tend not to bother to establish them, unless legally required to do so. This high standard deviation can be expected given the results of the second hypothesis, where on some issues audit committees in Jordan were found to probably vary among companies in terms of power and importance.

In addition, Table (4) shows that there is slight agreement among auditors that the business community in Jordan holds big and undue expectations from audit committees in the areas of corporate governance, while in reality they may be unable to meet such expectations due to several possible limitations on their role, such as their weak power in some companies and their limited roles and authorities as per current regulations. This is mirrored

by a general view that laws and regulations governing audit committees in Jordan are not sufficient (S20). Although, unfortunately, no respondent in the study provided particular views on this issue, the researcher argues that extending the current regulations in the direction of providing audit committees with more power and supervision over the external audit process, and more independence from management and executive members of the board of directors would probably strengthen their position and improve their effectiveness.

Hypothesis 4:

Factors of company size, debt, and composition of company's board of directors do not affect audit committees' effectiveness.

In this section, the respondents were asked about their views on whether the factors of company size, company debt, and some issues related to the company's board of directors would have an effect on audit committees existence and/or effectiveness. These factors were proven to have significant effects on audit committees' effectiveness in several other studies (see for example Pincus et al., 1989; Collier, 1993; DeZoort and Salterio, 2001). Table (5) summarizes the results from this section.

Testing the hypothesis for company size (statements S22 to S24), Table (5) shows that the mean value of statement S22 is significantly different from the neutral value 4 (p-value is less than 0.05), while the mean values for the other two statements are not. These results mean that the null hypothesis is rejected for statement S22 but not for statements S23 and S24. When testing the hypothesis for company debt (statements S25 to S27), the null hypothesis is not rejected for all of the three statements. Given that means for all of the six statements are very near neutral, it can be concluded that the factors of company size and company debt do not have a statistically significant positive effect on the existence (if that is voluntarily) and the effectiveness of audit committees in Jordan. In the case of existence of an audit committee, such results may arguably occur given that audit committee establishment is compulsory anyway in Jordan. However, as for audit committee effectiveness, it may be argued that the relatively neutral views on its association with size and debt of Jordanian companies is because the possible variation in audit committee effectiveness among companies is not related to size or debt but to different factors, including the formation of the board of directors and executive management.

Table 4: Views on possible limitations on audit committees' effectiveness.

Statement number	Statement text	Mean	Standard Deviation	P-Value for t-Test
S17	The formation of audit committees in Jordan is only to fulfill a legal requirement, and apart from that there would be no interest in forming them.	4.53	1.756	0.017
S18	Boards of directors of Jordanian public shareholding companies rely heavily on audit committees in performing control duties.	4.43	1.479	0.019
S19	Audit firms in Jordan encourage Jordanian public shareholding companies to establish audit committees.	4.52	1.460	0.006
S20	Legal regulations on audit committees in Jordan are not sufficient.	4.83	1.410	0.000
S21	The business community in Jordan holds big and undue expectations from audit committees.	4.99	1.320	0.000

Table 5: Views on factors that have a possible effect on audit committees' effectiveness.

Statement number	Statement text	Mean	Standard Deviation	P-Value for t-Test
S22	The possibility of the existence of an audit committee increases with the increase in the company's size.	4.59	1.632	0.004
S23	The effectiveness of an audit committee increases with the increase in the company's size.	4.33	1.492	0.074
S24	The possibility of publishing a report by an audit committee in the company's annual report increases with the increase in the company's size.	4.04	1.461	0.803
S25	The possibility of the existence of an audit committee increases with the increase in the company's debt.	3.73	1.666	0.191
S26	The effectiveness of an audit committee increases with the increase in the company's debt.	3.74	1.544	0.177
S27	The possibility of publishing a report by an audit committee in the company's annual report increases with the increase in the company's debt.	3.76	1.394	0.169
S28	The effectiveness of an audit committee increases if most or all of the company's board of directors were not members of the company's executive management.	4.75	1.418	0.000
S29	The effectiveness of an audit committee decreases if the company's general manager has strong influence in the company's board of directors.	4.60	1.667	0.004

In fact, the null hypothesis is rejected for issues regarding the board of directors of Jordanian companies (statements S28 and S29). It can therefore be concluded that auditors do agree, albeit slightly, that when members of the board of directors of a Jordanian company are not members of the executive management for the company,

the effectiveness of audit committees increases. It can also be concluded that auditors do slightly agree that when the company's general manager commands a strong influence on its board of directors' members, the effectiveness of the company's audit committee decreases. Given that in Jordan most general managers

Table 6: Statistically significant differences between mean responses for categories of personal background variables.

Variable 1: Age of respondent (years)						
No.	Statement text	< 25	25-30	31-40	40<	p val.
S6	The existence of an audit committee leads to increasing the independence of the company's external auditor.	4.94	3.93	4.93	4.89	0.048
S10	The existence of an audit committee leads to increasing the probability of selecting an external auditor who is a specialist in the company's business area.	5.19	4.64	4.29	3.50	0.040
S25	The possibility of the existence of an audit committee increases with the increase in the company's debt.	4.24	4.11	2.38	3.56	0.009
S27	The possibility of publishing a report by an audit committee in the company's annual report increases with the increase in the company's debt.	4.24	4.07	3.00	3.11	0.016
Variable 2: Experience of respondent in auditing (years)						
No.	Statement text	< 5	5-10	11-15	15<	p val.
S10	The existence of an audit committee leads to increasing the probability of selecting an external auditor who is a specialist in the company's business area.	4.76	5.11	3.14	3.57	0.007
Variable 3: Highest level of formal education the respondent has						
No.	Statement text	First university degree or less	Postgraduate degree (any)	p val.		
S25	The possibility of the existence of an audit committee increases with the increase in the company's debt.	3.93	2.60	0.030		
S27	The possibility of publishing a report by an audit committee in the company's annual report increases with the increase in the company's debt.	3.93	2.8	0.034		
Variable 4: Whether the respondent possesses an international qualification in auditing						
No.	Statement text	Yes	No	p val.		
S13	The existence of an audit committee leads to giving a more positive role to non-executive members of the board of directors in the corporate governance process.	5.56	4.94	0.030		
S23	The effectiveness of an audit committee increases with the increase in the company's size.	3.61	4.60	0.040		
Variable 5: Whether the respondent currently works for a big or small audit firm						
No.	Statement text	Big	Small	p val.		
S1	Audit committees in Jordanian public shareholding companies are generally effective in performing their duties	4.25	3.48	0.042		
S2	Audit committees perform a detailed study of the company's financial statements, especially in the areas of accounting policies and estimates, and compliance with laws and accounting standards	5.23	4.43	0.027		
S7	The existence of an audit committee leads to increasing the independence of the company's internal auditor.	4.70	3.96	0.034		
S15	Audit committees play a big role in appointing and dismissing the company's external auditor.	4.09	2.88	0.009		
S16	Audit committees play a big role in determining the fees of the company's external auditor.	3.86	2.83	0.046		

Variable 6: Whether the respondent has experience in auditing Jordanian companies with audit committees				
No.	Statement text	Yes	No	p val.
S5	The existence of an audit committee leads to increasing the quality of the company's financial statements.	4.80	5.56	0.038
S6	The existence of an audit committee leads to increasing the independence of the company's external auditor.	4.29	5.06	0.025
S9	The existence of an audit committee leads to increasing the probability of selecting an external auditor from the big audit firms.	4.49	5.56	0.007
S28	The effectiveness of an audit committee increases if most or all of the company's board of directors were not members of the company's executive management.	4.92	4.38	0.042
S29	The effectiveness of an audit committee decreases if the company's general manager has strong influence in the company's board of directors.	4.94	3.75	0.008
Variable 7: Whether the respondent currently works for an audit firm linked to an international audit firm or not				
No statements showed statistically significant differences in mean values.				

are very powerful in their companies, and the highest top management positions in public shareholding companies are held by members of their boards of directors or persons with close relations to them, such a corporate governance system may be seen as a potential limitation to the effectiveness of Jordanian audit committees.

Hypothesis 5:

The personal background characteristics of respondents to the questionnaire do not affect their responses to the questionnaire.

In this section, eight personal background factors were to be tested as to their possible effect on respondents' views towards issues included in the questionnaire. These factors are respondents' gender, age, experience in auditing, highest formal academic level achieved, possession of an international auditing certificate, working for a big/small audit firm, working for an audit firm linked/not linked to an international audit firm, and having experience in auditing Jordanian companies which have established audit committees. Details on the sample characteristics regarding these issues, along with any necessary definitions of some variables, were presented at the previous section on sample characteristics. Due to the very small number of females (only three) involved in the study, this variable was excluded from the analysis. In addition, some categories for some of the variables involved had to be

reclassified in order to apply the Kruskal-Wallis test, due to the categories' small sizes.

The Kruskal-Wallis test was applied for each of the 29 statements included in the questionnaire. The comparisons were made among mean responses for categories of each of the seven variables (excluding gender). Due to the large volume of data involved in this analysis, only statistically significant differences (at the 5% significance level) among mean responses for categories are reported in Table (6).

Table (6) shows that in only 19 cases (out of a total of 203; 29 statements multiplied by 7 variables) did a statement produce a statistically significant difference among mean responses of the personal background variables' categories. This means that the vast majority of the cases did not produce any statistically significant differences. In addition, there was no clear trend for the statistically significant differences, as they were scattered among variables and statements randomly, and most of them would have been deemed statistically insignificant had the researcher opted for a 1% significance level rather than a 5% one.

Therefore, the null hypothesis 5 is not rejected in the vast majority of the cases for all variables, and it can be concluded that personal background characteristics of the sample of respondents generally do not affect their views towards the issues covered in the questionnaire.

5. CONCLUSIONS AND RECOMMENDATIONS

This study covered the effectiveness of audit committees in Jordanian public shareholding companies, an issue which has become of prominent importance as a significant factor in improving the corporate governance process. Audit committees became mandatory in Jordan in 1998, and since then Jordanian companies have begun to establish them. This study aimed at exploring how effective such a process has been implemented. The study surveyed views and perceptions on this issue from Jordanian auditors working at audit firms involved in auditing Jordanian companies legally required to have an audit committee. This group was selected given its broad knowledge and experience in auditing a range of Jordanian companies and being involved in the corporate governance process.

Results of the study show that auditors tend to perceive that audit committees do fulfill their legal responsibilities as required by Jordanian regulations, but only to a limited degree. As for potential benefits expected to be gained from establishing audit committees, auditors tend to only slightly agree on the existence of some of the suggested benefits, while not agreeing on the existence of some others. Therefore, it can be argued that auditors do perceive audit committees in Jordanian companies as somewhat effective. Compared to results of Al-Farah (2001), it seems that, according to Jordanian auditors, audit committees' effectiveness in Jordan has slightly improved with the passage of time. Main limitations to audit committee effectiveness suggested by auditors are the owner/manager system of corporate governance, the insufficient legal requirement regarding audit committees, and the undue public expectations from audit committees. Auditors generally tend not to associate factors of company size and debt with the degree of audit committee effectiveness, although they slightly agree that the composition of the board of directors is a factor that affects audit committee effectiveness.

Compared to results from other environments, the results of this study seem to fall in the relatively positive area. However, such a comparison is not conclusive, given that results of international studies on aspects

related to audit committees' effectiveness have found mixed results, ranging from finding significant benefits associated with the formation and implementation of audit committees, such as improved auditor independence and lower likelihood of fraud and earnings manipulation, to low levels of effectiveness due to many limitations on the performance of audit committees, such as their limited power and their members' personal relations with management and their lack of experience and sufficient financial knowledge.

Given these results, the researcher proposes the following recommendations:

- 1- Given that the current level of regulations on audit committees is seen as insufficient, it is recommended that it be extended. Main issues of importance here are strengthening the independence of audit committees from management of companies, and strengthening their power and supervision on the financial reporting process. Suggested amendments here may include giving the audit committee more roles in appointing, dismissing, and determining fees of internal auditors.
- 2- Given that audit committees are seen as only slightly performing their required responsibilities, it is recommended that regulatory authorities, such as the Jordanian Securities Commission, increase their level of monitoring of the performance of audit committees.
- 3- It is important to educate the different parties of the business community, such as shareholders, auditors, managers, creditors, etc. about the important role the audit committee plays in the corporate governance process, since this is expected to improve the effectiveness of audit committees and reduce any incorrect or exaggerated expectations about its role.
- 4- This study has covered only external auditors, due to limitations previously discussed. The researcher recommends that it be replicated several years later on external auditors as well as on other groups, such as internal auditors, managers, and audit committee members in Jordan, in order to obtain comparative views about the issues included in it.

NOTES

- (1) Only one Jordanian study preceded this study (Al-Farah, 2001) but was much less detailed.
- (2) In cases of large audit firms, where most of the auditors possess the necessary qualifications for obtaining the Jordanian audit licence but do not actually hold it, such auditors were included in the

survey.

- (3) These audit firms are defined as those which employ a large number of licensed auditors or auditors possessing the same qualifications of licensed auditors. For the purpose of this study, this means firms which initially received seven or more questionnaires.

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