

¹ A Theoretical Analysis of the Audit Committee's Role in China

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⁴ *Received: 10 December 2013 Accepted: 4 January 2014 Published: 15 January 2014*

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⁶ **Abstract**

⁷ This paper aims to analyze the role of the Audit Committee (AC) in China by employing the
⁸ following theoretical frameworks: managerial hegemony theory to examine whether ACs in
⁹ China serve as a mere ?rubber stamp?; the origin of agency theory to determine whether ACs
¹⁰ are supported by the separation of ownership and control to act as overseers and supervisors;
¹¹ and to use resource dependence theory to assess whether ACs provide added value by acting
¹² as consultants and trainers in China. Telephone interviews surveying 330 listed companies in
¹³ China yielded 61 interviews, and the research results reveal that the AC? s role supports both
¹⁴ the resource dependency and agency theories but conflicts with managerial hegemony theory.

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¹⁶ **Index terms**— role, audit committee, supervisory board, corporate governance.

¹⁷ **1 Introduction**

¹⁸ The Sarbanes-Oxley Act ??SOX, 2002) was enacted in the United States in response to a series of scandals around
¹⁹ the turn of this century perpetrated by Enron and other companies. This act extends the responsibilities and
²⁰ status of the Audit Committee (AC). In 2002, China enacted its own form of Corporate Governance (CG).
²¹ According to China's "Code of Corporate Governance for Listed Companies", ACs may be established alongside
²² the existing monitoring system of the Supervisory Board (SB). Thus in China, establishing an AC is not legally
²³ mandatory but rather voluntary. The willingness to install an AC has increased from 1% (12) in 2000 to 99.86%
²⁴ (2106) in 2010 among listed companies in China (CCER, 2012). Alanezi and Albuloushi (2011) have advised
²⁵ all listed companies and policy makers to require the formation of ACs to increase the level of mandatory
²⁶ disclosure. Firth et al. (2007) noted that China's regulators have endeavored to improve accounting information,
²⁷ transparency, and corporate governance. The Chinese approach to supervisory CG structures in companies
²⁸ combines the AC found in the British and American governance models and the SB found in the German
²⁹ model. This dual-layered governance structure was created to suit China's unique economic, social and political
³⁰ environment.

³¹ The implementation of the singular governance structure of the AC on top of the bipolar structure of the SB
³² with dual monitoring institutions in the internal supervisory mechanism in China is explored to highlight the
³³ role of the AC in China. This paper aims to explore whether ACs are supported by the separation of ownership
³⁴ and control to act as overseers, as predicted by agency theory. ??ama and Jenson (1983) comment that the
³⁵ separation of ownership and control can be a result of efficient forms of economic organization. Agency theory
³⁶ implies a need for supervisory functions, as managers cannot be trusted to act in the interest of shareholders.
³⁷ This research uses shareholder agency theory as a foundation from which to understand the role of the AC as
³⁸ an overseer in China. Managerial hegemony theory is used to evaluate whether in China, the AC merely acts
³⁹ as a "rubber stamp" 1 1 According to the Merriam-Webster collegiate dictionary, the definition of a RUBBER
⁴⁰ STAMP is: " a mostly powerless yet officially recognized body or person that approves or endorses programs and
⁴¹ policies initiated usually by a single specified source."

⁴² The above question is answered based on data from surveys conducted through telephone interviews with 61
⁴³ out of 330 listed companies. The respondent for this survey was the General Secretary of the Bod/SB, whose
⁴⁴ key function is to organize the BoD and the SB and who has access to confidential data from top management
⁴⁵ that is normally difficult to access. The general understanding of Chinese listed companies is revealed in the

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46 responses, which provide a clear conclusion to this study. The survey indicates that over 95 per cent of sampled
47 companies' ACs can meet the definition of the role of AC as overseers and 92 per cent as supervisors through
48 their actual practice, which supports agency theory. Further, 60 per cent of companies' ACs perform the role of
49 consultants, thereby adding value to the company, and 23 per cent of companies' ACs act as trainers, thereby
50 providing extra service to the company. While both of these roles support the resource. Managerial hegemony
51 theory asserts that the Board of Directors (BoD) is a legal fiction and is dominated by professional management
52 from the organization (Mace 1971; Vance 1983; ??orsch and MacIver 1989). The resource dependency theory
53 suggests that the board serves as a strategic consultant to top managers rather than (or in addition to) exercising
54 independent control (Carpenter and Westphal, 2001). It is hard to refute the expectation that ACs bring benefits
55 to their organizations, for the AC is an invisible asset that may increase the enterprises' reputation, expertise,
56 coordination and connection to earn more resources. This paper primarily explores the role that the AC plays
57 in China. The AC is one of the sub-committees of the BoD. Resource dependency theory highlights that the
58 board's role is to expand the outward-looking boundary to enhance a business. This theory will be applied to
59 assess whether the ACs in China contribute added value or provide extra service to the company in addition to
60 executing independent control.

61 The above question is answered based on data from surveys conducted through telephone interviews with 61
62 out of 330 listed companies. The respondent for this survey was the General Secretary of the Bod/SB, whose
63 key function is to organize the BoD and the SB and who has access to confidential data from top management
64 that is normally difficult to access. The general understanding of Chinese listed companies is revealed in the
65 responses, which provide a clear conclusion to this study. The survey indicates that over 95 per cent of sampled
66 companies' ACs can meet the definition of the role of AC as overseers and 92 per cent as supervisors through
67 their actual practice, which supports agency theory. Further, 60 per cent of companies' ACs perform the role of
68 consultants, thereby adding value to the company, and 23 per cent of companies' ACs act as trainers, thereby
69 providing extra service to the company. While both of these roles support the resource dependence theory, 49 per
70 cent of companies' ACs act as the decision maker through their involvement in developing important company
71 policies, which appears to be in conflict with the independence of the AC's supervisory function. The findings
72 reveal that the roles the ACs play in China is not merely a legal fiction.

73 The remainder of this paper is organized as follows: Section II introduces the background and purpose of
74 this research. Section III is based on a study of related literature and regulations regarding the AC and CG to
75 understand the AC's role functions and to raise questions. Section IV describes the theories and develops the
76 hypotheses. Section V presents the empirical findings and analysis results, and Section VI concludes with an
77 assessment of the findings.

78 2 II.

79 3 Background and Purpose

80 The Corporate Governance (CG) supervisory mechanism in China is rather unique in that it simultaneously
81 established the Audit Committee (ACs) of the board and the Supervisory Board (SB). Initially in 1993, China
82 adopted two-tier boards, with SBs based on the German CG model. However, in 2002, China adopted ACs based
83 on the Anglo-American CG model, thus combining the two models of CG supervisory mechanisms. Xiao et al.
84 (2004) studied the role of the SB in China and found that a two-tier board is fraught with problems. Other
85 studies also found that there is no evidence indicating that the SB can effectively monitor management. Su et
86 al. (2005) found that neither board can perform an effective monitoring function. Liu and Sun's (2005) finding
87 suggests that CG supervisory control mechanisms over management could be further enhanced, particularly
88 through CG reform in China's transitional economy. Since 2002, China has allowed listed companies to choose
89 whether or not to establish an Anglo-American AC system. This system still raises questions regarding the
90 functional positions and responsibilities of the SB and the AC in China. a) Functions of the SB and the AC in
91 China Article 126 in China's Corporate Law stipulates that the SB in a Chinese company serves as the internal
92 supervisory unit responsible for supervising the directors' and managers' behavior. China's Corporate Law also
93 defines the system for the SB and provides guidance on how to supervise the organization of internal power as
94 exercised by the company's BoD and the layers of management on behalf of the shareholders. China's "Rules for
95 Listed Companies Governance" establishes five main CG duties for the AC. The duties of the AC and the SB as
96 stipulated in China's Corporate Law are very similar. The SBs oversee the BoDs on behalf of the stakeholders.
97 The AC oversees management on behalf of the BoD and provides balance to the internal directors within the
98 BoD. A comparison of the functions and responsibilities of the SB and the AC is provided in Table ???. From
99 this comparison, it can be observed that there are two functional areas in which the two institutions overlap.
100 First, both are internal supervisory units focusing on financial supervision. This overlap could result in confusion
101 regarding corporate structure and even reduce the effectiveness of the supervision. Second, both are responsible
102 for safeguarding against illegal behavior by directors and managers, such as serious improper transactions, which
103 could trigger conflict in the operations of the two units. The SB and the AC are both supervisory institutions
104 under different CG models. As the function of both institutions is essentially to provide oversight, adding the
105 AC in addition to the SB into the internal supervisory mechanism may enable the AC to provide contributions
106 in addition to its overseeing functions. Given the phenomena of functional overlap, it is therefore appropriate

107 to first clarify the issue concerning the role the AC plays in China. b) An Interactive Model of CG Structure
108 Cochran and Wartic (1988) asserted that CG solves specific problems by mandating types of interaction between
109 senior executives, shareholders, the BoD and other relevant parties within a company. An interactive model
110 demonstrating the interactions between the political institutions, product markets, capital markets, stakeholders,
111 shareholders, firms, BoDs, SBs, ACs, internal auditors, external auditors, Interactive Model of CG Structure.
112 The shareholders, BoDs, SBs, ACs internal auditors, managers and employees comprise relationships within the
113 company and interact within the CG structure. Many legal, economic, political, social and other forces are
114 continually involved in these interactions. The interactive model in Figure 1 can help to better understand the
115 impact of CG on the current internal supervisory mechanism and also help to explore possibilities for improving
116 the level of understanding of CG in the future. In terms of its role , the position of the AC in the firm can be
117 identified in Figure 1.

118 **4 c) The Role of the Audit Committee in Corporate Governance**

119 The World Bank (1993) reported that CG mechanisms consist of both internal and external mechanisms. The
120 internal mechanisms primarily solve relationship and structural problems between stockholders, directors and
121 managers, for example, the internal supervisory mechanism of the AC and the SB and the incentive mechanism
122 of the remuneration committee. The external mechanism impacts and controls the behavior and performance of
123 the company and is primarily comprised of the market and governance powers. Chang (2001) also acknowledges
124 this division: the internal definition indicates the system arrangements relating to the company's functions, the
125 BoD's structures, and the stockholders' powers; the external definition indicates an entire set of legal, cultural and
126 system arrangements relating to the company's control rights and the residual demand rights for allocation. The
127 OECD (1999) defines the structure of CG as involving a series of relationships between the company's managers,
128 the BoD, stockholders and other stakeholders. The position of the stockholders within this series of relationships
129 is defined in the "Principles of CG" issued by the OECD: one role for CG, corporate governance exists to protect
130 the rights of stockholders; in another, the BoD takes responsibility for stockholders. The narrow definition of CG
131 structure defines the shareholders as the target for protection; the broad definition of CG structure defines all
132 stakeholders as this target. This paper aims to discover the role of the AC in the internal supervisory mechanisms
133 for firms in China.

134 **5 III.**

135 **6 Literature and Questions**

136 Corporate governance is the system through which business operations are directed. The corporate governance
137 structure specifies the distribution of rights and responsibilities among different participants in the corporation,
138 such as the board, managers, shareholders, and other stakeholders, and spells out the rules and procedures for
139 making decisions on corporate affairs. Therefore, CG also provides the structure through which a company's
140 objectives are set and articulates the means for attaining these objectives and for monitoring performance
141 (Organization for Economic Cooperation and Development 1999; OECD 2004).

142 Corporate governance defines the procedures used to manage a company and thereby affects the managers in
143 a company (Cohen et al. 2010; Acharya et al. 2011). Cohen et al. (2010) indicated that in many instances, ACs
144 play a passive role in helping to resolve contentious financial reporting issues with management; the respondents
145 indicated that the auditor and management often try to resolve issues before they come to the attention of the AC.
146 The authors note that auditors indicate that management has a major influence over the hiring and termination
147 decisions for external auditors. Acharya et al. (2011) found that corporate governance affects the power balance
148 between managers and the firm and has important implications for the debate on executive pay. Specifically,
149 while better governance may incentivize managers to perform better, it also reduces the firms' ability to attract
150 the best managers. These two effects offset each other and may explain why it has so far proven difficult to find
151 direct evidence that corporate governance increases firm performance. In summary, management has the power
152 to influence firm decisions; an AC may play a passive role in helping management to make better decisions but
153 does not involve itself in creating important company policies. Hence, the following question is raised: Q1: In
154 China, does the AC involve itself in developing important company policies?

155 The Blue Ribbon Committee (BRC) (1999: 22) noted that "several recent studies have produced a correlation
156 between AC independence and two desirable outcomes: a higher degree of active oversight and a lower incidence
157 of financial statement fraud." According to the studies by Beasley (1996) ??004, the more independent the ACs
158 are, the better they can exercise their supervisory functions and provide appropriate oversight. It is anticipated
159 that the establishment of the AC will strengthen the oversight of management by the BoD. According to CSRC
160 (2006), the implementation of an AC introduces oversight independently into the decision making process of the
161 BoD rather than having the AC make decisions itself.

162 It appears that there is no universally accepted definition of an AC to be found in regulations, reports, surveys
163 and research studies. Instead, different definitions are presented such as those in Section 404 of SOX (2002),
164 ??lein (2002), Collier (1996), and ??raiotta (1981). These definitions state that the AC is a subcommittee of
165 the BoD, and they confine the definition primarily to the composition and the key responsibilities of ACs: "The
166 term "AC" means -a committee (or equivalent body) established by and amongst the BoD of an issuer for the

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167 purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial
168 statements of the issuer" (US Securities Exchange Act of 1934 #3 (a) (58); SOX Section 404, 2002)

169 These definitions emphasize the composition of the AC through the participation of independent directors with
170 the professional abilities to perform the key responsibilities of financial reporting, audit and internal control. In
171 summary, all definitions of the AC tend to emphasize its responsibility or operations: its primary tasks are to
172 review financial statements, the effectiveness of the company's accounting and internal control system, and the
173 findings of the auditors and to make recommendations on the appointment and remuneration of the external
174 auditor. An AC is set up to oversee, review and monitor the financial reporting process and the audit activities.

175 The research on the responsibilities of the AC is listed in Table ??: Documentary Source on the Responsibilities
176 of the AC in the American, British and Chinese models. Despite the variations in the specifications for the
177 functions of the AC in the Anglo-American and Chinese models, their common aim of supporting the management
178 targets of the BoD and providing an independent evaluation of operations are upheld. According to the definition
179 of the above regulations and literature, the key function of the AC is to act as an overseer.

180 An AC is a committee established by the board of directors to oversee the accounting and financial reporting
181 processes of the company and to audit its financial statements (US Securities Exchange Act of 1934 Section 3 (a)
182 (58); SOX Section 404, 2002). The AC's function is to monitor the board of directors to ensure that it operates
183 well. There are various issues associated with ACs, the first being AC effects ??He et ??010) examined AC
184 effects in the largest public hospitals in the US. The authors found that the presence of a committee and the
185 committee's specific qualities of independence, financial expertise, and increased activity positively correlate with
186 a reduced frequency of internal control problems. Ika et al. (2012) indicated that the timeliness of reporting is
187 associated with AC effectiveness. This result suggested that AC effects are likely to reduce financial reporting
188 lead times. In summary, an AC is effective and also improves the financial reporting quality of a company. The
189 AC acts as an overseer to monitor and audit the company's major financial information disclosure. Thus, the
190 following question is raised: Q2: In China, does the AC monitor and audit the company's major information
191 disclosure as an overseer 2 One issue with ACs is their characteristics In practice, it can be observed that
192 the internal governance of a firm may not be as strong as the formal structures suggest. This weakness may
193 impact the quality of the accounting information. The effects must be discussed in the context of three issues:
194 independence, expertise, and diligence. First, there is a relationship between independence and the effects of
195 the AC ??Zhang, Y et ??011) found that ACs are more independent when firms have large boards and more
196 insider ownership. These findings indicate that corporate governance could be considered an effective internal
197 tool to achieve greater audit independence. Sarkar and Sarkar (2012) examined AC independence in India. They
198 determined that strengthening auditor independence and enhancing the powers, functions, and independence of
199 the AC will be crucial for the governance of Indian companies. A highly perceived "independence quotient" for a
200 company's auditing process can be reassuring to outside shareholders, helping to reduce the risk premium when
201 raising capital and thereby providing a strong business case for strengthening auditor and AC independence. In
202 summary, independence is an important factor influencing the effects of an AC. Corporate governance could be
203 more effective if the AC is more independent. The independence of the AC is viewed as the key to oversight
204 and supervisory characteristics. ??006) examined whether the existence of an AC, AC characteristics, and the
205 use of internal audits are associated with higher external audit fees. The authors found that the existence
206 of an AC, more frequent committee meetings, and increased use of internal audits are related to higher audit
207 fees. These findings are consistent with an increased demand for higher quality auditing by ACs and by firms
208 that make greater use of internal audits. In addition, ??arua et ??2007) found that firms are more likely to
209 be identified with an internal control weakness if their ACs have less financial expertise or, more specifically,
210 have less accounting and non-accounting financial expertise. Krishnan and Visvanathan (2008) found that the
211 AC's financial experts can effectively perform their monitoring function and promote conservative accounting
212 only when they are on boards that are characterized by strong governance. Their findings were consistent with
213 the notion that accounting expertise contributes to improved monitoring by the members of the AC, which in
214 turn enhances multiple attributes of financial reporting quality. In summary, expertise is an important factor
215 influencing the ability of an AC to provide added value to the company.

216 There is a relationship between diligence and the effects of an AC ??Raghunandan and Raghunandan and
217 Rama (2007) note that prior researchers found that the number of AC meetings is associated with many "good"
218 outcomes related to financial reporting. The authors found that AC meetings are more frequent for firms that are
219 larger, have greater levels of outsider block-holdings, or are in industries prone to securities litigation. Stewart
220 and Munro (2007) found that the frequency of committee meetings and the auditor's attendance at such meetings
221 are significantly associated with a reduction in perceived audit risk. In summary, diligence is an important factor
222 influencing the effects of the AC's role in providing extra services to the company. The following question is
223 raised: Q5: In China, does the AC provide extra services to the company?

224 IV.

225 7 Theory and Hypothesis

226 The theories related to the AC within the CG of the company can benefit every party concerned. Because the
227 theory is applied with a certain purpose in certain conditions, it is not an all-powerful theory and cannot be
228 applied in every condition, nor can it be worked out in every environment (Wang, 2005). Moreover, because

229 the theory is developed in certain conditions by a human being, it has its limitations. Nevertheless, the theory
230 can have a critical influence when there are problems to be solved. In addition to Agency Theory, Managerial
231 Hegemony Theory and Resource Dependency Theory are also studied and analyzed as related to the role of AC.
232 a) Agency Theory Jensen and Meckling (1976) refer to the moral hazards arising from conflicts of interest in
233 the relationship between owners and managers: a basic assumption underlying agency theory is that managers
234 are inclined to act opportunistically to further their own interests before shareholders' interests and that there
235 are agency costs associated with keeping the managers' interests aligned with those of the owners. ??ama and
236 Jensen (1983) further noted that CG research should focus on agency problems and on how to reduce agents'
237 costs. Shleifer and Vishny (1997), however, stated that the problem lies in that most future contingencies are too
238 hard to describe and foresee, and as a result, complete contracts are technically unfeasible. Meanwhile, a basic
239 conclusion of agency theory is that the value of a firm cannot be maximized because managers possess discretions
240 that allow them to expropriate value to themselves. These authors therefore emphasized that CG should be
241 established to safeguard financial capital from investors and lenders and to protect the returns on investment
242 from that capital. In other words, these authors maintained that the core task of CG is to ensure the capital
243 suppliers' interests. The shareholder model as applied in the UK and the US shows that when shareholder wealth
244 is maximized, social wealth will be maximized as well.

245 The agency theory suggests that when the executives of enterprises are also the owners, they have the right
246 to ask for the enterprise's entire surplus and are therefore motivated to work hard. When the executives of
247 enterprises are not the owners, it can give rise to proxy shareholder problems. The harder the agent works, the
248 higher the agent's fee. The larger the income of the enterprise, the more profits the owner will make, wherein
249 the agent may become discontent, causing an inevitable conflict of interest. The shareholder's proxy

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251 Volume XIV Issue V Version I Year () D theory suggests that because the agent has more information
252 than the shareholder does, there is an information asymmetry that may affect the shareholder's rights. The
253 relationships between the agent, the shareholders and the executives can be defined as a contract and, because
254 of the incompleteness of the contract, problems under agency theory are unavoidable. Vafeas and Theodorou
255 (1998) indicated that because managers are under pressure to produce immediate results, they tend to ignore
256 investments that could have long payback periods. Shareholder's proxy theory noted the following four basic
257 problems (Jensen and Meckling, 1976): 1. Because executives pursue their own interests, there is no reason or
258 evidence indicating that they are unselfish or that they are naturally willing to maintain unanimity with the
259 shareholder's interests. 2. There may be information asymmetry -no one can have complete information because
260 information is distributed among individuals, but it is likely that those inside the company (such as the BoD)
261 will gain access to more information than those outside (such as shareholders). 3. The risk of moral problems
262 and reverse choice may exist. It is assumed that because agents are prone to opportunism, the agent post will
263 be neglected in the course of acting for, incurring damage to and encroaching on the shareholders' interests.
264 4. Because the market environment is full of uncertainty, it is difficult to judge whether the agent's behavior
265 indicates his hard work. Shareholder proxy problems not only exist between shareholders and managers but
266 also between minority and large shareholders, also known as 'control shareholders' (Shleifer and Vishny, 1997).
267 Normally, minority shareholders lack a strong interest in participating in shareholder meetings. Therefore, a
268 problem may arise as to who is going to control supervision with respect to shareholders and managers, which
269 explains why it is more difficult to protect the interests of shareholders. Control by the larger shareholders might
270 deprive minority shareholders of their utilities in much the same way that managers might deprive shareholders
271 of their utilities. These two types of agency problems are often interlinked. The mechanism of CG must therefore
272 be designed to solve these two types of agency problems and to determine which mechanism can act as a security
273 measure to protect minority shareholders from being taken advantage of by larger ones. In other words, the CG
274 mechanism is mandated to protect the external body of shareholders from encroachment by internal management
275 and controlling shareholders.

276 Because the interests of shareholders and managers are usually inconsistent, the CG mechanism is also designed
277 to alleviate the proxy problems between them. The essence of CG is to protect shareholder's interests from being
278 infringed upon, and at its core is a set of rules and systems to provide protection for shareholders and to guarantee
279 that shareholders receive fair repayment from their investment. The supervisory mechanism of CG provides checks
280 and balances on the managers on behalf of owners. Shareholder's proxy theory is particularly focused on the
281 internal supervisory mechanism within the company, with a view to analyzing the internal structure and the
282 internal relationships within the enterprise, which are not controlled by market strength. In essence, the internal
283 supervisory mechanism is a type of internal agreement, in that shareholders hold the decision-making power to
284 change the management team's membership or the corporate structure and to potentially disband the company.
285 The aim is to design a good mechanism using the power of checks and balances to maximize the company's value.

286 Modern enterprises regard combining internal management levels as the foundation for expanding business on
287 a large scale, and therefore they consider the division of the rights of control between ownership and management
288 to be essential. The difficulty lies in balancing the ownership rights between owners (shareholders) and managers;
289 if any imbalance in interests and information inconsistency is not managed through an effective CG mechanism,
290 problems will further escalate to involve potential agency problems. Eisenhardt (1989) assumes that because

9 C) MANAGERIAL HEGEMONY THEORY

291 managers are opportunistic, intent on gaining self satisfaction instead of maximizing profit on behalf of the
292 principal, there is potential conflict of interest in terms of risk sharing between the enterprises and agents.
293 Furthermore, she argues that agency theory has clear implications for the monitoring and control role of the BoD,
294 whereas implications regarding the BoD's strategic role are not definite. Zahra and Peace (1989) highlighted the
295 importance of the BoD's role in establishing guidelines for being implemented and effective control. ??ama (1983)
296 stated that the BoD should be viewed as the ultimate internal monitor of the set of contracts called a firm. Hill
297 (1995) concluded that agency theory does have implications for the strategic role of the BoD in terms of corporate
298 control. McNulty and Pettigrew (1999, page 50) noted, "little has been said by agency theorists about strategy
299 as a means of control over managers."

300 It is generally acknowledged that the British and the American CG models fall under the category of the
301 shareholders' model (Wang 2005). China adopted the form of AC found in the British and American CG systems.
302 The question has arisen as to whether the ACs in China can act as overseers and supervisors to strengthen internal
303 supervisory mechanisms and thereby safeguard the interests of all shareholders, particularly small shareholders
304 as indicated in Q2-3. It is hypothesized that the role that the ACs play in China as overseers and supervisors
305 lends support to Agency Theory. On the contrary, the Q1 role as decision makers runs counter to this theory.
306 b) Resource Dependency Theory Pettigrew (1992) argued that both sociology and management doctrines are
307 employed to form resource dependency theory. This theory is based on the concept of cooptation, focusing in
308 particular on the attempts by BoDs to create appropriate linkages with the external environment to expand the
309 enterprise. Pfeffer and Salancik (1978) added that when an organization appoints an individual to its board, it
310 expects that as a board member, the individual will come to support the organization, will concern himself with
311 its problems, will favorably present it to others, and will try to aid it. The BoD is the key cooperative mechanism
312 through which the organization links to the external environment to access important resources and to buffer
313 itself against adverse environmental change (Pfeffer and Salancik (1978), Pearce and Zahra (1991), ??oodstein,
314 Gautam et al. (1994)).

315 Ingle and Van der Walt (2001) defined a "resource" as the connection to a nation's elite, industrial intelligence
316 and competitors, market or capital. Further, inter-organizational linkages such as the appointment of outside
317 directors can also be used to manage environmental contingencies (Muth and Donaldson 1998). Price (1963) and
318 Zald (1967) asserted that the board is viewed as a helper to the organization by influencing other constituencies
319 on behalf of the focal organization. The professions and communities of the directors can provide resources within
320 organizations. Overall, resource linkages by means of the board are aimed at maximizing its performance ??Zald
321 1969;Pfeffer 1972;Pfeffer and Salancik 1978).

322 From such linkages, the following four types of organizational benefits are defined by Bazerman and Schoorman
323 (1983): a) Building reputation - Useem (1984) asserted that the BoD can affect the organization's reputation
324 and demonstrate that the organization is linked to external organizations. b) Access to expertise- Mizruchi and
325 Stearns (1988) and Stearns and Mizruchi (1993) (Bazerman and Schoorman (1983). d) Vertical coordination -to
326 reduce uncertainty about the availability of resources and perhaps even to secure favorable treatment for the
327 organization, vertical linkages to suppliers are vitally beneficial to the organization (Bazerman and Schoorman
328 (1983)).

329 Criticisms have been raised about resource dependence theory, for example, the theory focuses on the role
330 of boards in potentially obtaining resources and ignores how they could be involved in exploiting resources
331 (Finkelstein and Hambrick 1996;Hung 1998). Therefore, it is suggested that the board serves as a strategic
332 consultant to top managers rather than (or in addition to) exercising independent control (Carpenter and
333 Westphal 2001). Overall, the shortcomings of resource dependence theory center upon several board activities:
334 providing advice (Lorsch and MacIver 1989; Westphal 1999); monitoring (Fama 1980;Bainbridge 1993;Johnson
335 et al., 1996); and strategizing ??Lorsch and MacIver 1989;Kesner and Johnson 1990) It is hard to refute the
336 expectation that the members of ACs will bring benefits to their organizations, for the AC is an invisible asset
337 that could improve the enterprises' reputation, expertise, coordination and connection, allowing it to earn more
338 resources. The AC is one of the sub-committees under the BoD. Resource dependency theory emphasizes that
339 the role of the board expands the outward-looking boundary to enhance a business. It may therefore be asked
340 whether the AC's contribution in China brings added value or provides extra service to the company, as indicated
341 in Q4-5, in addition to executing its independent control. It is hypothesized that the role the AC plays in China,
342 as indicated in Q4-5, lends support to the Resource Dependency Theory.

343 9 c) Managerial Hegemony Theory

344 Managerial hegemony theory primarily asserts that the BoD is a legal fiction and is dominated by professional
345 management in the organization (Mace 1971;Vance 1983; ??orsch and MacIver 1989). Drucker (1974) asserted
346 that the BoD is an important ceremonial and legal fiction. Most boards only perform effectively during a period
347 of crisis (Mace 1971;Clendenin 1972). Hung (1998) added that the governing board of a company serves primarily
348 as a "rubber stamp". Whisler (1984) and Lorsch and MacIver (1989) stated that directors are constrained from
349 setting strategies, although they would often like to become involved. Ingle and van der Walt (2001) proved
350 that, in practice, boards are not involved in establishing strategies. It may that boards lack, in relative terms at
351 least, the required knowledge of the organization (Hung 1998).

352 Some points explaining managerial hegemony theory are described as follows: in shareholder control, thereby

353 giving management a relatively stronger foothold over the board's control of the company. 2. Given the
354 nature of information asymmetry between non-executive directors and management, management clearly holds
355 an advantage in terms of in-house information. A board principally composed of non-executive directors would be
356 deemed more passive regarding the activities and information within the company than management. 3. Internal
357 directors rely on the chief executive officer (CEO) for compensation and career advancement and invariably report
358 to him in practice. Under this circumstance, it is unavoidable that internal directors support the CEO at board
359 level, which reduces the effectiveness of the BoD by shifting the balance of power against external directors.
360 Moreover, management may escalate its influence to control the board. 4. Managers can also use retained
361 earnings to determine financial investment independently (Mizruchi 1983; ??rd Parrino et al. 1998), allowing
362 them to reduce board control. 5. In most instances, management handpicks board members (Pfeffer 1972);
363 therefore, the board directors are deemed to be in the control of management by virtue of the selection process.
364 Similarly, Herman (1981) also said that the board only plays a superficial review and approval role, similar to a
365 "rubber stamp" function. Some studies have refuted the managerial hegemony theory. For instance, Zeitlin (1974)
366 argued that the growth of ownership by large shareholders and interlocking directorships considerably reduced the
367 ability of management to control boards. Mizruchi (1983) argued strongly that the board has ultimate control
368 over management through their designated right to hire or fire the CEO. Therefore, Stiles and Taylor (2001)
369 concluded that empirical support for hegemony theory has its limitations, emphasizing its dependence on the
370 definition of the term "control".

371 It is hypothesized that the role the AC plays in China is not consistent with Managerial Hegemony Theory.
372 The five questions raised above were all designed to prove this hypothesis.

373 10 V.

374 Design and Method a) Questionnaire Design Survey research by telephone can be defined in this case as personal
375 face-to-face interviews arranged in advance by telephone (Frey, 1989). This research adopts the telephone survey
376 method because it facilitates the collection of quality data in an efficient and timely manner. Lavrakas (1993)
377 describes telephone surveys as most closely approaching the level of unbiased standardization that is the goal of
378 all good surveys. The survey questionnaire should be designed as a call sheet in advance. This survey is aimed to
379 explore Q1-5, and Appendix A: Call Sheet -Survey by Telephone Interview is designed accordingly. Following up
380 on the developed questions, the five functional roles being explored for the AC are therefore called the Decision
381 Maker, Overseer, Supervisor 3 b) Sampling , Consultant and Trainer.

382 Skillful interviewing is important because a sudden anxiety may surface during the conversation, resulting in
383 the respondent hanging up the telephone (Frey, 1989). Therefore, an initial feeling of trust on the part of the
384 respondent can motivate him or her to answer confidential questions without hesitation. Establishing this trust is
385 critical to avert higher refusal rates and to obtain accurate information. However, because of the limitation on the
386 complexity and length of the questions raised in a telephone interview, questionnaires should be designed to be no
387 longer than 30 minutes to avoid respondent fatigue (Lavrakas, 1993). Fully structured questions were designed
388 for the telephone interview to gain a sufficient understanding of the role the AC plays in China (Appendix A).

389 Sampling was via random selection from over 50% of the listed companies with ACs in China. The sample
390 frame consists of 635 companies; from among these, 330 companies were contacted in 2009. The respondent in a
391 sampling unit was identified as the General Secretary of the BoD, whose key function is to organize the BoD/SB,
392 including the AC's business, and the coordinator of the ACs/SBs for the related institutions. Telephone numbers
393 for the sample frame were retrieved from the records on the information website for Chinese listed companies.
394 For a total of 330 of the 635 listed companies, the General Secretary of the BoD was contacted, and over 61
395 responded to every survey question. The remaining 269 of the 330 listed companies rejected the survey. The
396 major reason for rejecting the survey could be assumed to revolve around the probability of leaking confidential
397 information. Some companies suspected that the interviewer could be a potential investor seeking to obtain first-
398 hand information about their supervisory performance, while others went as far as suspecting the interviewer to
399 be an undercover agent from the Security Exchange Commission or another related Chinese government agency.
400 A total of 305 out of 635 3 According to Merriam-Webster's collegiate dictionary, the definition of SUPERVISOR
401 is : "a person who supervises someone or something. Supervise: to be in charge of (someone or something) or to
402 watch and direct (someone or something)." According to Merriam-Webster's collegiate dictionary, the definition
403 of "SUPERVISOR": "not only covers "OVERSEER", to watch and direct, but also means to be in charge of
404 someone or something.

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406 Volume XIV Issue V Version I Year () D ownership could perhaps lead to relative weakness General Secretary
407 of BoD could be contacted. Various types of excuses were made to avoid the telephone interview: for example,
408 no one answered the phone call; the wrong telephone number was used, or the General Secretary of the BoD was
409 either not in the office or too busy to answer the call. Nevertheless, these 305 listed companies may be considered
410 as having the potential to cooperate and to respond to related questions in similar research in the future.

411 Despite several challenges, in this research, telephone surveys with 635 companies were smoothly conducted,
412 330 companies received the phone call and 61 (5%) of these were willing to respond to the survey questions. The

15 CONCLUSION

413 samples are categorized according to the Shanghai Stock Exchange and CCER database; the CSRC definition is
414 described; and the sample industries in this research are shown on Table ??: Industry Statistics, Share type and
415 Listed Year of Research Samples.

416 The summary of the respondent's background, company information and the classification is listed. A total
417 of 61 listed companies accepted the telephone interview; though the response rate is only 5% (61/330), given the
418 high level of the information, a refusal to respond could be assumed to revolve around the probability of leaking
419 confidential information. Meanwhile, confidential data and top management are both difficult to access. The
420 respondents' are all confirmed as holding the position of the General Secretary of the BoD/SB. The respondents
421 must be reported and recognized by the SSE in China at a high management level, which is normally equal to
422 a VP or manager, depending on the individual company's definition. The listed year for the sample firms is
423 between 1990 to 2004, so these companies have conducted supervisory functions for at least 5 years. In terms
424 of share type, 61 firms have A shares and 7 firms have A+B share. The research samples cover almost every
425 categorization of industry except Z: No Associated. In this research, the manufacturing industry occupies 50%
426 of the sample companies, reflecting the industry allocation in China.

427 12 c) Contacting Procedure

428 The procedures for contacting respondents are outlined in the following six steps: First step: send emails featuring
429 the biography of the interviewer and emphasizing the sincere desire to have a positive mutual interaction with
430 the responding company and to share experience and exchange knowledge regarding the subject matter.

431 Second step: send out fully structured questionnaires by email to achieve the following two objectives: 1) obtain
432 a voluntary response by email and 2) introduce the interviewer to gain the respondent's trust and confidence and
433 to inform them in advance that the interviewer would call over the subsequent days. This information allows the
434 respondents ample time to prepare answers to the survey should they be willing to respond.

435 Third step: call the companies that received advance emails. An average number of sampled companies was
436 called each day so that every batch of sampled companies was called within the target day.

437 Fourth step: complete follow-up calls if the respondents were not contacted; the calling procedure is repeated
438 as in the original call.

439 Fifth step: a call sheet (Appendix A) with a questionnaire for each number was prepared for use by the
440 interviewer as the working paper for this research. The interview was solely executed by the author with the
441 interview wording standardized principally as the call sheet. The working papers were collected to calculate the
442 statistical number for each question as evidence of this research once the sample calls were completed.

443 Sixth step: the telephone interview was conducted in Chinese. Accurate translation was checked by four levels
444 of review: first by a peer review in Chinese and English, second by the supervisor in English, third by the panel
445 team in English, and a final review by internal and external examiners in English.

446 13 VI.

447 14 Result and Analysis

448 From the responses, the statistics on the roles that the AC plays in China were calculated and analyzed as
449 indicated in Table 4. The analytical steps proceeded as follows:

450 First, based on the literature, the possible roles that the AC could play under the CG system in China are
451 identified and questions are summarized (A); the next step is to analyze the characteristics of the AC that may
452 impact its role (B); the third step, based on the literature, is to define the relationship between the AC's role
453 and its characteristics (C); step four applies the three previously mentioned theories as the basis of an analysis
454 to examine the designed questions: the role that the AC plays in China (D-E); the final step is based on the
455 previous four steps and analyzes whether the results support or conflict with the theories (F-G).

456 The results from these analytical steps are summarized as follows: 1. A total of 95% of ACs in China act as
457 an overseer by monitoring and auditing the company's major information disclosure; this role supports Agency
458 Theory but is not in congruence with Managerial Hegemony Theory (

459 15 Conclusion

460 To implement an AC under the dual layer governance structure existing in China impacts the original practice and
461 diverges from its internationally recognized role. The AC in China remains at a rudimentary and experimental
462 stage, experiencing a process of innovation as well as trial and error. Therefore, the AC in every company in
463 China still appears to be in the process of exploring practices suitable to its unique CG setting and model. These
464 findings are considered from the perspectives of the applied theories to reveal the degree of the AC's contribution
465 in China, rather than providing a mere judgement of "good" or "poor" implementation of supervisory functions.
466 The results support Agency Theory in that ACs in China play the role of a financial overseer (95%) and provide
467 professional opinions on transactions in a supervisory role (92%). However, the findings run counter to the
468 independence of overseers as decision makers (49%); they also run counter to the theory of Managerial Hegemony
469 because they prove that the AC is not just a legal fiction in China, as some have alleged. Meanwhile, the AC in
470 China is not limited to exercising independent control.

471 The AC provides added value and extra services, acting as a trainer (23%) and a consultant (60%) in addition
472 to independent control of overseers and supervisors in the actual creation and disclosure of financial statements,
473 which support the theory of Resource Dependency.

474 Different CG theories tend to have their specific value, but every theory also has its inherent limitations.
475 Thus, it stands to reason that at a particular time period and under certain conditions, a country might need
476 a particular CG theory to suit its needs. Perhaps this reasoning was why Stiles and Taylor (2001) noted that
477 no single perspective adequately explains this strategic role, though the managerial, the agency and the resource
478 dependence theories provide insight. These authors therefore summarized the view that one theory alone does
479 not illuminate the entire spectrum of board endeavors, which receives strong support from an examination of
480 these theory's shortcomings. It is not simply a matter of selecting between agency theory, managerial hegemony
481 theory or resource dependence theory. Rather, each theory has a unique contribution to make to promote our
482 better understanding regarding the corporate governance debate (Kiel and Nicholson, 2003).

483 In summary, the findings based on agency theory, managerial hegemony theory and resource dependence theory
484 as reported in this paper and other related comments on the interpretation of those findings and suggestions
485 based upon them are useful as a reference for users such as regulators, supervisors or Boards of Directors when
486 considering what role ACs should play in companies in China. The findings in this research can also be effective
487 for improving the supervisory functions and for avoiding redundancies and gaps in internal supervision with
488 a view to proposing how managers and owners can improve interaction and coordination with SBs in China.
489 Finally, the investigation and the results reported in this paper may offer a basis for continuing research on the
490 effectiveness, operation and coordination of supervisory governance after the introduction of an AC, as well as
491 for studies of other monitoring functions such as audit and internal control.

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Figure 1:

Figure 2:

Figure 3:

Figure 4:

¹© 2014 Global Journals Inc. (US) 12 According to Merriam-Webster's collegiate dictionary, the definition of OVERSEER is : "a person who watches and directs the work of other people to be sure that a job is done correctly".

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Figure 5:

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[Note: Dcompanies were called]

Figure 6: Table 4 :

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