
Improving audit committee performance in the Middle East: do Egyptian audit profession norms support international standards?

Jennifer Bremer*

Public Policy and Administration Department,
American University in Cairo,
AUC Avenue, New Cairo 11835, Egypt
E-mail: jbremer@aucegypt.edu
*Corresponding author

Mohamed Hegazy

Accounting Department,
AUC Avenue, New Cairo, Egypt
E-mail: mahegazy@aucegypt.edu

Auday Sabri

United Nations Development Programme,
United Nations Assistance Mission for Iraq,
Baghdad, Iraq
E-mail: audaysabri@aucegypt.edu

Abstract: Audit committee effectiveness is shaped by formal institutional frameworks but mediated by audit profession norms. Through normative isomorphism, these values may play a greater role in the Middle East, where formal codes and enforcement lag global practice. This research examines whether Egyptian professional norms support global audit committee standards by surveying professional auditors' support for amendments to the current Code of Corporate Governance to align it with US and UK codes and regulations. Senior audit experts strongly endorsed proposed reforms, confirming that professional norms can supplement weak governmental oversight to support compliance.

Keywords: audit committee; governance codes; audit standards; Egypt; Middle East; corporate governance; professional norms; normative isomorphism.

Reference to this paper should be made as follows: Bremer, J., Hegazy, M. and Sabri, A. (2011) 'Improving audit committee performance in the Middle East: do Egyptian audit profession norms support international standards?', *Int. J. Business Governance and Ethics*, Vol. 6, No. 3, pp.225–248.

Biographical notes: Jennifer Bremer is Associate Professor of Public Policy and Chair of the Department of Public Policy and Administration at the American University in Cairo's School of Global Affairs and Public Policy. Her work focuses on economic development, corporate governance and social responsibility. She previously directed the Washington Center of the Kenan Institute of Private Enterprise, a unit of the University of North Carolina

business school and holds a PhD (1982) and MPP (1975) from Harvard's Kennedy School, an MA (1976) from Stanford in Development Economics (1976), and a BAcl (1972) from Columbia University's Barnard College in Political Science.

Mohamed Hegazy is Visiting Professor of Financial Accounting and Auditing at the American University in Cairo. He is a partner at Crowe Dr. A.M. Hegazy & Co, a member of Crowe Horwath International, a Fellow of the Egyptian Association of Accountants and Auditors (EAAA) and the Egyptian Tax Association (ETA), and a member of the American Accounting Association (AAA). He co-founded and chairs the Financial Consultancies Company for Marketable Securities, which provides valuation studies for Egyptian listed companies. He holds a BCom from Cairo University (1982) and an MSc (1984) and PhD (1988) from the University of Birmingham.

Auday Sabri is a certified professional Accountant practicing in Iraq. He is a financial specialist with the United Nations Development Programme in Baghdad. He completed his Master's Degree in Public Policy and Administration at the American University of Cairo in 2010, presenting a thesis on audit committee standards that provided much of the basis for this paper. Prior to joining AUC, he provided professional accounting services in Iraq.

1 Introduction

The increasing integration of Middle Eastern corporations into global capital markets, both as targets for international investment and as investors themselves, raises the importance of Corporate Governance (CG) standards in the region. While regional standards have advanced notably in recent years, they continue to lag behind global practice, as further discussed below. This suggests a need to reform official codes to raise the bar and to strengthen enforcement to ensure that tighter standards translate into improved governance performance. In achieving these advances, professional norms and standards offer an important but overlooked tool to support reform.

The Egyptian government is working to raise governance standards in the business sector generally and in particular for listed companies. In 2003, it established the Egyptian Institute of Directors (EIOD) under the authority of the Minister of Investment. The EIOD developed the Egyptian Code of Corporate Governance for private sector companies in 2005 and issued a governance code for public (state-owned) enterprises in 2006. Review and revision of these codes is underway and in February 2011 the EIOD issued a revised guide to corporate governance that, *inter alia*, introduced improved standards for audit committee independence and operations (see below).

This paper considers the development of higher governance standards in Egypt. Specifically, it seeks to measure whether current professional norms within Egypt's audit profession support higher CG standards. We argue that professional norms take on increased importance in emerging market countries such as Egypt where regulatory and market pressures are likely to be lower than in more mature markets.

The research presented focuses on the degree of support for improvements to the structure and operation of the audit function and the Audit Committee (AC). Professional standards are arguably of particular importance to achieving governance improvements

in this area, because the standard of governance relies heavily on the diligence of the AC members and the auditors, which is difficult for those outside the AC to observe. To measure the degree of support for international AC norms, the authors survey senior audit professionals in Egypt to assess their support for a set of 53 audit function reform measures derived from a comparison of Egyptian AC standards with US and UK governance codes.

The analysis is presented in four sections, following this introduction. A literature review first considers theoretical considerations that shape our understanding of observed levels of standards compliance, presenting the conceptual framework that underpins the remainder of the analysis. This framework emphasises the need to give greater consideration to professional norms as an adjunct to regulatory and market-based mechanisms to enforce global standards, or even as a substitute for such mechanisms in emerging markets. The importance of normative isomorphism suggests a need to measure the strength of professional norms in such environments, rather than looking only at the codes and formal enforcement mechanisms.

Section 2 situates Middle Eastern and Egyptian corporate governance standards within the context of global practice for CG reform processes, with particular reference to the emergence of CG codes as a tool to drive reform globally, and considers progress in developing and strengthening CG codes in Egypt and the Middle East more generally.

Section 3 presents the methodology used in the research reported here to fill the gap identified in the literature with respect to assessing the strength of professional norms favouring stronger audit committees in the Middle East. This methodology applies the concept of normative isomorphism to measure support among senior Egyptian auditors for the introduction of audit committee standards more closely in line with international practice. A survey of senior audit professionals explores support for international audit committee norms. The survey assesses the degree of consensus around 53 potential improvements to the Egyptian standard, identified by the authors by comparing this standard with audit committee guidance adopted in the USA (Morrow, 2008) and the UK (Financial Reporting Council, 2008). Four hypotheses regarding the level of support for related groups of norms are formulated based on these improvements. The results of the survey are used to test these hypotheses.

Section 4 presents the findings of the survey to assess support for the modifications proposed and draws conclusions for improvement of audit committee practice in Egypt, while the final section discusses the study's findings and conclusions.

2 The theory and practice of standard-setting for corporate audit: application to the Middle East and Egypt

The analysis that follows relies on two theoretical foundations growing out of the broader literature on corporate governance and standards: principle-agent theory and institutional theory.

The development of structures, rules and procedures for corporate governance, including those shaping the operation of the audit committee, may be considered a response to the principal-agent problem (Fama and Jensen, 1983). Al-Lehaidan (2006) notes in his comparison of audit committees in Saudi Arabia and Australia that:

“[Because] conflicts arise [from] the separation of ownership and management and the inability of principals to observe the actions of the agent, [p]rincipals and agents have economic incentives to invest in various information systems and control mechanisms to reduce agency costs associated with information asymmetry.” (Al-Lehaidan, 2006)

In this context, the audit committee may be considered an investment in both better information and tighter control to overcome the principal-agent problem. Standard audit committee rules that specify a membership drawn from independent board members and that assign to them the responsibility for oversight over financial report accuracy and reliability reduce the scope for principal-agent failures.

Institutional theory explores the source of pressures on institutions such as the audit committee that push participants to adhere to the rules established. DiMaggio and Powell's (1983) classic institutional theory paper identifies three such sources of pressure leading to adoption of standard institutional forms, roles, and mechanisms ('institutional isomorphism'): coercive, mimetic, and normative. DiMaggio and Powell describe normative pressures as being particularly identified with professionalisation and the development of professional standards, including accounting standards.

More recently, the role of social norms in achieving widespread compliance has received increased attention. Feldman and Harel's 2008 experimental study found that,

“... when the law is ambiguous (standard-like legal norm) and the social norm dictates noncompliance, legal noncompliance behaviour is higher than when information concerning the social norm is absent.” (Feldman and Harel, 2008)

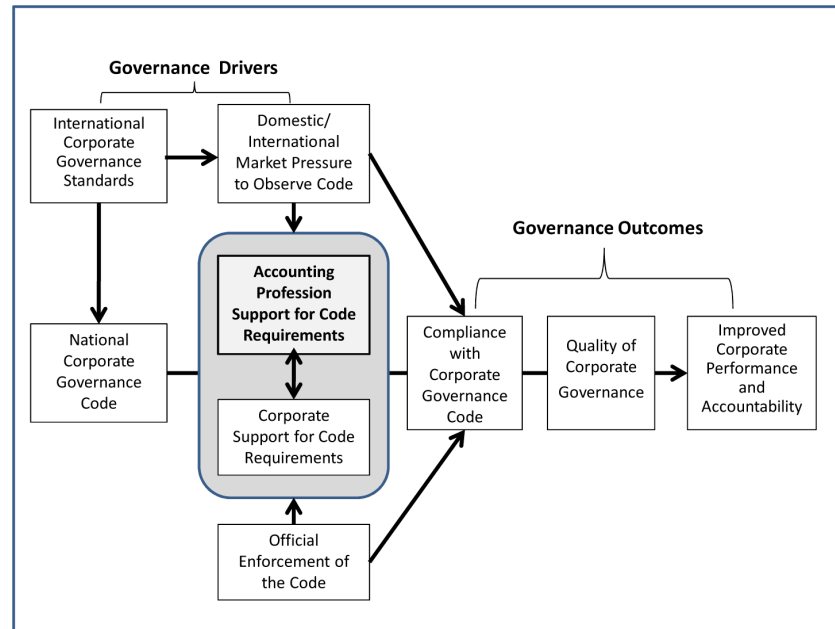
Sunder (2005) has argued for greater reliance on social norms rather than on ever-tighter formal standards as a strategy to improve accounting compliance. He concludes his analysis by asking rhetorically,

“Can authority without social norms bring a semblance of order to the chaos to financial reporting? After seven decades of incessant effort, the answer stares us in the face.” (Sunder, 2005)

The present analysis examines the strength of these normative pressures in the Egyptian accounting profession. The application of these theories to the development of the audit committee in Egypt is incorporated into the conceptual framework shown in Figure 1.

In this model, corporate governance standards in a given national environment are set through the interaction of national and international standards and codes. These in turn affect corporate compliance with the code through three governance drivers: external pressure from the market, government enforcement, and professional norms within the environment of the corporation and its accountants, whether internal or external (the dark lozenge). The resulting level of compliance with governance standards leads to governance outputs in the form of better governance and enhanced corporate performance and accountability. Within the corporate environment, the normative standards of the accounting profession interact with those of the corporations themselves and, on a more general level, with the mimetic and coercive standards of the capital market and those imposed by the legal environment within which the firms operate. This interaction shapes the level of compliance with governance norms, which in turn influences governance outcomes and firm performance.

Figure 1 Theoretical model of relationships among accounting profession support for corporate governance code, other governance drivers, and governance outcomes (see online version for colours)



Source: Authors' analysis

Professional norms influence compliance with governance standards both within the firm, through the actions of professionals involved in the audit function at all levels, and through interaction between the firm and external auditors. The research reported here focuses on the strength of the professional norms in the accounting profession (the lighter grey rectangle), an area that has received considerably less attention than have market pressures and government enforcement actions.

It must be noted that, although the concept of 'professional norm' is widely used, specific definitions of the concept in the literature are vague. In particular, scholars have not clarified the strength or uniformity of agreement around a given behaviour or set of behaviours norm within a given profession that would be considered the minimum level to classify that behaviour as a norm. For example, Sunder (2005) defines the norms of a social group as "the common knowledge expectation of its members about how others behave in various circumstances", but does not clarify what percentage must hold this view or how strongly they must hold it to meet the definition.

In this analysis, we will define a given standard as a professional norm when the average level of agreement among senior professionals is at least 'agree' on a five-point Likert scale (from disagree strongly to agree strongly). This definition recognises the role that senior accounting professionals play in setting the standards for professional performance for the audit function, whether those adopted by senior professionals themselves, by more junior professionals, or by non-accountants serving on the AC or in other roles related to the audit function and corporate governance more generally.

Based on the factors underlying AC effectiveness identified by Al-Lehaidan (2006), we argue that professional norms for AC structure and operation must encompass six areas: AC composition, AC authority, AC resources, the competence of AC members, their diligence, and their independence. The remainder of this paper explores whether the norms and standards of the audit profession in the Middle East and in Egypt specifically reflect these principles.

3 Audit committee practice in the Middle East: recent developments and progress toward global standards for AC structure and operation

In developed and emerging markets alike, adoption of mandatory or voluntary codes and standards has become an established element within the overall effort to promote good corporate governance. The website of the European Corporate Governance Institute (ECGI) lists 270 governance code documents from 76 countries (ECGI website and author's calculations). The earliest code document indexed by the ECGI is the 1992 Cadbury Report from the UK, followed shortly by the 1994 King Report from South Africa. As of mid-2010, nine new country-specific documents were shown for the year, originating in locations as diverse as Ireland, Colombia and Yemen.

The evolution of codes indexed by the ECGI clearly shows increasing engagement of developing country organisations in developing codes, even relative to the rising global volume of code publication overall. Only 8% of the developing country codes indexed was produced prior to 2000, compared to 20% of codes from industrialised countries. Codes from developing countries accounted for only 16% of all codes issued prior to 2000, compared to 36% in the more recent period (ECGI website and author's calculations).

The increasing focus on codifying corporate governance standards reflects the widespread belief that investors pay close attention to governance standards when comparing companies or countries as targets for their investment. The index of codes maintained by the European Corporate Governance Institute, cited above, provides evidence that the Middle East and North Africa (MENA) region lags in developing corporate governance codes to respond to this investor preference.

The authors' analysis of this index indicates that Egypt's code, the first issued in MENA, did not appear until 2006, fully a dozen years after South Africa's first King report. The MENA-wide average for the number of standards listed (including revisions to previously issued codes) is the lowest of any region at 1.1 per country, compared to the average of 3.6 for all 76 countries included in the index.

MENA countries such as Egypt and the UAE have moved toward acceptance of corporate governance, motivated in part by a desire to attract more foreign portfolio investments. A recent Hawkamah publication notes that "investors would be willing to pay a premium of from 15% to 30% to obtain stakes in well-governed companies in the region" and estimates such a response would translate into \$200–300 billion in increased investment (Smith, 2009).

A draft OECD assessment of corporate governance in 10 MENA countries, based on a survey completed by investment officials, found that audit committee requirements range quite widely across the region (OECD, undated draft). Table 1 presents the findings from this survey with regard to audit committees.

Table 1 Comparison of audit committee framework in selected Middle Eastern countries

<i>Current guidance for audit committees</i>	<i>Algeria</i>	<i>Bahrain</i>	<i>Egypt</i>	<i>Jordan</i>	<i>Kuwait</i>	<i>Morocco</i>	<i>Oman</i>	<i>Qatar</i>	<i>Tunisia</i>	<i>UAE</i>
Calls for establishment of an audit committee or a similar internal audit body	NO	NO	Stat	Stat	Stat	Stat	Stat	Adv	NO	Adv
Calls for the participation of independent directors in the audit committee	NO	N/A	Stat	Stat	Stat	NO	Stat	NO	NO	Vol
Recommends proportion of independent directors participating in the audit committee	NO	N/A	Stat	Stat	Stat	NO	Stat	NO	NO	Vol
Recommends that all members of the audit committee/internal audit body are independent	NO	N/A	NO	Stat	NO	NO	Stat	NO	NO	Rec
Gives guidelines about the powers of the audit committee/the internal audit body	NO	N/A	Stat	Stat	Stat	NO	Stat	NO	NO	Stat
Recommends authorising the audit committee/internal audit body to obtain the assistance of an internal auditor	NO	N/A	Stat	Stat	Stat	NO	Rec	NO	NO	Rec
Recommends that the audit committee/internal audit body meet a minimum number of times per year	NO	N/A	Stat	Stat	Stat	NO	Stat	NO	NO	Rec

Explanation of notations:

N/A: Not available.

NO: Absent or not required.

Stat: Statutory or required by financial exchange.

Rec: Recommended, and in case of deviation company must explain.

Vol: Voluntary, provision is recommended but company is not obliged to explain non-compliance.

Adv: Advisory, the company is encouraged to comply with the provision of the code/principle.

Source: Adapted from OECD (undated draft)

Corporate governance standards and practice in the Middle East are progressing, but still lag behind global standards. This situation casts doubt on the strength of the norms favouring strong corporate governance in the region, given the presence of formal codes and enforcement mechanisms.

A 2009 report by the Gulf Cooperation Council Board of Directors Institute (GCCBDI) cites the “low levels of information disclosure” in the region, for example, and notes that:

“For example, only 27% of the companies reviewed disclosed the number of board meetings they held per year. Yet in a similar study, 100% of European and US companies disclosed this data.” (GCC Board Directors Institute, 2009)

With regard to the regional practice on the audit committee specifically, the GCCBDI study found that:

“Audit, remuneration and nomination committees are less common on GCC boards. BDI’s research, which was focused on publicly-traded companies, found that fewer than 50% of boards in the region have a separate audit committee ...” (GCC Board Directors Institute, 2009)

Their research showed that only 47% of the boards of 100 listed companies surveyed had an audit committee, compared to a European company rate of 98% (GCC Board Directors Institute, 2009).

It should be noted that recent research by one of the authors into audit committee standards compliance, while finding a near-identical rate for the presence of audit committees among UK listed firms (97%), nonetheless found much lower rates of compliance for other practices widely accepted as desirable. For example, only 45% of firms reported that the board conducted an annual review of the audit committee and only 16% reported whether the audit also provided non-audit services (Hegazy and Hegazy, 2010).

Turning to the case of Egypt, we find that formal codes are a relatively recent development, but have progressed rapidly (see Arab Republic of Egypt, Ministry of Investment, Capital Market Authority, 2002, 2006; Arab Republic of Egypt, Ministry of Investment, Egyptian Financial Supervisory Authority, 2008; Arab Republic of Egypt, Ministry of Investment, Egyptian Institute of Directors, 2006, 2007, 2011; McKinsey & Company, 2001).

The country’s first corporate governance code was drafted by the EIOD only in 2005. The EIOD is a government body formed to promote corporate governance improvement through training, research, and public education, as well as through code issuance. Like the UAE-based Hawkamah Institute referenced above, it was formed in the early 2000s to support the work of capital market regulatory bodies and of the stock exchanges in promoting better corporate governance.

The EIOD’s initiative built on capital market regulations issued in 2002 by the Egyptian Capital Markets Authority (now incorporated within the Egyptian Financial Supervisory Authority). Decree 30 of 2002 required all listed companies to publish financial statements in two widely circulated newspapers and to establish an audit committee (Arab Republic of Egypt, Ministry of Investment, Capital Markets Authority, 2002; see also UNCTAD, 2008).

Despite the progress made in issuing regulations and guidance, compliance with global standards remains limited, even among listed companies. This weakness is demonstrated by earlier findings (Bremer and Elias, 2007) that independent board

members were quite rare in Egypt as recently as 2007. Fawzy (2003) confirms this finding, noting that:

“In most companies, there is no actual separation between the board of directors and the executive management... The board of directors does not include independent members...” (Fawzy, 2003)

Similarly, in a 2006 study by the Egyptian Banking Institute, 8% of banks surveyed reported that the external auditor does not provide a written comment on the adequacy of the bank’s internal controls, while a quarter indicated that they do not require rotation of external auditors according to fixed terms (Arab Republic of Egypt, Central Bank, Egyptian Banking Institute, 2006). Dahawy and Samaha (2009) also found that disclosure levels are low among listed companies in Egypt. The government has continued to seek international assistance to strengthen standards compliance in the banking sector (Arab Republic of Egypt, Central Bank, 2010).

Recent actions by regulators underscore the growing recognition of both the value of standards compliance and the need for further progress in this regard. In the former area, UNCTAD’s 2008 report, cited above, notes that, “[t]he Capital Market Authority (CMA) is fully committed to bring the Egyptian capital market in line with international standards ...” (UNCTAD, 2008).

In the latter area, to cite one example of such efforts to narrow the gap with international standards, the Egyptian Financial Supervisory Authority, EFSA, found it necessary to reaffirm the audit committee requirement in 2008, six years after it was initially included in the listing requirements, and to begin imposing fines on firms that had still not complied by the first quarter of 2009 (Arab Republic of Egypt, Ministry of Investment, Egyptian Financial Supervisory Authority, 2008).

With regard to the audit committee’s structure and operations, the authors’ review of the Egyptian AC code finds that the formal guidance, embodied in the CMA 2006 corporate governance guidance document discussed above, offers only a brief treatment of audit committee formation and operations, roughly a page. Egypt thus does not have detailed regulations comparable to those in the USA or UK, which underscores the value of developing thorough and precise guidelines for audit committees and of determining whether professional norms reinforce effective AC operation.

The section of the Egyptian Corporate Governance Code referring to the AC specifies several requirements for the establishment and operation of the AC, including the following:

- The AC should be comprised of a minimum of three non-executive board members, with the option of hiring members from outside of the company, should sufficient non-executive members not be available. At least one member should be a financial expert.
- The General Assembly should issue, upon a recommendation from the board, a manual for hiring AC members and determine their term, responsibilities and remuneration.
- The management should provide the AC with all available resources and help to conduct its responsibilities including appointment of external advisors and counsels.

The code further specifies that the AC should meet at least every three months with a specific agenda and prepare a report on its activities every three months for the board (Arab Republic of Egypt, Ministry of Investment, Capital Market Authority, 2006).

While formal requirements have remained limited, government agencies working in corporate governance such as the EIOD have nonetheless worked to give companies more specific guidance on audit committee operations, among other governance matters. The EIOD produced a more comprehensive audit committee guidance manual (Arab Republic of Egypt, Ministry of Investment, Egyptian Institute of Directors, 2007) and in February 2011 issued new corporate governance guidance addressing audit among other topics (Arab Republic of Egypt, Ministry of Investment, Egyptian Institute of Directors, 2011), but neither document has regulatory force. Nonetheless, these developments demonstrate government commitment to bring the standard of performance in line with US practice. This latest guidance introduces a number of improvements to audit code guidance, recommending *inter alia* that:

- The AC chair should be an independent BD member and that the majority of AC members be independent, whereas independence was not mentioned at all in the previous code; only a requirement that members should preferably be non-executives was included.
- The AC should assess the ‘effectiveness’ rather than only the ‘competence’ of its members.
- The AC should follow up on any comments made by the external auditor to determine what actions were taken, rather than only reviewing such comments.
- The chair of the AC should prepare a separate report on the committee’s activities for the AGM.

These further steps offer additional evidence of official support for strengthening audit committee practice in the directions suggested by the authors, but it does not shed light on the critical question of support for these changes among audit professionals.

4 Study methodology: measuring auditor support for improvements to the Egyptian code

The literature review identified a gap with respect to measuring the strength of professional norms, the drivers of normative isomorphism. Previous work has focussed on the development of codes and on formal enforcement, but has not addressed the professional norms as a source of support for better corporate governance. In an environment such as that prevailing in Egypt and many other emerging markets, where coercive (regulatory) and mimetic (market-based) pressures may not be sufficient to ensure standards compliance, normative (professional) standards may take on increased importance as determinants of governance outcomes. It is therefore useful to explore the strength of these pressures as they apply in such a market by assessing the attitudes of the senior members of the accounting profession, key opinion leaders for norm-setting.

The research reported here seeks to fill this gap by examining the strength of support within the Egyptian accounting profession for provisions present in the international standards that govern the audit committee’s operations but are absent or incomplete in the

Egyptian guidance. To test whether potential improvements to the Egyptian CG code on AC structure and operations would be supported by prevailing auditor norms in Egypt, the researchers first developed a set of 53 specific proposals for modifying the current code language, based on a comparison of two major US and UK standards, used as a proxy for global standards. The researchers then surveyed leading members of Egypt's audit profession to assess whether there is a consensus of support for each of these steps towards global standards and for groups of related, mutually supportive proposals.

To develop the list of potential improvements, the authors compared the 2006 Egyptian guidance to two global standards: the audit committee language in the UK Financial Reporting Council (FRC, 2008; see also FRC 2003, 2005 for comparison) and the US AICPA Audit Committee Toolkit for public companies (Morrow, 2008). The selection of the US and UK standards as the comparator reflects the broad recognition of the US and UK standards for corporate governance, as noted by Sunder, who argues that,

“The practices proposed for universal use are those prevalent in the English-speaking countries, especially USA and UK. Such ethnocentricity would be rejected in most other fields of social sciences but it has remained largely unchallenged in financial reporting.” (Sunder, 2005)

It should be noted that the US and UK audit committee guidance documents differ in some respects, indicating that the evolution of global norms is not yet complete. For example, most of the topics within the first category, Establishment and Role, are very detailed in the UK AC Code while the US toolkit and the Egyptian Code give these areas only a brief treatment. Table 2 compares the treatment of the AC topics in each of these documents. A more granular comparison of the US and UK guidance could be useful for countries considering new or revised AC guidance and is suggested as a topic for future research.

The 53 proposals are organised into 11 topics, addressing AC establishment, resources, member skills, financial reporting, internal control, whistle-blowing, internal audit function, AC-board relations, communication with shareholders, external audit function, and the annual audit cycle.

These 11 topics are further collected to form four groups (A–D) based on their mutually reinforcing relationships. Table 3 presents these topics and groups and relates them to the six criteria identified by Al-Lehaidan (2006) as the elements of audit committee effectiveness.

The 53 proposals are summarised in Table 4. Annex 1 provides further detail on the proposals reviewed by the audit professionals. For reasons of space, the proposals are presented in summary form in Annex; the full text may be obtained on request from the authors in English or Arabic.

Based on the above analysis, a set of four hypotheses were formulated regarding the strength of support for the norms embodied in the proposals stated:

H1: Senior audit professionals in Egypt support higher standards for the establishment and role of the audit committee.

H2: Senior audit professionals in Egypt support higher standards for the essential control functions.

H3: Senior audit professionals in Egypt support higher standards for communication with the board and shareholders.

H4: Senior audit professionals in Egypt support higher standards for the external audit and annual audit cycle.

Table 2 Comparison of UK, US, and Egyptian audit committee standards (see explanation of coding used for ratings below)

<i>Category and topic</i>		<i>UK</i>	<i>USA</i>	<i>Egypt</i>
1	Establishment and role			
	Establishment	Very detailed	Brief	Brief
	Appointment	Very detailed	Brief	Brief
	Meetings of AC	Very detailed	Very detailed	Brief
2	Resources			
	AC resources	Detailed	Detailed	N/A
	Adviser/counsel	Brief	Very detailed	Brief
	Remuneration	Very detailed	N/A	N/A
3	Skills and experience			
	AC financial expert	Brief	Very detailed	Brief
	Experience and training	Very detailed	Very detailed	N/A
4	AC relation with board of directors	Very detailed	Detailed	N/A
5	Financial reporting	Very detailed	Very detailed	Detailed
6	Internal control (fraud)			
	Internal control	Very detailed	Very detailed	Brief
	Fraud	N/A	Very detailed	N/A
7	Whistle-blowing	Brief	Very detailed	N/A
8	Internal audit function			
	Internal audit process	Detailed	Detailed	Detailed
	Evaluation	Detailed	Very detailed	Brief
9	External audit			
	Appointment	Very detailed	Detailed	Brief
	Independence	Very detailed	Detailed	Detailed
	Non-audit services	Very detailed	Brief	Detailed
10	Annual audit cycle	Very detailed	Very detailed	Brief
11	Communication with shareholders	Very detailed	Brief	N/A

Explanation of coding:

‘Brief’ means that the subject was mentioned but not discussed. A rating of ‘very detailed’ or ‘detailed’ was assigned by the authors based on the length of and comprehensiveness of each subject in the reference documents.

Source: Financial Reporting Council (2008), Morrow (2008), and authors’ analysis

To test these hypotheses, a questionnaire was developed and administered to a sample of experienced Egyptian audit professionals. The authors used purposive and snowball sampling techniques. Selection of experienced auditors relied in the first instance on the authors' knowledge of individuals' experience as auditors and/or audit committee membership to ensure that the sample would include senior audit profession members most likely to serve as opinion leaders in the setting of professional norms. To ensure a sufficient sample, members of this group were also asked to identify other senior auditors in whom they had confidence.

Approximately 90% of the sample consisted of audit professionals in Egyptian accounting firms, of whom all responded to the sample. About 10% of the sample consisted of audit professionals serving on corporate boards. The non-response rate in this smaller group was somewhat higher, but still within acceptable bounds. A specific response rate cannot be calculated because snowball sampling was used within some of the larger firms.

Survey participants were asked to state their agreement with each proposal on a 1–5 Likert scale (from disagree strongly to agree strongly) in order to assess whether support for the improved provisions is consistent with normative isomorphism. To encourage a high level of response, the survey was made available in both an Arabic (paper-based) and an English version (administered online, using an online survey tool).

In all, 54 professionals completed the full survey. A small number of incomplete surveys were discarded. The professional panel's responses were then analysed to assess the level of support for each recommendation and to determine the strength of support for related sets of proposed improvements.

Table 3 Summary of proposals examined

<i>Group A: Establishment and role</i>		<i>Group C: Communication with board/shareholders</i>	
<i>Topic 1 Establishment</i>		<i>Topic 4 AC relations with the board of directors</i>	
1.1	AC appointment method	4.1	AC chair reporting to BD
1.2	AC term limitation	4.2	AC terms of reference
1.3	No more than 3 boards/AC member	4.3	Solve AC-BD variance
1.4	Conflict of interest disclosure	4.4	AC written charter
1.5	Timing of AC-BD meetings	<i>Topic 11 Communications with shareholders</i>	
1.6	AC meeting documentation	11.1	AR disclose AC compliance
<i>Topic 2 Resources</i>		11.2	AC terms, information in AR
2.1	AC resources adequate	11.3	AC chair at AGM
2.2	AC independent advisors	11.4	AR include disagreements, CPA-issues
2.3	AC salary level reflects duties	<i>Group D: External audit management</i>	
<i>Topic 3 Skills</i>		<i>Topic 9 External audit function</i>	
3.1	AC financial expert qualified	9.1	AC oversees CPA
3.2	AC member training	9.2	Investigation of CPA resignation
3.3	AC financial literacy	9.3	AC report to AGM on CPA

Table 3 Summary of proposals examined (continued)

<i>Group B: Essential control functions</i>	9.4	AC-CPA pre-audit engagement letter review
<i>Topic 5 Financial reporting</i>	9.5	AC evaluate CPA qualifications and fee
5.1 AC review financial statements first	9.6	AC review CPA quality control annually
5.2 Report any issues on financials to BD	9.7	AC confirm CPA rotation
<i>Topic 6 Internal control</i>	9.8	AC review ex-CPA employee hiring
6.1 AC confirm internal controls in annual report	9.9	AC review non-audit services
6.2 AC review control systems, risk	9.10	Certain non-audit services by CPA prohibited
6.3 Deter management override	<i>Topic 10 Annual audit cycle</i>	
6.4 Response to fraud reports	10.1	AC review CPA workplan against scope
<i>Topic 7 Whistle-blowing</i>	10.2	AC review CPA plan with CFO, CAE
7.1 Whistle-blowing response	10.3	CPA to give opinion on accounting quality
7.2 Broad access to AC for whistle-blowing	10.4	AC-CPA-mt. meet quarterly on financials
7.3 AC investigations recommend action	10.5	AC review CPA representation letter
<i>Topic 8 Internal audit function</i>	10.6	AC assess audit cycle annually
8.1 Internal audit reports to AC	10.7	AC resolve CPA-management disagreements
8.2 Internal audit resources adequate		
8.3 AC review IAF budget, plans		
8.4 AC assure adequate IAF resources		
8.5 IAF resources preserved from cuts		
8.6 5-yr. review of IAF, AC-execs-CPA annually		
8.7 AC ensure internal audit access to chair		

Abbreviations used:

AC: Audit Committee; AR: Annual Report; BD: Board of Directors; CAE: Central Audit Executive; CFO: Chief Financial Officer; CPA: Certified Public Accountant; IAF: Internal Audit Function.

Source: Authors' analysis

Table 4 Summary of proposals for which support was measured

<i>AC effectiveness components (After Al-Lehaidan)</i>	<i>Group and number of norms</i>	<i>Topics</i>
Composition and independence	Group A: establishment and role of the AC (12 proposals)	1 AC establishment
Resources		2 AC resources
Competence		3 AC skills
Authority	Group B: essential control functions (16 proposals)	5 Financial reporting
Authority		6 Internal control

Table 4 Summary of proposals for which support was measured (continued)

<i>AC effectiveness components (After Al-Lehaidan)</i>	<i>Group and number of norms</i>	<i>Topics</i>
Authority		7 Whistle-blowing
Authority		8 Internal audit function
Diligence	Group C: communication with board and shareholders	4 AC-board relations
Diligence	(8 proposals)	11 Communication with shareholders
Diligence	Group D: external audit management	9 External audit function
Diligence	(17 proposals)	10 Annual audit cycle

Source: Al-Lehaidan (2006) and authors' analysis

5 Findings from the survey of audit professionals

Six tests of the survey results were used to test the four hypotheses stated above. Three tests assessed the degree of support for the 53 proposals individually and three additional tests measured whether the proposals constituted constructs at the group and topic levels. First, the average level of support for each proposal and topic was assessed, with a proposal considered to be supported if it received an average Likert score of four (agree) or above. It should be noted that, although Likert scales are generally considered to be ordinal rather than interval measures, it is common to report the average score, particularly in a comparative context.

Second, the breadth of consensus was measured by the proportion answering agree or strongly agree, with a minimum proportion of 75% set as the cutoff for support. Third, the degree of opposition was assessed by examining the level disagreeing, with a maximum proportion of 15% set as the standard. It should be noted that the cutoff of 4 is more conservative than the alternative practice used by some authors of setting a cutoff for 'agree' at 3.4, based on dividing the range of 1–5 into five equal segments. While the authors were not able to find standards for agreement or disagreement, both the levels chosen and the use of a disagreement standard to supplement the agreement measure may be regarded as conservative, compared to a standard of majority or even two-thirds agreement.

Fourth, at the topic and group level, Spearman correlations were calculated to assess the degree to which support for one set of proposals in the group was related to support for the other related topics. Spearman correlations were used rather than the more common Pearson correlations because Likert variables are ordinal rather than measured. Finally, the reliability and validity of the measured support for each of the topics was assessed using Cronbach's Alpha tests. The reliability test measures the consistency of answers to individual questions and groups of proposals across the respondent population, whereas the validity test measures whether the data supports a conclusion that all of the proposals within a given group are part of a single theoretical construct.

Table 5 provides the results for the test of the 53 individual proposals and 11 topics, using the first three tests above. A proposal was judged to be supported if it passed at least two of the tests.

These results show support by the audit professionals surveyed for 45 of the 53 proposals considered. Eight proposals, indicated by shading in Table 5, failed to reach at least two of the standards set for consensus.

Seventeen proposals won strong support from the senior auditors surveyed, with more than 90% of respondents indicating agreement. Support was particularly strong in Group C, communication with the board and shareholders, with seven out of 16 proposals receiving support from more than 90% of those surveyed.

All 11 topics passed the three tests for consensus support, with average Likert scores of at least 'agree', with more than 75% signalling agreement, and no more than 15% indicating disagreement. Consequently, all four groups also passed the three tests used at this level.

Table 5 Level of support for proposals reflecting international standards

<i>Topic/proposal</i>	<i>Avg.</i>	<i>% Agree</i>	<i>% Disagree</i>	<i>Topic/proposal</i>	<i>Avg.</i>	<i>% Agree</i>	<i>% Disagree</i>
<i>A Establishment and role</i>				<i>C Communication with board/shareholders</i>			
<i>1 Establishment</i>	4.2	0.84	0.09	<i>4 AC-BD relations</i>	4.2	0.86	0.07
1.1	4.0	0.85	0.11	4.1	4.4	0.94	0.06
1.2	3.9	0.72	0.19	4.2	4.1	0.80	0.13
1.3	3.9	0.72	0.19	4.3	4.2	0.89	0.06
1.4	4.5	0.93	0.02	4.4	4.2	0.81	0.06
1.5	4.4	0.98	0.02	<i>11 Communication</i>	4.4	0.81	0.10
1.6	4.2	0.83	0.04	11.1	4.3	0.87	0.04
<i>2 Resources</i>	4.1	0.78	0.12	11.2	4.3	0.89	0.04
2.1	4.5	0.89	0.02	11.3	4.6	0.94	0.02
2.2	4.1	0.80	0.11	11.4	4.3	0.85	0.04
2.3	3.6	0.65	0.24				
<i>3 Skills</i>	4.3	0.92	0.06	<i>D External audit management</i>			
3.1	4.4	0.96	0.04	<i>9 External audit</i>	4.0	0.79	0.10
3.2	4.3	0.94	0.02	9.1	3.3	0.56	0.37
3.3	4.1	0.87	0.11	9.2	4.3	0.91	0.04
				9.3	3.9	0.72	0.09
<i>B Essential control functions</i>				9.4	3.5	0.54	0.17
<i>5 Fin. Reporting</i>	4.5	0.95	0.01	9.5	4.2	0.91	0.04
5.1	4.5	0.94	0.02	9.6	4.2	0.89	0.06
5.2	4.4	0.96	0.00	9.7	4.3	0.83	0.02
<i>6 Internal control</i>	4.4	0.89	0.03	9.8	3.9	0.80	0.07
6.1	4.5	0.94	0.02	9.9	4.1	0.81	0.07
6.2	4.5	0.96	0.02	9.10	4.2	0.89	0.09
6.3	4.4	0.85	0.02	<i>10 Annual audit</i>	4.1	0.84	0.10
6.4	4.1	0.81	0.06	10.1	4.1	0.87	0.13

Table 5 Level of support for proposals reflecting international standards (continued)

<i>Topic/proposal</i>	<i>Avg.</i>	<i>% Agree</i>	<i>% Disagree</i>	<i>Topic/proposal</i>	<i>Avg.</i>	<i>% Agree</i>	<i>% Disagree</i>
<i>B Essential control functions</i>				<i>D External audit management</i>			
7 Whistle-blowing	4.2	0.84	0.04	10.2	4.2	0.83	0.07
7.1	4.2	0.87	0.04	10.3	3.6	0.67	0.24
7.2	4.2	0.81	0.07	10.4	4.4	0.94	0.00
7.3	4.2	0.83	0.00	10.5	4.2	0.87	0.06
8 Internal audit	4.3	0.89	0.04	10.6	3.9	0.78	0.15
8.1	4.3	0.85	0.09	10.7	4.4	0.91	0.02
8.2	4.2	0.83	0.04				
8.3	4.4	0.93	0.06				
8.4	4.4	0.94	0.02				
8.5	4.3	0.89	0.02				
8.6	4.3	0.87	0.02				
8.7	4.3	0.91	0.04				

See Table 3 above for clarification of each proposal. A five-point Likert scale from 1 (strongly disagree) to 5 (strongly agree) was used for all questions. Shading indicates proposals that demonstrate the least support.

Source: Survey data and authors' calculations

Turning to the two additional tests used to assess consensus at the topic and group levels, we find that the correlation analysis supported a conclusion that the proposals constitute a construct in three of the four groups, but did not support this conclusion for the first group, establishment and role. In particular, as shown in Table 6, responses to the skills and establishment topics were strongly correlated with each other, but neither was strongly correlated with the responses to the resources proposals.

The final test, Cronbach's alpha, measures, first, whether individuals' answers are consistent within each group (reliability) and, second, whether the answers are consistent with a conclusion that the questions themselves make up a theoretical construct (validity). A widely-used rule of thumb for the Cronbach's Alpha reliability test is 0.70 or higher for a substantial sample, although social science data may be held to a lower threshold of 0.60 (<http://www.experiment-resources.com/cronbachs-alpha.html>, 2010). A threshold of 0.83 or higher is set for the measure of validity with a lower threshold of 0.80 deemed acceptable for social science testing.

Again, nearly all of the topics passed these tests, although the support for proposals to provide more adequate resources to the AC and for improved financial reporting was comparatively low. Nine of the 11 groups were also supported by the Cronbach's alpha tests, as shown in Table 7, but two groups, resources and financial planning, failed to meet the standard set for either reliability (0.6) or validity (0.8).

Considering all of the above results, we find that most of the individual proposals have consensus support from the senior ranks of the audit profession, but that the level of support for the four hypotheses stated above differs among the four groups. Each will be considered in turn.

Table 6 Spearman correlations of average response within groups

<i>Group/topic</i>		<i>Category</i>		
<i>Group A: Establishment and role</i>		<i>1</i>	<i>2</i>	
1	Establishment	1		
2	Resources	0.218	1	
3	Skills	0.377*	0.087	
<i>Group B: Essential control functions</i>		<i>5</i>	<i>6</i>	<i>7</i>
5	Financial reporting	1		
6	Internal control	0.515*	1	
7	Whistle-blowing	0.579*	0.558*	1
8	Internal audit function	0.478*	0.664*	0.662*
<i>Group C: Communications with board and shareholders</i>		<i>4</i>		
4	AC relation with board	1		
11	Communication with shareholders	0.655*		
<i>Group D: External and annual audit</i>		<i>9</i>		
9	External audit	1		
10	Annual audit cycle	0.431*		

*Indicates significance at the 0.01 level.

Source: Survey data and authors' calculations

Table 7 Estimated reliability and validity for question groups (Cronbach's Alpha)

<i>Categories of norms</i>		<i>Reliability</i>	<i>Validity</i>
1	Establishment (Group A)	0.674	0.821
2	Resources (Group A)	0.424	0.651
3	Skills (Group A)	0.701	0.838
4	AC relation with BD (Group C)	0.649	0.806
5	Financial reporting (Group B)	0.558	0.747
6	Internal control (Group B)	0.681	0.825
7	Whistle-blowing (Group B)	0.798	0.894
8	Internal audit function (Group B)	0.835	0.914
9	External audit (Group D)	0.681	0.826
10	Annual audit cycle (Group D)	0.728	0.853
11	Communication with shareholders (Group C)	0.748	0.865

Source: Survey data and authors' calculations. Shading indicates levels below the cutoffs set for reliability and validity

With regard to the establishment and role of the AC (Group A), three of the proposals failed to attract consensus support, as defined here, while support for proposals to provide adequate resources was weakly connected to other areas within the group. Thus hypothesis H1, that there is a consensus around Group A proposals, is not supported.

The proposals related to essential control functions, Group B, were all supported and the correlation analysis showed that there are strong connections among the different

proposals, although one of the four topics failed the Cronbach's alpha test for validity and reliability. Overall, this hypothesis, H1, is supported, but there is indication of a need to build a stronger consensus around the provision for adequate review of financial reporting.

Hypothesis H3, that there is consensus support for better communications with the board and shareholders (Group C), is the most strongly supported of the four proposals. This hypothesis passed all five tests at the level of individual proposals, related topics, and the group considered as a whole, and is therefore supported by the research findings. This is an encouraging sign for better governance in the critical area of stakeholder communications.

Hypothesis H4, regarding support for external audit management (Group D), received intermediate support. Five individual proposals among the 17 analysed fell short of consensus support, but Group D nonetheless passed both tests at the group level, indicating that the proposals are closely related to each other in the view of the audit professionals surveyed. This finding suggests a need to build support for the specific proposals where consensus is weakest, which generally govern the relationship between the AC and the CPA firm.

Overall, the high level of agreement for the 53 proposals advanced offers important confirmation that the auditing profession is prepared to support a tightening of standards for audit committees in Egypt. This support is critical to achieving higher standards in the absence of either activist shareholders or effective regulatory enforcement. Audit committee support takes on additional importance, given the provision in Egyptian governance regulation for non-board members to sit on audit committees in the event that sufficient independent board members with financial expertise are not available.

6 Conclusions

The findings of this analysis, taken as a whole, demonstrate that the norms of the audit profession are consistent with improvements to the audit committee standards in Egypt. At the same time, they also indicate a number of areas where further consensus-building is needed to establish strong normative support for higher standards of AC operations.

The survey findings confirm that many knowledgeable participants in corporate governance in Egypt would favour updating and clarifying the current corporate governance code in Egypt as it applies to the audit committee. This provides encouragement to the ongoing efforts of the Government of Egypt to strengthen governance and in particular to improve transparency, accountability and disclosure of the performance of listed firms.

The analysis indicates two areas where the evidence for professional norms is comparatively weak, however, and therefore may merit increased attention to building consensus around global norms for audit committee operations. First, audit professionals are relatively less convinced that audit committees need greater and more assured access to financial resources to do their job. This may suggest a lack of consensus on the level of effort constituting adequate diligence on the part of the committee, although this deserves further exploration.

Second, the need for active oversight of the external audit group emerges as an area where professional norms do not appear to be as strong as in other areas. Three of the proposed standards in this area fell short of the 'agree' cutoff, although the remaining

14 standards were supported. This finding argues for greater consensus-building around the value of professional oversight, even where the auditors on the receiving end of the oversight are judged to be experienced and trustworthy.

The survey findings provide confirming evidence for the existence of strong professional norms among audit opinion leaders in Egypt. Further research is needed to determine whether these norms are also widely held by board members and others having oversight on corporate governance, such as regulators. It would also be of value to determine whether senior auditors, in addition to holding these norms themselves, believe that these norms are held by their peers.

This evidence offers encouragement for continued improvement in the standards of audit committee operations and for corporate governance overall in Egypt. As argued above, the support of the audit professionals for reform proposals may be nearly as important as the regulatory framework itself in an environment of weak or irregular enforcement such as that found in many emerging markets, including Egypt. In such environments, where activist shareholder groups are also absent, the ability to rely on the 'soft enforcement' pressure generated by professional norms arguably reinforces compliance and leads to better governance.

More effective audit committees have the potential to bring Egypt's listed companies greater stability and resistance to economic shocks. At a time when the global economic crisis is far from over and when Egypt's companies confront louder calls from the public for transparency and accountability, stronger audit committees and corporate governance that complies with global standards must be seen as valuable assets for the development of emerging markets such as Egypt.

References

- Al-Lehaidan, I. (2006) *Audit Committee Effectiveness: Australia and Saudi Arabia*, Dissertation, School of Accounting and Finance, Faculty of Business and Law, Victoria University.
- Arab Republic of Egypt, Central Bank (2010) *Economic Review*, No. 50, Cairo, CBE, Retrieved from: <http://www.cbe.org.eg/public/economic1-6-2010.pdf>, July.
- Arab Republic of Egypt, Central Bank, Egyptian Banking Institute (2006) *Survey Results: Corporate Governance Survey of the Egyptian Banking Sector*, Egyptian Banking Institute, Cairo, Egypt.
- Arab Republic of Egypt, Ministry of Investment, Capital Market Authority (2006) *Draft Executive Regulations for Corporate Governance of Companies Listed on the Cairo and Alexandria Stock Exchange* (in Arabic), Capital Market Authority, Cairo, Egypt.
- Arab Republic of Egypt, Ministry of Investment, Capital Market Authority (2002) *Securities Listing and De-listing Rules of Cairo and Alexandria Stock Exchanges, Decree Number 30 of the Capital Market Authority's Board of Directors*, Capital Market Authority, Cairo, Egypt.
- Arab Republic of Egypt, Ministry of Investment, Egyptian Financial Supervisory Authority (2008) *Decree Number 94 of the Board of the Authority: Amendments to the Listing Rules of the Egyptian Stock Exchange* (in Arabic), Egyptian Financial Supervisory Authority, Cairo, Egypt.
- Arab Republic of Egypt, Ministry of Investment, Egyptian Institute of Directors (2011) *Daleel qawaid wi maayeer hawkat-al-shirikat bi-gomhuriyyat masr al-arabiyya* (Guide to the rules and standards for corporate governance in the Arab Republic of Egypt), in Arabic, Retrieved from www.eiod.org, February.

- Arab Republic of Egypt, Ministry of Investment, Egyptian Institute of Directors (2007) *Audit Committee Manual*, Retrieved July 2010 from: <http://www.eiod.org>
- Arab Republic of Egypt, Ministry of Investment, Egyptian Institute of Directors (2006) *The Code of Corporate Governance for the Public Enterprise Sector*, retrieved July 2010 from www.eiod.org
- Bremer, J. and Elias, N. (2007) 'Corporate governance in developing economies: the case of Egypt', *Int. J. Business Governance and Ethics*, Vol. 3, pp.430–445.
- Dahawy, K. and Samaha, K. (2009) 'Determinants of corporate governance disclosure in a developing market: the case of Egypt', *Proceedings of the 2009 AAA Annual Meeting and Conference on Teaching and Learning in Accounting – Accounting at a Tipping Point*, 1–5 August, New York, pp.1–37.
- DiMaggio, P.J. and Powell, W.W. (1983) 'The iron cage revisited: institutional isomorphism and collective rationality in organisational fields', *American Sociological Review*, Vol. 48, No. 2, pp.147–160.
- Fama, E.F. and Jensen, M.C. (1983) 'Agency problems and residual claims', *Journal of Law and Economics*, Vol. 26, No. 2, Corporations and private property: a conference sponsored by the Hoover Institution, pp.327–349.
- Fawzy, S. (2003) *Assessment of Corporate Governance in Egypt*, Egypt Centre for Economic Studies, Working Paper No. 82, August, Cairo.
- Feldman, Y. and Harel, A. (2008) 'Social norms, self-interest and ambiguity of legal norms: an experimental analysis of the rule vs. standard dilemma', *Review of Law and Economics*, Vol. 4, No. 1, pp.81–126.
- Financial Reporting Council (FRC) (2003) *The Combined Code on Corporate Governance*, Financial Reporting Council, London.
- Financial Reporting Council (FRC) (2005) *Guidance on Audit Committees (the Smith Guidance)*, Financial Reporting Council, London.
- Financial Reporting Council (FRC) (2008) *Guidance on Audit Committees*, Financial Reporting Council, London.
- GCC Board Directors Institute (GCCBDI) (2009) *Building Better Boards: A Review of Board Effectiveness in the Gulf*, GCC Board Directors Institute, Dubai.
- Hegazy, M. and Hegazy, K. (2010) 'Corporate governance in the UK: audit committees and disclosure arrangements – a web-based analysis', *Journal of Business Studies Quarterly*, Vol. 1, No. 2, pp.32–55.
- McKinsey & Company (2001) *Giving New Life to the Corporate Governance Reform Agenda for Emerging Markets*, McKinsey Emerging Market Investor Opinion Survey, pp.1–6.
- Morrow, J.F. (Ed.) (2008) *The AICPA Audit Committee Toolkit, Public Companies*, 2nd ed., American Institute of Certified Public Accountants, New York.
- Organisation for Economic Cooperation and Development (OECD) (undated draft) *Advancing the Corporate Governance Agenda in the Middle East and North Africa: A Survey of Legal and Institutional Frameworks*, Retrieved from <http://www.oecd.org/dataoecd/43/59/38186933.pdf>, July 2010.
- Smith, P.A. (2009) 'Gulf aims to take lead in corporate governance', *Middle East*, No. 396, pp.52–55.
- Sunder, S. (2005) 'Minding our manners: accounting as social norms', *British Accounting Review*, Vol. 37, pp.367–387.
- United Nations Conference on Trade and Development (UNCTAD) (2008) *Review of Practical Implementation Issues Relating to International Financial Reporting Standards – Case Study of Egypt*, Note by the UNCTAD secretariat. TD/B/C.II/ISAR/45.

Websites

Cronbach's Alpha, Retrieved July 2010 from Experiment Resources: <http://www.experiment-resources.com/cronbachs-alpha.html>

Index of Codes, Retrieved July 2010 from European Corporate Governance Institute: http://www.ecgi.org/codes/all_codes.php

Annex 1: Summary of proposals presented for audit professional's review

This annex presents the 53 proposals for which audit professional support was assessed. As noted above, these proposals are organised into 11 topics (1–11) and the topics are further aggregated into four groups (A–D), each bringing together proposals in 2–4 related topics. Group A is made up of topics 1–3, Group B consists of topics 5–8, Group C comprises topics 4 and 11, and Group D covers topics 9 and 10.

Group A: Establishment and role of the AC

Topic 1: AC establishment. AC members should be appointed by the BD on the recommendation of the nomination committee in consultation with the AC chairman. If any AC member serves in more than three listed companies, the BD should determine whether this situation will impair the ability of such AC member. Each AC member should disclose any potential conflict of interest in advance. There should be sufficient time between AC and BD meetings to allow actions to be carried out. AC meeting discussions should be documented and circulated to internal and external auditors as appropriate.

Topic 2: Allocating financial resources to the AC. This topic included questions on the following changes: supplying the AC with adequate resources to undertake its duties; hiring independent counsel and other advisers to help the AC as necessary; and providing a salary to AC members that takes into account the extra responsibilities, skills, duties and time required of AC members (including whether AC members may receive higher salaries than other BD members).

Topic 3: AC member skills. The AC members should have financial expertise with professional qualification. AC members' training should be timely and ongoing and related to company bylaws with a focus on new AC members; companies must have AC members who are financially literate or will become financially literate within a reasonable time.

Group B: Essential control functions

Topic 5: Internal control. The AC's responsibility to guard the company from fraud includes the need to confirm that controls are in place and operating successfully. In addition, the AC should approve annual report statements in relation to internal control and management of risk. The AC should assess the company's risk profile and support the preparation of a statement on internal control in the annual report. The AC should deter management override of internal controls and review annually the organisation's code of conduct. Fraud must be reported to the AC by the CPA firm, and the board then has one business day to notify the EFSA (regulatory authority) of suspected fraud, while the CPA firm is required to report to the EFSA by the end of the next business day.

Topic 6: Financial reporting elements. The AC should review information related to financial statements. The BD's approval of the financial report is required. If the AC is not satisfied with any aspect of the proposed financial reporting, it shall report this to the BD.

Topic 7: Whistle-blowing. Proposals on this topic, a new tool for Egyptian companies, include a requirement for the AC to review any complaints received, internal or external, regarding internal controls and financial statements. AC contact information should be provided on the company's website or through a hotline. Confidentiality of the employee and protection against any retaliation should be guaranteed. The complainant should be able to follow procedures set up by the AC. The AC investigation should determine corrective action or recommend action to the full board.

Topic 8: Internal audit function (IAF). The IAF should be directly supervised by the AC and should report directly to it. The AC creates an agenda for the coming year or approves the central audit executive's agenda. An adequately resourced internal audit function can provide the board with objective assurance of internal controls. The AC should review the IAF budget and plans and ensure that they reflect the CPA firm's objectives. The AC should guarantee that the internal audit function has resources and access to information and is fully equipped. Companies should perform an internal IAF improvement and quality assurance programme once every five years. The AC should meet annually with executive managers and the CPA firm to discuss Central Audit Executive (CAE) performance. The AC must ensure that the internal auditor team has direct access to the board chairman and is accountable to the AC.

Group C: Communication with the board and shareholders

Topic 4: Relation between AC and the board. The AC chairman should report formally to the board after each meeting. The AC should receive formal terms of reference from the board, which should be reviewed annually by the board; disagreement between the AC and BD should be allocated enough time for resolution; if the issue is not resolved, the AC should report the issue to the shareholders. The AC must have a written charter that includes: annual performance evaluation, purpose, etc., and the charter must be posted on the company's website.

Topic 11: Communication with shareholders. The AC is obligated to disclose the work done by the committee during the previous fiscal year in the annual report, including confirmation of whether members of the AC are satisfied that they are fulfilling the charter, which should be attached to the annual report every three years. The EFSA (the regulator) should have jurisdiction over reporting of information to the public; the terms of reference of the AC should be made available in the annual report and should include the number of AC meetings, a summary of the AC role, etc. The AC chairman should be available at the Annual General Meeting to answer any question about the AC. The annual report should include other matters concerning any disagreement between the AC and board, the appointment of the CPA firm, provision of non-audit services and certain matters regarding the CPA firm.

Group D: External audit management

Topic 9: External audit. The AC is responsible for overseeing the organisation's relations with the CPA firm and the engagement letter should state that the client's representative

is the AC, so that the CPA firm is accountable primarily and directly to the AC. If the CPA firm resigns, the AC should investigate and consider the need to include the risk associated with the departure of the CPA firm in their risk evaluation. The AC should report to shareholders on the appointment, reappointment or removal of the CPA firm. If the board does not accept the AC's recommendation, this should be disclosed in the annual report; the AC should review the engagement letter with the executive partner at the start of each audit; the AC evaluation should take into consideration the CPA firm's qualifications and whether the audit fee is proper to the size, risk, complexity and control profile of the company. The AC should review annually the CPA firm's internal quality control, peer review, governmental inquiries and any steps taken to deal with such issues. The AC should ensure follow up of the mandatory rotation taking place within the CPA firm with regard to the lead and other partners after five years and then apply a five-year time-out. The same rotation process also applies for non-audit services. The AC should agree with the board on a policy for employing former CPA firm employees who were part of the audit team, should affirm in the annual report that the provision of any non-audit services did not harm CPA firm independence, and verify both that the payment for such services was not more than 5% of the total amount paid to the CPA firm and that AC approval was obtained. Furthermore, CPA firms should be prohibited from providing certain non-audit services at the same time that they are performing audits, such as actuarial and human resource services.

Topic 10: Annual audit cycle. The AC should consider whether the CPA firm's overall work plan is consistent with the scope of the audit engagement and review it with the CPA firm, CFO and CAE. The AC should review the audit plan and scope with the IAF team to reduce unnecessary efforts. Guidance should require the CPA firm to offer their opinion of the quality, not just the acceptability, of the accounting principles used in the company. The AC must meet with management and the CPA firm to review the audited quarterly and annual financial statements. It should review the CPA firm representation letters before signature by management, and also review management letters including the recommendations of the CPA firm and management's responses. At the end of the annual audit cycle, the AC should assess the effectiveness of the audit process, review whether the CPA firm has met its audit plan and obtain feedback from key executives involved. The AC should discuss with the CPA firm any difficulties faced during the audit cycle and any major disagreements with management and ensure solution of disagreements regarding financial reporting.