

Original Paper

Overlapping Status of the Supervisory Functions Implementing Audit Committee and Supervisory Board Simultaneously in China

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Abstract

Imposing the mechanism of a single Audit Committee (AC) on the dual supervisory mechanism of a Board of Directors alongside a Supervisory Board (SB) has raised questions regarding the overlapping status in implementing effective monitoring functions. A functionality checklist of these different governance mechanisms is documented in this article by interviewing five listed companies in China. Both comparisons of regulation and the issues raised in the interview point out the redundancies and gaps in implementing effective supervision through these distinct governance mechanisms. The evidence presented provides useful guidelines of how key operational items of effectiveness and co-ordination can be improved to make supervisory functions in China more effective.

Keywords

audit committee, supervisory board, corporate governance

1. Introduction

Shortly after the founding of the People's Republic of China in 1949, the supervisory profession in China disappeared almost completely. Independent monitoring was virtually non-existent under the planned economy before the 1980s, when the State both owned and ran enterprises. The re-emergence of independent supervision was a result of mushrooming Sino-foreign joint ventures, conveyed by China's open door policy, adopted in the early 1980s. Due to non-state owned interests in the joint ventures, demand emerged for the verification of capital contributions and audits of annual financial statements and income tax returns by registered non-government-employed Chinese certified public

accountants (Xiao et al., 2000). The progress of full-scale economic reforms, with the separation of ownership and management of enterprises, led to agency problems in business firms. Independent monitoring is thus called for, in order to alleviate these problems.

There are two primary patterns of board structure: the unitary board system commonly referred to as the Anglo-American system and the two-board system commonly known as the German-Japanese system. Under the unitary board system, a company establishes only one board, comprising the executive directors and the independent directors. The executive directors are in charge of the company's business operation, while the independent directors act as supervisors of the management. Under the two-board system, the Board of Directors (BoD) is responsible for running the company, whereas the Supervisory Board (SB) functions as a special monitoring unit and it may have the same mandates as the BoD or even have higher status than the BoD. In China, in keeping with the regulations of the Chinese Company Law, listed firms have adopted the typical two-board system in which both the BoD and the SB are established.

The Chinese Company Law adopted in December 1993 became the first piece of Chinese legislation specifying that every listed company establish a SB to supervise the company's financial activities and the conduct of its directors. In countries such as the United States and the United Kingdom, it is compulsory for listed companies to establish an Audit Committee (AC) to oversee the aspects of the company's internal control and financial reporting (Sarbanes-Oxley Act [SOX], 2002: Sec.2 (a) (3); Combined Code, 2003: Sec.C3.1). In China, under the equivalent regulation in the Code of CG for Listed Companies in China (China Securities Regulatory Commission & State Economic and Trade Commission [CSRC & SETC], 2002: Section 52), the establishment of an AC is voluntary rather than mandatory. In practice, the willingness to install the AC has increased from 1% (12) in 2000 to 99.86% (2016) in 2010 among listed companies (Lee, 2015, p. 2, Table 1). Given that many Chinese companies have introduced ACs into their governance structures, it is indeed a peculiar system of implementing a singular mechanism of the AC on top of the dual supervisory mechanism of the SB. The goal of this new measure is to establish a majority of external directors in the Board of Directors (BoD) in 2020 (OSC, 2017). Given that the SB in the Chinese system has similar duties to that of the AC in the Anglo-American system, it is unclear how these two bodies will interact with each other and whether this will result in the duplication of supervision. The issue as to how the functions of the two institutions should be co-ordinated to avoid redundancies and gaps in internal supervision in the future in China. The functions between these two governance elements represent overlapping status as the important subject for research while two institutions exist simultaneously. The issue in this article may be summarized as follows: *The overlapping status of the supervisory functions of the SB and the AC in China.*

This article intends to elucidate the Chinese internal supervisory mechanism, potential areas of redundancies and gaps in internal supervision, and to better understand the operation contents of the two institutions' supervisory functions with information obtained interviewing five listed companies in

China. Five interviews of five listed companies point out the issue of co-ordination between SBs and ACs in the future. The evidence presented forms a basis for proposals of how key functions of monitoring and co-ordination can be improved to make supervisory functions in China more effective.

2. Literature and Regulation

2.1 Literature

SBs. After 2006, the newly amended Chinese Corporate Law significantly enhances the role played by SBs. They find that before the new corporate law became effective, SBs did not affect executive compensation, although their role after that became significant. Corporate failures (Christensen, Kent, Routledge, & Stewart, 2015) and increasing business risks (KPMG, 2015) imposes the supervisory mechanism of SB and AC on corporate governance. Ding, Wu, Li, and Jia (2010) explain that China's CG system implements both American and German style mechanisms, but the SB, a typical feature of German style governance, is generally considered dysfunctional. Xiao, Dahya, and Lin (2004) examine how SBs function in Chinese-listed companies. Particular attention is paid to the problems that are faced by the SB and to the likely causes and consequences of these problems. Gorton and Schmid (2004) document that under the German CG system of co-determination, employees are legally allocated control rights over corporate assets through seats on the SB—that is, the board of non-executive directors. Firth, Fung, and Rui (2007) find that the types of the dominant shareholder, the size of the SB, and the percentage of independent directors have an impact on the frequency of modified audit opinions. Qin (2007) examines the relationship between corporate performance and the characteristics of the SB. He suggests that the SB functions effectively in China and that improving SB functions could result in better corporate performance. One specific proposal for improving the SB system advanced in Wei and Jiang (2010) is to create public supervisors and creditor supervisors. Bezemer, Maasen, Bosch, and Volberda (2009) suggest that a separate board with the power to influence management through consent, advise and incentives is an effective, pre-emptive form of monitoring. Block and Gerstner (2016, p. 50) find that the American board has begun to reflect German two-tier model in function if not in form and they remark “The heightened monitoring standards for boards and the rising importance of committees has made the one-tier board in America more akin to a multi-tiered board”. Block and Gerstner (2016) stressed that another important monitoring task is the supervision of executive actions, where effectiveness depends on (1) independence from management, (2) information access, and (3) overcoming operational challenges.

ACs. Block and Gerstner (2016, p. 50) find that the American board has begun to reflect German two-tier model in function. Be ´dard, Chtourou, and Courteau (2004) find a significant association between earnings management and AC governance practices. Goodwin-Stewart and Kent (2006) find that the existence of an AC, more frequent committee meetings, and increased use of internal audits are related to higher audit fees. These findings are consistent with an increased demand for higher quality auditing by ACs and by firms that make greater use of internal audits. Chen and Zhou (2009) find that

firms with effective ACs are associated with less earnings management and less audit fees, and are less likely to have modified opinions and delayed filings. Chien, Mayer, and Sennetti (2010) find that the presence of a committee and the committee's specific qualities of independence, financial expertise, and increased activity positively correlate with reduced frequencies of internal control problems. Ika and Ghazali (2012) suggest that AC effects are likely to reduce financial reporting lead times. In addition, Iyer, Bamber, and Griffin (2013) find that professional accounting certification and AC experience are valued positively by the BoD when designating an AC member as a financial expert. In summary, the characteristics of independence, expertise, and diligence of the SB and the AC are a prerequisite for the effective exercise of monitoring functions. More Expectations to the ACs have evolved as a corporate governance structure (Lin, Xiao, & Tang, 2008; Narayanaswamy, Raghunandan, & Rama, 2015).

China has entered a period of unprecedented transformation, within which business operations have become more complex. It is a period of rapid innovation as well as that of trial and error in the evolution of businesses and business processes. The relevant studies of Li, Du, and Tang (2006), Li and Chen (2006), Li and Liu (2005), Li (2007), and Chang (2001) all suggest that China must enhance governance mechanisms in its listed companies and the development of the capital market by refining the basic principles of "Corporate Law", "Securities Law", and "Rules for Listed Companies Governance" as well as by learning from the best reform practices of domestic and overseas CG. Block and Gerstner (2016) stressed that another important monitoring task is the supervision of executive actions. For future research, Stuart and Zaman (2014) suggest: (1) greater consideration of the organizational and institutional contexts in which audit committees operate; (2) explicit theorization of the processes associated with audit committee operation; (3) complementing extant research methods with field studies; and (4) investigation of unintended as well as expected consequences of audit committees.

2.2 Regulation

First, in 2006, China's National People's Congress (NPC) specified the SB as the special institution for financial inspection and supervision, whereas in 2002 the Chinese Security Regulatory Commission (CSRC) mandated that both the SB and the ACs were responsible for financial supervision, and both have the same financial supervisory function of overseeing the authenticity and reasonableness of the disclosure of the company's accounting information. Second, both are responsible for safeguarding against questionable conduct of the Directors, and related transactions of senior managers. Therefore, both try to operate within their functions on the same issue, identified as including financial reporting, auditing, internal control and compliance.

2.2.1 The Supervisory Board

The duties of the SB. According to the German regulations on CG, the SB (Aufsichtsrat) oversees and advises the BoD (Executive Board, Vorstand), and also has control over fundamental and important decisions. According to Paragraph 1 of Article 111 of the German Company Act (Aktiengesetz; AktG),

the SB has the right and responsibility to oversee (überwachen) the operations of the company (Chen, 2007, p. 154). The supervisory board reviews the management by inspecting the books (Note 1), reviewing the annual report (Note 2), issuing and overseeing the work of an external auditor (Note 3), analyzing the information provided by the management board (Note 4) and reporting to the general meeting (Note 5). In addition, the supervisory board also has standing for court actions against the management (Note 6). The characteristic of the existing German system of CG indicates that the SB plays the role of overseeing the operations, compliance, auditing and finance of the company. In addition to the appointment and removal of directors, the most important right and responsibility of the SB is to oversee the operations of the directors (Yang, 2004, p. 102). In the Chinese system of CG, there are two institutions participating in the Shareholders Assembly Meeting: the BoD which is responsible for making important day-to-day managerial decisions, the removal of managers, and the execution of day-to-day operations, whereas the SB is responsible for the supervision of the company's finance, the violation of laws, regulations, or company constitution by the directors and managers in their execution of their duties to the company (Yang, 2004). According to Article 126 in China's Corporate Law, the SB in a Chinese company is the internal supervisory unit responsible for supervising the directors and managers' behaviour. Corporate Law also stipulates the system of the SB and guides it on behalf of the shareholders to supervise the organisation of internal power, exercised by the BoD and the layers of management of the company. In both the German and the Chinese systems, it is the right and responsibility of the SB to oversee the conduct of the BoD. In the German system, the SB has a rank position above the BoD, whereas in the Chinese system, the SB has the equal rank position as the BoD. This structural difference might have some impact on the supervisory effectiveness, the powers, and roles of the SB in both systems. Now, with the addition of the AC, there are two institutions in the Chinese system that both have the functions and responsibilities to supervise the compliance, auditing, finance and operations of the company. To understand this seemingly redundant arrangement between two institutions is investigated by comparing its duties in their operations.

It is the duty of the Supervisory Board to exercise supervision over the policies adopted by the BoD and over the general conduct of the business. Furthermore, the Supervisory Board shall provide the BoD with advice. The general duties of the Supervisory Board include supervising, monitoring, and advising the BoD on three key aspects:

Aspect A: Financial Reporting; Aspect B: Auditing; Aspect C: Internal Control and Compliance

2.2.2 The Audit Committee

It appears that there is no universally accepted definition of an AC to be found in regulations, reports, surveys, and research studies. Instead, different definitions are presented such as those in Section 404 of SOX (2002), Klein (2002a), Collier (1996), and Braiotta (1999). These definitions state that the AC is a sub-committee of the BoD, and they confine the definition primarily to the composition and the key responsibilities of ACs:

The term "AC" means—a committee (or equivalent body) established by and among the BoD of an

issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer (U.S. Securities Exchange Act of 1934 #3 (a)(58); SOX Section 404, 2002).

These definitions state that the AC is a sub-committee of the BoD and confine the definition mainly to the composition and the key responsibilities of ACs. They also discuss the composition of the AC, particularly with regard to the participation of independent directors with professional abilities to perform the key responsibilities of financial reporting, audit, and internal control. In a nutshell, all the above-quoted definitions of the AC tend to emphasize the two attributes of its composition, namely independence and financial expertise, as well as its responsibility over operations. It is contrasted with the SB with regard to their service scopes, their functional positions and responsibilities, as well as their operations.

The duties of the AC. According to Section 52 of the Code of CG for Listed Companies in China, the BoD of a listed company may establish an AC. China's "Rules for Listed Companies Governance" set out five main duties of CG for the AC:

- 1) Provide suggestions for engaging or changing the external audit firm (CPA);
- 2) Supervising the Internal Audit system and its implementation;
- 3) Be responsible for the internal and external auditing communication;
- 4) Verify and reveal the financial information of the company;
- 5) Check the internal control system.

It is the duty of the Audit Committee to ascertain that the Company maintains adequate procedures and control systems to manage the financial, operational and risks to which the company are exposed, to prevent fraud and to oversee the integrity of the Company's financial reporting (FRC-UK, 2016). The general duties of the Audit Committee include supervising, monitoring, and advising the BoD on activities with respect to three key aspects:

Aspect A: Financial Reporting; Aspect B: Auditing; Aspect C: Internal Control and Compliance.

The duties of the AC and the SB as stipulated in Corporate Law and the Code of CG for Listed Companies in China are essentially similar, involving supervising the company's functions on the same issue, identified as including financial reporting, auditing, internal control and compliance. However, organizationally they are not affiliated to each other, as the AC is under the jurisdiction of the BoD, while the SB is parallel to the BoD. This can cause confusion in their respective responsibilities if there is lack of clarification or co-ordination, and it may appear that many institutions are supervising but no unit actually performing that function. Clarification or co-ordination includes defining the duties, functions and position of the AC in the organisation, and establishing a legal standard for the AC, but such clarification measures are still outstanding.

The investigation on operational aspects of these two institutions—the overlapping items and percentages between them—was therefore performed through an interview of five listed companies with experience of having implemented ACs.

3. Research Design

3.1 Design

This article aims to answer the research question by in-depth interviews with five listed companies in Shanghai, China and referring to the work of Gendron, Be ´dard, Turley and Zaman, Spira, and others. As these researchers performed only limited research on internal processes, they have called for more research to be carried out. Thus, the interviews with five companies will help identify overlapping and gaps of the two institutions caused by their co-existence in the same supervisory mechanism for the realization of effective supervision, rooted in their practical experiences, in response to calls by the relevant researchers to unravel the black box of the monitoring system, as this cannot be achieved through quantitative methods. Generally, the qualitative method will analyze the responses from five interviewees of five listed companies to identify operational items both on the understanding of the SB/AC concrete practices and on comparing the practical level of implementation by revealing the contexts of supervisory functions in five sampled interviewees. Hence, this study uses interviews intended to highlight the ways to improve the effectiveness of supervisory functions in practice, by completing the checklist of operation items of supervisory functions implemented due to the co-existence of SBs and ACs in China.

3.2 Sample Target

In order to clarify overlapping and gaps in the functions of the two institutions caused by their co-existence in the same system for the realization of effective supervision, the survey of five listed companies in Shanghai, China, was designed to discover the practice of the supervisory functions in each individual company. The scarce resources of firms implementing SB and AC simultaneously with experience are willing to reveal their practices. Yet five qualified firms were selected as the research samples and all were willing to cope with filling and answering the questions designed in this paper. Furthermore, the functions of the SB and the AC at the practical level were compared. The purpose of conducting this survey by face-to-face interview is to complete the checklist of operation items of supervisory functions, which is defined by the study of archival study of related regulations and charters presented in the empirical study. The research participants were selected according to their ability to provide information about the phenomena being studied (Saldaña, 2011). Five interviews were conducted with the General Secretary of the BoD identified as the interviewee, as he is in charge and the co-ordinator of the BoD and SB, including ACs and its related parties, who was questioned about the process of typical supervisory functions, and the extent to which the company's AC/SB fulfilled its mandate in practice in China, to make data collection more systematic for each interviewee, it was intended to keep the interview fairly conversational and situational. The data were then analyzed and consolidated to generate conclusions.

3.3 Technique

Prior to fieldwork, questionnaires were specified as checklists based on the research objective, literature review and experience of three themes of financial reporting, auditing and internal control related to key functions of ACs/SBs; while being flexible enough to explore new approaches during the interview. Semi-structured interviews allowed the interviewee to express their point of view for mutual understanding related to the ACs' co-ordination by function with SBs (Rubin & Rubin, 1995). Therefore, semi-structured questions were designed for in-depth interview based on the checklist for each sample company, to arrive at the general understanding of the co-ordination between ACs and SBs. Empirical data was primarily collected through semi-structured interviews, which were validated (Creswell, 2007; Yin, 2013) by reviewing company documents (e.g., annual financial statements). Questions were prepared in order to design a checklist of supervisory functions including three aspects: (1) Financial reporting; (2) Auditing including internal audit and external audit; (3) Internal control, including compliance. The questions were made known to each category of interviewees before the fieldwork commenced.

All in depth field study interviews were recorded by the checklist and partially video-recorded. The interview was processed through rigorous theoretical procedures in four steps as follows:

- 1) To develop a functionality checklist of supervisory functions as the main theme for each interview;
- 2) To mark on the functionality checklist through the interview and modify it when a new function emerges from an interview;
- 3) To consolidate the checklists from five in-depth interviews of five listed companies as a consolidated matrix of five checklists to summarise the main themes by matching and integrating the function items after completing the interview;
- 4) To arrive at statistics on overlapping, missing items and percentages among the five sampled companies.

3.4 Data Consolidation

The interviewees were asked to describe their actual practices; the interviewees were encouraged to express their opinions when explaining their practices, especially on the items that were not listed on the functionality checklist, and the items on the functionality checklist that they did not practice. During the interview, they were also encouraged to share their opinions freely on the interaction between ACs and SBs regarding the functions practised. Each company's functionality checklist was then consolidated into a matrix in order to check for overlapping and missing functions between ACs and SBs. A consolidated matrix of five checklists was prepared, in order to summarise the main themes discussed by the interviewees, then re-examine the interview material to gain a better understanding of the meanings surrounding the functions' overlapping and omissions of ACs and SBs in the internal supervisory mechanism. Each interviewee's answers were checked for consistency to ensure the validity of the interview. The data was then analysed through combining and consolidating the checklist results from all interviewees. After analyzing the interview data, the samples from the five companies

were co-ordinated and the statistics calculated to assess the degree of overlapping and omitted items. The items were re-examined and re-classified to fit into the key aspects of financial reporting, auditing and internal control. Finally, the percentages and totals of the function overlaps and gaps were calculated from the total number of functions for each key aspect which are the indicators for evaluating the overall impact across the three key aspects, to reveal the status of function overlapping of co-ordination between ACs and SBs coexisting in China.

4. Empirical Studies

4.1 Interviews with the Five General Secretaries of BoDs

This study is structured by presenting the interview responses of five general secretaries of five sampled companies in China. Each face-to-face interview lasted more than three hours and every company's interview was conducted on each functionality list, and marked on the checklist and partial conversation recorded on video. The data was then analysed through combining and consolidating the checklist results from all interviewees as the matrix with three aspects is given below. Three operational aspects of supervisory functions by SBs and ACs:

4.1.1 Aspect A: Financial Reporting, Totalling 23 Items (Table 1) Are included, Supervising the Following Four Key Areas:

- Overseeing the auditing results by the external independent accountants;
- Examining all the accounting policies of the company, and reporting major changes and other dubious points;
- Previewing the interim and annual financial reports and the reports of the BoD;
- Organizing special investigations on the company's financial activities.

The findings of overlapping and missing items and percentage (the items of findings divided by total items) are summarised individually in the table below:

Company 1: Overlapping with 3 items, 14%; missing 7 items, 30%.

Company 2: Overlapping with 1 item, 4%; missing 2 items, 9%.

Company 3: Overlapping with 9 items, 39%; missing 3 items, 13%.

Company 4: Overlapping with 7 items, 30%; missing 0 items, 0%.

Company 5: Overlapping with 1 item, 4%; missing 0 items, 0%.

Companies 4 and 5 have no missing items, but every sampled company has overlapping items.

Table 1. The Financial Reporting of Supervisory Functions between the SB and AC Implemented in China

No.	Appraisal Questions	Overlapping	SB	AC
		(O)	/ Missing	
		(M)		

<i>Aspect A</i> Financial Reporting		<i>O</i>	<i>M</i>	<i>Yes</i>	<i>No</i>	<i>U</i>	<i>Yes</i>	<i>No</i>	<i>U</i>
1	Financial Reporting (Total O/M Items)	21	12						
1.1	Review Documents and Meeting and Discussion (Total 10 O/M Items)	7							
1.1.1	Does the unit review filings (including interim reporting) with the SEC and other published documents containing the Company's financial statements and consider whether the information is accurate?	3	2	3	2	0	3	2	0
1.1.2	Will the Chairman of the unit participate in a telephonic meeting among Finance management and the public accounting firm prior to earnings release?	0	3	0	4	1	1	3	1
1.1.3	Does the unit review the Company's critical accounting policies with Finance management and the public accounting firm at least annually?	1	2	1	4	0	3	2	0
1.1.4	Does the unit have a full understanding of the composition of the company's balance sheet, including the degree of management judgement inherent in the various accounts?	1	0	1	4	0	5	0	0
1.1.5	Does the unit understand which financial ratios and indicators are key to the company and industry, how the company's performance compares with its budgetary targets and its competitors, and how management plans to address any unfavorable variances?	3	1	3	1	1	4	1	0
1.1.6	Does the unit discuss significant/complex/unusual transactions with management and the external auditors?	3	0	3	1	1	5	0	0
1.1.7	Does the unit understand which areas represent high risk for material mis-statement of the financial statements, and discuss assumptions/approaches used with management and the external auditors?	3	1	3	2	0	4	1	0
1.1.8	Does the unit review with Finance management any significant changes to GAAP and/or MAP policies or standards?	3	0	3	1	1	4	0	1
1.1.9	Does the unit review policies and procedures with respect to transactions between the Company and officers and directors, or affiliates of officers or directors, or transactions that are not a normal part of the Company's business?	4	0	4	0	1	4	0	1

No.	Appraisal Questions	Overlapping		SB		AC			
		(O) / Missing							
		(M)							
Aspect A	Financial Reporting	O	M	Yes	No	U	Yes	No	U
1.1.10	Does the unit understand and approve the company's approach to providing earnings guidance? Does the unit discuss financial information and earnings guidance provided to analysts and rating agencies with management, ideally before the information/guidance is released?	3	1	3	1	1	3	1	1
1.1.11	Does the unit review periodic reports on the appropriateness of executives', officers', and directors' expenses and perquisites?	1	3	1	3	1	1	3	1
1.2	Interim Financial Reports (Total O/M Items)	4	0						
1.2.1	Is the unit clear about its responsibilities for overseeing interim reports-discussing both earning releases and quarterly filings? Ideally, is the unit's involvement prior to release of earnings/filings?	4	0	5	0	0	4	1	0
1.2.2	Are all the unit's members involved in overseeing interim reports?	4	0	5	0	0	4	1	0
1.2.3	Does the unit review and discuss the earnings releases and any significant issues, and is satisfied disclosures are adequate, before the earnings are released?	4	0	5	0	0	4	1	0
1.2.4	Does the unit review and discuss with management (and the external auditors) the quarterly filings, any related issues, and any differences from earnings releases, before filing takes place?	4	0	5	0	0	4	1	0
1.3	Annual Financial Reports (Total O/M Items)	7	5						
1.3.1	Review with Finance management and the public accounting firm at the completion of the annual audit:								
	a. The Company's annual financial statements and related footnotes.	3	0	3	2	0	5	0	0
	b. The public accounting firm's audit of the financial statements and its report thereon.	4	0	4	1	0	5	0	0
	c. Any significant changes required in the public accounting firm's audit plan.	3	1	3	2	0	4	1	0

No.	Appraisal Questions	Overlapping (O) / Missing (M)		SB Yes No	AC U Yes No U
Aspect A Financial Reporting		O	M	Yes No	U Yes No U
	d. Any serious difficulties or disputes with management encountered during the course of the audit.	0	3	0 3	2 0 3 2
	e. Other matters related to the conduct of the audit, which are to be communicated to the Committee under Generally Accepted Accounting Standards.	3	1	3 2	0 4 1 0
1.3.2	Does the unit commit sufficient time to review, discuss and consider the financial statements?	4	1	4 1	0 4 1 0
1.3.3	Does the unit discuss with selected corporate officers (e.g., compliance officer, legal counsel, tax director, Internal Audit, etc.) and external auditors the substance and quality of reserves, judgments, and estimates used in the financial statements, and the issues that may have an impact on such reserves and estimates?	2	1	2 2	1 3 1 1
1.3.4	Based on its review and discussions with management and the external auditors, is the unit comfortable in recommending to the BoD/shareholders that the audited financial statements be included in the company's SEC filing?	5	0	5 0	0 5 0 0

4.1.2 Aspect B: Auditing: 21 Items (Table 2) Were Included, Covering the Following Two Key Areas

- Internal Audit: through the oversight function of the Internal Audit, overseeing key financial and management risks and the internal control, examining the scopes of the Internal Audit plans, appraising the skills of the Internal Auditors, and determining the financial budgets of the Internal Audit, etc.
- External Audit: presiding over the affairs of the external audit, selecting the independent accountants, discussing the scope, process and plan of external audit, evaluating the capabilities of the independent accountants; in order to give suggestions for the appointments and dismissal of the external auditing institutions, the AC should be confined to supporting sound suggestions made by the chartered accountants and actively co-ordinate with the latter on major auditing matters, as well as co-ordinating the relations between the latter and the management to ensure the smooth operation of the auditing tasks.

The results are presented individually in the table below:

Company 1: Overlapping with 7 items, 33%; missing 10 items, 48%.

Company 2: Overlapping with 10 items, 48%; missing 6 items, 29%.

Company 3: Overlapping with 2 items, 10%; missing 3 items, 14%.

Company 4: Overlapping with 0 items, 0%; missing 0 items, 0%.

Company 5: Overlapping with 0 items 0%; missing 0 items, 0%.

Both the fourth and fifth companies show no overlapping and missing items in auditing.

Table 2. The Auditing of Supervisory Functions between the SB and the AC Implemented in China

No.	Appraisal Questions	Overlapping(O) SB AC / Missing (M)								
Aspect B Auditing		O	M	Yes	No	U	Yes	No	U	
2	Auditing (Total O/M Items)	19	19							
2.1	Oversight Independent Auditor (Total O/M Items)	11	11							
2.1.1	Does the unit appoint, approve the compensation of, 1 and provide oversight of the public accounting firm?		3	1	4	0	2	3	0	
2.1.2	Does the unit confirm annually the independence of 2 the public accounting firm, and quarterly review the firm’s non-audit services and related fees?		2	2	3	0	3	2	0	
2.1.3	Has the unit embraced its direct responsibility to 1 oversee the engagement of the external auditors?		2	1	4	0	3	2	0	
2.1.4	Does the unit pre-approve the audit work to be 1 performed?		1	1	3	1	3	1	1	
2.1.5	Does the unit approve the proposed audit fees and is 2 comfortable they are appropriate for the scope of work envisioned?		2	2	2	1	3	2	0	
2.1.6	Does the unit discuss with the external auditors the 2 scope of their annual audit, key risk areas, how the audit plan responds to the risk of financial statement fraud and approves modifications to the annual audit plan?		2	2	2	1	3	2	0	
2.1.7	Does the unit review material written 3 communications the external auditors provide to management and discuss any concerns?		0	3	1	1	5	0	0	

2.1.8	Does the unit annually receive the letter disclosing all 2 relationships between the external auditors and the company, discuss it with the external auditors, assess impacts on the auditor's independence, and make any recommendations needed to the board/shareholders for actions to ensure the auditor's independence?	1	2	1	2	2	1	2
2.1.9	Does the unit discuss with the external auditors 2 difficulties encountered in performing the audit and improvements considered for future engagements?	1	2	3	0	3	1	1
2.1.10	Does the unit resolve disagreements between 0 management and the external auditors regarding financial reporting, if needed?	2	0	5	0	2	2	1
2.1.11	Does the unit pre-approve all non-audit work to be 1 performed by the external auditors, after considering its permissibility under SEC rules and its impact on auditor independence?	2	1	4	0	2	2	1
2.1.12	Does the unit set clear hiring policies for employees 1 or former employees of the external audit firm?	3	1	3	1	1	3	1
2.2	Oversight Internal Audit (Total O/M Items) 8	8						
2.2.1	Does the unit consider and review with Finance management and the Internal Audit Director:							
	a. Significant findings during the year and 1 management's responses thereto?	1	1	1	3	2	1	2
	b. Any difficulties encountered in the course of their 2 audits, including any restrictions on the scope of their work or access to required information?	1	2	1	2	2	1	2
	c. Any changes required in planned scope of their 2 audit plan?	1	2	1	2	2	1	2
2.2.2	Does the unit review and concur in the appointment, 0 replacement, reassignment, or dismissal of the Chief Audit Executive (CAE)?	3	0	4	1	0	3	2
2.2.3	Does the unit ensure direct access to Internal Audit - 2 either through a direct or dotted line reporting relationship with Internal Audit-supporting its independence from management?	1	2	1	2	2	1	2

2.2.4	Does the unit hold regular private meetings with the 1 director of Internal Audit to allow frank discussion of issues and concerns?	1	1	2	2	2	1	2
2.2.5	Does the unit review with the Internal Audit Director, 2 the public accounting firm and Finance management the audit scope and plan, and coordination of audit efforts to assure completeness of coverage, reduction of redundant efforts, the effective use of audit resources, and the use of independent public accountants other than the appointed auditors of MS?	1	2	2	1	3	1	1
2.2.6	Does the unit consider and review with the public accounting firm and the Internal Audit Director:							
	a. The adequacy of the Company's internal controls 2 including computerized information system controls and security?	1	2	1	2	3	1	1
	b. Any related significant findings and 3 recommendations of the independent public accountants and Internal Audit together with management's responses thereto?	0	3	0	2	4	0	1

4.1.3 Aspect C: Internal Control and Compliance: 22 Items (Table 3) Were Included:

- Overseeing the recommendations on internal control made by internal and external auditing.
- Overseeing the company's compliance with regulations and business ethics, keeping effective control in revealing conflict of interest and errors through reviewing reports of outstanding litigations, major conflict of interests, and various policies of the company.

The results are presented individually in the table below:

Company 1: Overlapping with 6 items, 27%; missing 7 items, 32%.

Company 2: Overlapping with 5 items, 23%; missing 2 items, 9%.

Company 3: Overlapping with 2 items, 9%; missing 0 items, 0%.

Company 4: Overlapping with 5 items, 23%; missing 0 items, 0%.

Company5: Overlapping with 4 items, 18%; missing 0 items, 0%.

The third, fourth and fifth companies show no missing items on internal control and compliance items of supervisory functions, yet every sampled company has overlapping items.

Table 3. The Internal Control and Compliance of Supervisory Functions between the SB and the AC Implemented in China

No.	Appraisal Questions	Overlapping(O) SB AC / Missing (M)							
		O	M	Yes	No	U	Yes	No	U
3.	Internal Controls and Compliance (Total O/M Items)	21	9						
3.1	Internal Control (Total O/M Items)	13	7						
3.1.1	Do the unit's members understand internal controls, their 4 role in the organization, and how they are to work?		0	4	0	1	4	0	1
3.1.2	Does the unit discuss with management any significant 1 deficiencies or material weaknesses identified in the design or operation of internal controls, implications, steps management has taken to ensure the financial reports are reliable, and the adequacy of corrective actions underway, and as appropriate, the committee discusses these internal control issues with the internal and external auditors?		1	1	3	1	3	1	1
3.1.3	Does the unit regularly meet with Internal Audit and 1 discuss internal control deficiencies discovered during the course of its work, its recommendations for addressing the deficiencies, and management's response? Does the committee then monitor the status of management's corrective action?		2	1	3	1	2	2	1
3.1.4	Does the unit discuss with the external auditors any 1 significant deficiencies or material weaknesses discovered during the course of their work and control improvement suggestions? Does it discuss with management how the deficiencies are being addressed?		1	1	2	2	3	1	1
3.1.5	Does the unit consider the need to engage outside 1 advisors (e.g., counsel, forensic auditors) when concerns arise about significant fraud or impropriety on the part of management? Does the unit actively direct such advisors and experts in their engagements?		1	1	1	3	1	1	3

3.1.6	Does the unit regularly review the trends in complaints 2 received about accounting, internal accounting controls, and auditing matters, and is it satisfied with corrective actions taken by management and that management and the external auditors have adequately taken into account the impact of the complaints on the financial statements and the audit?	2	2	2	1	2	2	1
3.1.7	May the unit ask members of management or others to 5 attend the meeting and provide pertinent information as necessary?	0	5	0	0	5	0	0
3.1.8	Does the unit enquire of Finance management, the 5 Internal Auditor head, and the public accounting firm about significant risks or exposures and assess the steps management has taken to minimize such risk to the Company?	0	5	0	0	5	0	0
3.1.9	Is sufficient time provided for private meetings with 4 Internal Audit, external auditors, and management?	0	4	0	1	4	0	1
3.1.10	Does the unit meet with the public accounting firm in 3 executive session to discuss any matters that the unit or the public accounting firm believe should be discussed privately with the unit?	0	3	1	1	4	0	1
3.1.11	Does the unit meet with the Internal Audit Director in 2 executive sessions to discuss any matters that the unit or the Internal Audit Director believes should be discussed privately with the unit?	1	3	1	1	2	2	1
3.1.12	Does the unit meet with Finance management in 4 executive sessions to discuss any matters that the unit or Finance management believes should be discussed privately with the unit?	0	4	0	1	4	0	1
3.1.13	Will the agenda for the unit's meetings be prepared in 3 consultation between the unit's chair (with input from the Committee members), Finance management, the Internal Audit Director and the public accounting firm?	1	3	1	1	3	1	1
3.2	Compliance (Total O/M Items) 9	2						

3.2.1	Does the unit understand and periodically update its 2 understanding of the major legal and compliance risks facing the company, how does management address those risks, what impact the risks have on the financial statements, and how does management monitor for emerging risks?	0	2	2	1	4	0	1
3.2.2	Does the unit monitor the appropriate standards adopted 2 as a code of conduct for the company? Does the unit review with Finance management and Legal and Corporate Affairs the results of the review of the Company's monitoring compliance with such standards and its compliance policies?	0	2	2	1	4	0	1
3.2.3	Does the unit review legal and regulatory matters that 2 may have a material impact on the financial statements, related Company compliance policies, and programs and reports received from regulators?	0	2	2	1	4	0	1
3.2.4	Does the unit periodically discuss with management 1 policies with respect to risk assessment and risk management? This discussion includes an understanding of how management learns about emerging risks.	0	4	0	1	1	2	2
3.2.5	Does the unit provide an open avenue of communication 4 between the Internal Auditors, the public accounting firm, finance management and the BoD? Does the unit report the unit's actions to the BoD / shareholders with such recommendations as the unit may deem appropriate?	0	4	1	0	5	0	0
3.2.6	Has the unit established procedures for receipts, 1 retention, and treatment of complaints received by the company regarding accounting, internal accounting controls, or auditing matters, including anonymous submissions by employees?	2	1	3	1	2	2	1
3.2.7	Shall the unit have the power to conduct or authorize 5 investigations into any matters within the unit's scope of responsibilities? Shall the unit be empowered to retain independent counsel, accountants, or others to assist it in the conduct of any investigation?	0	5	0	0	5	0	0

3.2.8	Does the chair report after each meeting to the 5 board/shareholders' meeting on the unit's activities, major issues discussed, and recommendations for board/shareholder actions?	0	5	0	0	5	0	0
3.2.9	Does the unit provide a report in the annual proxy that 4 includes the unit's review and discussion of matters with management and the independent public accounting firm?	1	4	1	0	4	1	0

Note. O: overlapping; M: missing; U: un-applied.

Overlapping items: it is defined that at least one of the sampled companies performed the identified supervisory functions by ACs and SBs at the same time.

Missing item: it is defined that at least one of the sampled companies did not perform the identified supervisory functions by ACs or SBs at the same time.

4.2 Summary

A summary of the overlapping and missing items and percentages on the integration of the financial reporting, auditing, and internal control and compliance reports from five sampled companies is presented in the table below:

Company 1: overlapping with 16 items, 24%; missing 24 items, 36%.

Company 2: overlapping with 16 items, 24% missing 10 items, 15%.

Company 3: overlapping with 13 items, 20% missing 6 items, 9%.

Company 4: overlapping with 12 items, 18% missing 0 items, 0%.

Company 5: overlapping with 5 items, 8% missing 0 items, 0%.

5. Conclusion

Imposing the singular mechanism of AC on the dual supervisory mechanism of SB in China results in overlapping and omitting problems at three operation aspects. By interviewing five listed companies with practicing both AC/SB simultaneously, this experimental research was intended to point out what should be done in practice between SBs and ACs in China and has offered the operational checklist (Tables 1-3) at helping the internal supervisory mechanism work more effectively in China by providing a benchmark, gained from experience of the five sample companies. The findings show that the five sampled companies implemented the operation items with different distribution between SBs and ACs. No consistency exists among the listed companies as to the current status. The overlapping items reached 24 per cent in company 1 and 2, which may point towards redundant work in one organization; the missing outcome reached 36 per cent of items, which may pose a risk to the organization by omitting oversight of risky items. All sampled companies' interviewees said that "it remains to be seen how these institutions should work together". The further research calls to reveal the

co-ordination between the two institutions in terms of organization. Inter-dynamic relationships in functions will influence the effectiveness of the internal supervisory mechanism. The present research which should be useful as a reference source for other emerging markets and corporations, for future and more in-depth research endeavor to enhance and improve both their research and evaluation of supervisory functions.

The findings from this study contribute to suggestions as to how the functions of the two institutions should be co-ordinated to avoid redundancies and gaps in internal supervision in the future. In addition, this research provides practical proposing how they can improve key operations between two institutions of SBs and ACs. Finally, the investigation and results reported in this article may offer a basis for continuing research on the effectiveness, operation, and co-ordination of supervisory governance after the introduction of an AC in China, and for studies of other monitoring functions such as audit and internal control. The research results of this article may also serve as a useful reference point for carrying out similar studies on this topic in the future.

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5.3 Note

Recent studies on Audit Committee (AC) include those by Block, David and Gerstner, Anne-Marie (2016); Turley and Zaman (2014); Agoglia, Douppnik, and Tsakumi (2011); Brown-Liburd and Wright (2011); Cohen, Dey, and Lys (2005); Krishnan, Wen, and Zhao (2011); Caskey, Nagar, and Petacchi (2010); Magilke, Brian, and Pike (2009); Naiker and Sharma (2009); Abbott, Parker, Peters, and Rama (2007); and Krishnan (2005).

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Notes

Note 1. Section 111 Para. 2 sent. 1 & 2 AktG.

Note 2. Section 171 Para. 1 sent. 1 AktG.

Note 3. Sections 111 Para. 2 sent. 3, 170 Para. 1 & 2, 171 Para. 1 AktG, No. 7.2.2 GCGC.

Note 4. Section 90 Para. 1 AktG.

Note 5. Sections 118 Para. 3 sent. 1, 124 Para. 3 sent. 1, 171 Para. 2 AktG.

Note 6. Section 112 AktG.