AN INVESTIGATION OF THE RELATIONSHIP BETWEEN AUDIT COMMITTEE CHARACTERISTICS AND QUALITY OF FINANCIAL REPORTING IN STATE OWNED ENTERPRISES IN THE TRANSPORT SECTOR

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Dedication

This research study is dedicated to my father, Marksman Chigwena (1936-2011) and mother, Jane Chigwena. Your integrity, humility, love and compassion for all people left an indelible impression on my life; I will be eternally being grateful for your example.

To my wife Sifiso, the woman of my dream and my best friend, I dedicate this research study, and my life to you. You amaze me more every day. When God gave you to me, he gave me the very best. Your unconditional love and enthusiastic spirit have made me into the man that I am today. I love you.

To Tadiwanashe and Tinotenda, my two precious treasures. You bring me more joy than I could have ever hoped for. Being your dad is my greatest reward.
Declaration

I, Percy Chigwena, do hereby declare that this dissertation is the result of my own investigation and research, except to the extent indicated in the Acknowledgements, References and by comments included in the body of the report, and that it has not been submitted in part or in full for any other degree to any other University.

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Abstract

The Zimbabwean economy in general and the State Owned enterprises in the transport sector in particular have been hard hit by a number of operational constraints which include among others; lack of affordable working capital, unavailability of economic enablers such as electrical power, antiquated machinery and poor corporate governance practices.

Lack of effective audit committee has led to massive fraud cases and poor quality financial reporting in state owned companies in the transport sector. This poor quality financial reporting has led to reduced investor confidence and some of these companies are facing total collapse. This problem of poor quality financial reporting has caused the researcher to initiate carrying out the research. The purpose of the research is to establish whether a relationship exists between audit committee characteristics and quality of financial reporting holding other factors constant.

The research was quantitative in nature taking the form of survey zeroing in on the relationship between audit committee characteristics and quality of financial reporting.

The research findings showed that poor quality financial reporting in state owned enterprises in the transport sector were mainly as a result of ineffective audit committees which lacked independence, financial expertise and which did not meet frequently.

Some of the recommendations are that audit committees should at least meet four times a year, the committee should have a minimum of three members with the majority or two thirds being independent members and also that at least one member of the committee should possess financial expertise.
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CHAPTER ONE

INTRODUCTION AND BACKGROUND

1.0 Introduction

The Zimbabwean economy in general and the public sector in particular have been hard hit by a number of operational constraints which include among others: lack of affordable working capital, unavailability of economic enablers such as electrical power, outdated machinery and poor corporate governance.

Focus has been given to corporate governance in recent studies being carried out worldwide after corporate failures of some biggest organizations which include Enron, Aldphia and WorldCom due to corporate scandals. Interest in the role of audit committees has increased recently because it is regarded as a tool of corporate governance whose aim is to increase the role of audit and its independence after failures of many companies (Hamdan and Mushtaha, 2011). Under this unpredictable and complex environment it has become increasingly difficult to predict and control the factors that affect the performance of firms (Kuratko and Morris (2003). Corporate governance is considered to have significant implications for the growth prospects of an economy.

Best corporate governance practice play a very important role in attracting investment capital and enhancing the performance of firms. Corporate governance is organized differently across countries due to differences in the level of economic activity, social and political factors. In this study the researcher carried out an investigation as to whether audit committee effectiveness impact positively on the quality of financial reporting of State Owned Enterprises in the transport sector in Zimbabwe.
1.1 Background

Governance has proved to be an issue since people began to organize themselves for a common purpose. “From the onset, human kind has sought to discover the best way to make decisions for its groups, to find ways to govern so as to resolve disputes, control destructive behaviour, achieve goals that advance mutual welfare of the members of the society” Colley Jnr (2003:13). The effectiveness of a given approach to corporate governance has determined to a large extent, the survival and prosperity of that firm or organization.

Blair, (1997:48) postulates that corporate governance has its origins in the 19th century arising in response to the separation of ownership and control following the formation of joint stock companies. The owners or shareholders of these companies, who were not involved in the day to day operational issues required assurances that those in control of the company, the directors and managers were safeguarding their investments and accurately reporting the financial outcome of their business activities, (Ibid).

Colley Jnr (2003:21) asserted that the need and complexity of corporate governance arose from the practical need to separate ownership and managerial control of organizations as a result of the growth of companies from the sole trader structure to more complex company structures. This cushioned for the need and complexity of the governance theory and has been the evidence of trust by management of companies. This led to the formulation of corporate governance structures which are being continuously improved.

While State Owned Enterprises and corporate governance practices in general have been matters of domestic policy interest for many decades, the broader concept of corporate governance and its relationship with a wide range of public sector performance and operational efficiency has become a cause for concern. Choruma (2008) postulates that every organization should be guided by good business ethics as characterized by discipline, transparency, independence, accountability, fairness and respect. He further explores that all facts in place, ethics make a difference between a board that exceeds and a board that fails.
The dramatic increase in corporate problems such as bankruptcy, scandals and overall lack of ethical behaviour on the part of those entrusted with the direction of the enterprise led to an outcry for a well structured system. The recent cases of poor corporate governance in state owned enterprises has seen some firms collapsing and some failing to settle their debts whilst the bosses were paid very high salaries and allowances which were not in tandem with firm performances. Air Zimbabwe last year had to suspend servicing international routes because international creditors wanted to attach its fleet of aero planes as a way of trying to recover overdue debts. National Railway of Zimbabwe (N.R.Z) is failing to service daily routes for intercity and recently its workers advised management of their intention to stage a strike because of nonpayment of salaries for the past sixteen months. Central Mechanical & Engineering Department (C.M.E.D) was reported to have been duped of close to US$3million in a fuel scam. At Air Zimbabwe we saw the suspension of the Company Secretary and the Chief Executive Officer as they were implicated in an insurance scam involving Navistar Insurance Company. Air Zimbabwe’s problems arise from interplay of factors that include weakly constituted board, abuse by senior government officials, undercapitalization, debt overhang, poor management and corruption (http://www.dailynews.co.zw). The Air Zimbabwe’s procurement manager who is currently on indefinite leave told the court that the airline’s house was not in order as the procurement procedure was fragmented. He said this while testifying in the court and he said that he did not know how Navistar Insurance Company was appointed because the insurance procuring process was under the company secretary’s portfolio. In 2009 Mr. C Nherera, the former chairman of Zimbabwe United Passenger Company (ZUPCO) was convicted of graft charges. He was charged with soliciting for bribes from a South African firm, Gift Investments, who were supplying coaches to ZUPCO and he was said to have gained US$85 000-00 at US$5000-00 for each bus newsdesk@newzimbabwe.com

Most of the Parastatals in Zimbabwe are relying on government support for their survival. Recent outbursts by the minister of finance, Mr. P Chinamasa to the effect that Parastatals that continue to make losses and bleeding the economy through budgetary support will face closure or liquidation is a cause for concern. He pointed out that the
parastatals bleeding the economy need to justify their continued existence. He also indicated that government was contemplating closing several loss making parastatals which he said were hurting economic recovery through perennial dependence on the fiscus. The minister said this while addressing the Institute of Chartered Accountants in Zimbabwe (ICAZ) winter school in the resort town of Victoria Falls in July 2014. He noted that parastatals were grappling with high overheads, inter-parastatal debts, maladministration, undercapitalization, corruption and lack of good corporate governance which have negatively impacted on their operations (www.financialgazette.co.zw). The issue of corporate governance was also touched upon by the ICAZ president at the same seminar when he said, “As widespread breaches of corporate governance that saw capital flight from industry to its burial sites in the mortar and brick in Borrowdale Brooke, Glenlorne, Shawasha Hills and many other new prestigious suburbs the focus is on public sector (www.zimbabweindependent.co.zw).

The beginning of the year saw most of the parastatal heads being exposed of receiving very high salaries and allowances which were not in sync with the performance of firms they were running. During the recent Herald Business Zim- Sino agreements held on the 10th of September 2014, the Minister of Finance Honorable P Chinamasa was asked by the president of Confederation of Zimbabwe Industries (CZI). Mr. K Katsande on what lessons they were learning from China in terms of managing parastatals and how they were ensuring that the country does not go back to the same problems that caused Air Zimbabwe, NRZ and CSC among others to be where they are today. The CZI president went on to ask on how management and leadership were appointed pointed out the fact that there was a tendency of putting politicians on parastatal boards (www.herald.co.zw).

Prior to 2012 regulators pointed out the increasing role of good corporate governance practices by advocating for the National Code of Corporate Governance. This was necessitated by the fact that most state owned enterprises had their financial statements given either adverse or qualified opinions by the office of Comptroller & Auditor General with some going for years without producing audited accounts. Air
Zimbabwe, ZUPCO and NRZ had gone for the period 2009 to 2012 without producing audited accounts. This has demonstrated the problems with the quality of financial reporting and auditing. These scandals and adverse opinion reports have damaged investor confidence in corporate financial reporting and raised doubts about the effectiveness of audit committees. The publicized scandals have highlighted the need for regulators and organizations to improve the effectiveness of audit committees. As pointed out by Carcello et al, 2002, the audit committee has a vital responsibility to the internal audit, including the reviewing of the internal audit programme and ensuring the adequacy of the internal audit activities.

The research aims to show the impact of audit committee characteristics on quality of financial reporting in state owned enterprises in the transport sector in Zimbabwe. Studying the relationship between the audit committee characteristics and quality of financial reporting is important since the current focus on corporate governance has directed attention to the role played by the audit committee in improving the quality of financial reporting.

1.1.1 Macro Environmental Analysis
Businesses do not operate in a vacuum but exist within a broader society that puts its pressures and in the process affecting the way the business compete and make profits. A macro-environmental analysis of Air Zimbabwe, National Railways of Zimbabwe, Zimbabwe United Passenger Company, Civil Aviation Authority of Zimbabwe, Zimbabwe National Road Authority and Central Mechanical Equipment Department was carried out.

1.1.2 Political & Legal
As indicated by events after the elections to present, no meaningful investment has taken place by the outsiders as they await the new government to clearly chart a sustainable economic policy which can override the current foreign 49% to local 51% on every investment above US$500 000-00. Therefore without a consistent policy in place, Foreign Direct Investment injection and multilateral financial support, deindustrialization has continued to be the order of the day. Political interference by senior government
officials in appointing boards and in the day to day running operations of these companies is worsening an already sad situation, (Hawkins, 2013).

1.1.3 Economical
State owned companies in the transport sector have continued to face stiff competition from both local and foreign transport operators. Lack of long term financing continues to hinder any meaningful development in the sector. Therefore with hindsight of the current economic constraints in the Zimbabwean transport sector, only adaptive companies survive. The research aims to highlight good corporate governance practices as one of the potential adaptive strategies.

1.1.4 Technological
Technologically Zimbabwe now lags behind following the lost decade of 2000 to 2009. This was confirmed in the 2013 CZI report that 47% of companies reinvesting in 2013 were replacing worn out machinery and equipment" (CZI, 2013:30). Use of outdated machinery is the major hindrance to the sector performance. Most of the state owned vehicle, railway and aero plane fleet have outlived their lifespan. This problem of failure to replenish ageing fleet has caused the researcher to initiate carrying out the research.

1.2 Problem Statement/ Statement of the Problem
Most parastatal boards are poorly constituted in terms of autonomy, membership, capitalization, lack of commitment and lack of common vision with the leadership. Majority of parastatals are operating under untenable operational framework of obese structures which are difficult to manage, huge debts, skills deficit, operating below optimal levels, failure to settle bills, lax cost control, poor quality financial statements or none at all. Mismanagement, corruption, undue influence from public office, bureaucracy, wastages, incompetency and irresponsibility by directors and employees are the main problems that have made parastatals fail to achieve their expected performance and operational efficiency (Report of the Auditor-General for the year ended December 2012 State Enterprises and Parastatals Volume ii of iii)
The collapse of National Railways of Zimbabwe, scandals at Air Zimbabwe, ZUPCO, VID, ZINARA and CMED and recent outbursts by the Minister of Finance and Economic Development, Mr. P Chinamasa that parastatals that continue making losses and bleeding the economy through budgetary support will face closure or liquidation has caused the researcher to initiate carrying out the research. The Minister noted in the 2014 Mid-Year Fiscal Review Statement presented to parliament in early September that challenges related to public sector enterprises manifest through: unsustainable salaries, allowances and benefits for board members, chief executives and other top managers at the expense of service delivery; weak oversight on public entities under line ministries’ purview; absence of boards to give direction to public entity, with some operating this way for long periods; corrupt practices through diversion of resources, interference on recruitment, selection, staffing and firing of employees; and failure to recover debts from customers which has undermined efforts to raise working capital and payment of creditors. The area of corporate governance continues to attract considerable attention and interest of people. The corporate scandals and failure to produce quality financial statements has cast some doubts on the effectiveness of audit committees since they are tasked with the responsibility of monitoring the integrity of financial statements, reviewing the work of external audit, overseeing the work of internal audit and reviewing the internal control systems of an organization. Had the committees been effective in discharging their mandate they should have prevented some of these problems hence the decision to carry out the research.

1.3 Research Objectives

The major study objective of the research is to establish the relationship between audit committee characteristics and quality of financial reporting.

This objective is broken down into the following sub objectives:

i. Investigate whether a relationship exist between audit committee independence and quality of financial reporting.

ii. Examine the effect of Audit Committee financial expertise on quality of financial reporting.
iii. Establish the relationship between Audit committee size and quality of financial reporting.

iv. Determine whether frequency of audit committee meetings affect the quality of financial reporting.

1.4 Research Questions

The major study research question is as follows:

Do the audit committee characteristics influence the quality of financial reporting in state owned enterprises in the transport sector?

This research question can be further broken down to sub questions as follows:

i. What is the effect of audit committee independence on the quality of financial reporting?

ii. What is the effect of audit committee financial expertise on quality of financial reporting?

iii. What is the relationship between audit committee size and quality of financial reporting?

iv. Does frequency of audit committee meetings influence firm performance?

1.5 Hypothesis

H1: The establishment of effective audit committees has a positive impact on quality of financial reporting.

1.6 Justification of Research

The study will provide the researcher with the research skills for further academic and scientific researches and therefore enhances the researchers’ understanding in the field of corporate governance. The study of the relationship between audit committee characteristics and quality of financial reporting is vital as the current focus on corporate governance has directed the attention to the role played by the audit committee in improving the quality of financial reporting. The research enlightens the researcher on corporate governance issues which can be applied by state owned enterprises and it
also give a platform for the researcher to link theory learnt over the past two years with practice.

To the University, the research will proffer as literature review and will open avenues for further study by other students and members of staff who may in future want to carry out researches in the area of corporate governance. Moreover the findings can be used to cover the educational gaps that might have been omitted by previous researchers. There has not been any reported research of the evaluation of the association between firm performance of State Owned Enterprises in the transport sector in Zimbabwe and audit committee characteristics.

To state owned enterprises, this will go a long way in highlighting the effects of good corporate governance principles. Findings are aimed at improving the operational efficiency and performance of state owned enterprises in the transport sector and state owned enterprises in general. A significant contribution to this study is to provide guidelines for successful implementation of polices meant to enhance the effectiveness of the audit committee. The research will also contribute to literature for future references should the problems in state owned enterprises arise again in Zimbabwe.

1.7 Scope of Research
Forecast of the study is conceptually on the impact of corporate governance mechanisms on performance of state owned enterprises in the transport sector in Zimbabwe. The research will be confined to audit committee characteristics and financial performance of state owned enterprises in the transport sector. The research is limited to state owned enterprises in the transport sector only because we have seventy eight (78) state owned enterprises in Zimbabwe and to try to cover all these sectors will be a daunting task considering the time constraint and costs involved. The research will cover a period of five years from year 2009 to 2013. The period is being chosen because this is the period when the theme of corporate governance issues gathered momentum in Zimbabwe due to dollarization of the economy.
1.8 Dissertation Outline

The dissertation will have five chapters. Chapter one presents the introduction and background of study, problem statement, research objectives and questions, hypothesis, justification of study and scope of research. Chapter 2 deals with literature review which covers an introduction paragraph, relevant theories relating to corporate governance, roles of audit committees, audit committee characteristics and the conceptual framework. Chapter 3 is concerned with the research methodology and this covers areas such as introduction, research design, population and sampling techniques, sources of data, research instruments, data analysis, research limitations and research ethics and data credibility. Chapter 4 deals with quantitative data analysis and areas covered are response rate, population distribution (frequencies), reliability and validity, normality tests, descriptive analysis and inferential statistical analysis. The last chapter which is chapter 5 looks at conclusions and recommendations and we have the introduction, conclusions, validation of research hypothesis, recommendations and areas of further study.

1.9 Chapter Summary

In this chapter the researcher has highlighted the introduction and background of the study, statement of the problem, research objectives, research questions, hypothesis, justification and scope of research. The next chapter will dwell on literature review.
CHAPTER TWO

LITERATURE REVIEW ON AUDIT COMMITTEES AND QUALITY OF FINANCIAL REPORTING

1.0 Introduction and importance of literature review
This chapter dwells on the literature review on corporate governance and audit committees. Review of literature is defined as a deep and warranted analysis of the merits and weaknesses of key literature in a given area of study that is already known, (Saunders, Lewis & Thornhill, 2009). The main purpose of reviewing literature is to gain an understanding and insight of relevant past researches and changes in trends that is taking place. This chapter looks at the empirical and theoretical evidence of articles, journals and textbooks which focuses on literature related to corporate governance and audit committees.

2.1.0 Overview of Corporate Governance
As defined by the King II Report (2002), corporate governance is a system by which companies are directed and controlled, that is leadership. According to Oman (2001) corporate governance refers to laws, regulations and accepted business practices which together govern relationships in a market economy between corporate managers and entrepreneurs on one hand and those who invest resources in corporation on the other. Coyle (2004) defines corporate governance as the way in which companies are governed and to what purposes. Jarrell and Brickley (2007) defines corporate governance as a set of processes, customs, policies, laws, and institutions affecting the way a corporation is directed, administered or controlled. This also includes relationships among the various stakeholders involved and the objectives for which the corporation is administered. Primary stakeholders include shareholders, management
and the boards of directors. Other stakeholders include employees, customers, creditors, suppliers, regulators and the community at large (Kotler and Lee, 2005). Favourable corporate governance regimes assist in ensuring that corporations use their capital efficiently and also aid in ensuring that corporations take into account the interests of a wide range of areas, as well as the communities in which they operate and that their boards are accountable to the company and to the shareholders (La Porta, Lopez –de- Salines, and Shleifer, 1999). This will assist in ensuring that corporations operate for the good of the society as a whole. Investor confidence will be enhanced and maintained from both the national and international markets. Lebens (1995) suggests that such a situation substantially improve a firm’s prospects of making more profits. The OECD (2004) and the King III report (2010) are in agreement that fundamental essentials of corporate governance include integrity, honesty, transparency, accountability, sustainability, responsibility, risk management, independence and compliance.

2.1.1 Theoretical Basis of the Audit Committee

Most of the studies dealing with the study of the audit committee focused on two different approaches namely the Agency theory and Institutional theory.

2.1.2 Agency Theory and the Audit Committee

Agency theory is concerned with contractual relationships within the firm, between the principal and an agent, whose rights and obligations are specified by a contract of employment (Collier and Agyei-Mpomah, 2009). The theory recognizes the behaviour of an agent (the manager) whose actions the principal (shareholder) seeks to influence and control through a management control system.

The principal wishes to influence what the agent does but delegates authority to the agent in an uncertain environment. The agent will in turn expend effort in carrying out the duties assigned and the results are dependent on both the internal and external factors and the amount of effort expended. Accounting reports play a very important role in regulating the activities of agents as they provide output measures from which an agent’s efforts can be inferred though the measure may not accurately reflect the effort.
expended (Collier and Agyei-Mpomah, 2009). This will lead to uncertainty about the relationship between the accounting measure and the agent’s effort expended.

Where the principal cannot observe the agent’s effort or infer it from the measured output, the agent may have the incentive to act in a manner that is not consistent with the employment contract. On the other hand a principal who recognizes the efforts of the agent but without access to the entire information privy to the agent will not be aware whether the effort put by the agent has been based on the agent’s information or whether the agent has 'shirked' (Collier and Agyei-Mpomah, 2009). All these problems are a result of information asymmetry.

Agency relationships are formed when the principal delegates authority to the agent and the welfare of the former is affected by the actions of the later (Arrow 1985). Malatesta (2008), shows that this delegation of decision making authority from the principal to the agent often are typically diverged due to separation of ownership and control in modern corporations.

McConnell and Servaes (2009) and Hafer (2007) agree on the assertion that the agency theory is the theory of the firm that discusses the managerial incentive problems arising out of the separation of ownership and decision making. In the same vein Jensen and Meckling (1976) state that the agency theory posits that agents will not act to maximize the profits of shareholders and that the shareholders have limited ability to monitor whether or not their interests are being perused by the agents.

Jensen and Meckling (1976) defines an agency relationship as a contract where the principal hires the agent to perform services on their behalf and which involve principals delegating some decision making authority to the agent. Agents are entrusted with the responsibility of using and controlling the economic resources of the firm. However the agents may not always act in the best interest of shareholders and shareholders must therefore monitor the activities of managers to ensure that they live up to the provisions of their contracts (Goddard et al 2000). Shleifer and Vishny (1986) and Jensen and Meckling (1976) basing on the agency theory state that principal-agent conflict may arise when management roles are separated from ownership roles, coupled with the
existence of asymmetric information. They argue that this is due to the misuse of company assets arising from the managers’ self interest satisfaction in pursuing projects that are very risky but not prudent with the adverse consequences on the suppliers of capital.

To guard against management failures, Moldoveanu and Martin (2001) argue that shareholders should put in place ratification, monitoring and sanctioning (reward and punishment) mechanism. They defined ratification as mechanisms put in place to validate the decisions of the agent in giving final approval for an initiative or actionable plan of the agent. Monitoring mechanisms are put in place to observe, record and measure the output of efforts of the managers. They went on to define sanctioning mechanisms as measurers designed to provide selective rewards and punishment to the agents with the aim of motivating them to exert effort towards directions that are aligned with the interests of the shareholders.

Power (2002) argues that the primary means of monitoring is through the annual reports (financial statements) whose reliability is enhanced by the audit report. He however notes that accounts may be inadequate for monitoring purposes due to information asymmetry.

Easterbrook (2009) notes that there are two main sources of agency problem: moral hazard (hidden actions including shirking) and adverse selection (hidden information). Moral hazard involves situations in which the agent’s actions are either hidden from the principal or are too costly to fully monitor the behaviour of the top management team, since effort and ability are not easy to observe. On the other hand adverse selection occurs when an agent possesses information which is unobservable or costly for the principal to obtain. Boards of directors are at an information disadvantage when dealing with the chief executive officers.

Following these conflicts between the agent and the principal, companies are obliged to use control mechanisms to reduce agency costs and information asymmetry like the audit committee (Kalbers & al 1988). Similarly Adam (1994) states that in order to reduce agency costs between principals and agents the firm may invest more in the
internal audit function and pay higher fees for external auditors to ensure reliability of the financial reporting and the audit quality.

To ensure effectiveness of an audit committee according to the agency theory managers are encouraged to prepare financial statements or accounting reports adequately specifying the return generated by the firms. Based on the agency theory, Beasley (1996) and Felo & al (2003) provides for the existence of a significant positive relationship between audit committees and quality of financial statements. According to the agency theory the mere existence of an audit committee within the board of directors is enough to ensure quality financial reporting. However Treadway (1987) conclude that the simple reason that an audit committee is present in the board of directors is no guarantee that the committee is effective in discharging its role of overseeing the accounting and financial reporting processes.

2.1.3 Audit Committee: Roles and Responsibilities

An audit committee is a formally constituted sub-committee of the main board which should normally meet at least twice a year (Collier and Agyei-Mpomah, 2009). It further states that the majority of the committee members should be independent. According to Mallin, (2007) the audit committee is the single most important subcommittee of the board because of its specific role of protecting the interest of shareholders in relation to financial oversight. Arens et al (2009) defines an audit committee as a group of persons selected from members of the board of directors who are tasked with the responsibility of retaining the independence of the auditor. Securities and Exchange Commission (SEC) and Sarbanes-Oxley Act (SOX) (2002) defines an audit committee as a committee established by the board of directors 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 and where no such committee exists with respect to the issuer, the entire board of directors is deemed to be the audit committee. The Association of Certified Chartered Accountant (2010) defines an audit committee as a committee of the board of directors consisting entirely of independent non executive directors of whom at least one has had a recent relevant financial experience.
Code 3 of the Combined Code (Financial Reporting Council, 2003) states that the board should establish an audit committee of at least three, or in the case of small companies two members, who should be independent non executive directors. It further states that the board should satisfy itself that at least one member of the board has recent and relevant financial experience.

According to Poonam and Yaspaln (2014), the audit committee should have a minimum of three directors as members and two thirds of the members should be independent. They argue that all members of the committee should be financially literate and at least one member should have an accounting or related financial management expertise. Audit committees play a very crucial role in safeguarding the interest of stakeholders by preventing fraudulent reporting and ensuring transparency and correctness of financial statements.

The primary function of the audit committee is to assist the board to fulfill stewardship responsibilities by reviewing systems of internal control, the external audit process, the work of internal audit and the financial information which is presented to shareholders (Collier and Agyei-Mpomah, 2009). Thus the main roles and responsibilities of the audit committee should include:

i. Monitoring the integrity of the company’s financial statements or annual reports
ii. Reviewing the company’s internal control and risk management systems
iii. Monitoring and reviewing the internal audit function.

Audit committee role is therefore essential to the protection of shareholders and other stakeholder’s interest. Fig 1-3 below shows the main roles of the audit committee.
Figure 1: Role of Audit Committee

An audit committee of a company is charged with the responsibility of overseeing the financial and other reporting processes of an organization to enable to show credibility, integrity and transparency in their operations including financial reporting. According to Carcello et al. 2002 an audit committee has a vital responsibility to the internal audit, including reviewing the internal audit programme and ensuring the adequacy of the scope of the internal audit activities. It is the function of the board to ensure that the audit committee is constituted according to the laid down policies which would make it able to carry out its statutory duties effectively.
2.1.4 Audit Committee Characteristics.

Audit committee characteristics are separated into: Independence, financial expertise, meetings and size while quality of financial reporting is measured by the audit opinion issued by the external auditors. Mohiuddin and Karbhari (2010) in their study found out that an audit committee that will influence corporate financial reporting positively and effectively carry out their agency duties must possess attributes such as independence, financial expertise, membership mix, size and number of meetings.

2.1.5 Audit Committee Independence and Quality of Financial Reporting.

The independence of directors has been widely covered in literature. Previous studies for example by Marrakchi et al (2001) and Bradbury et al (2006) use the percentage of outside directors to measure independence. Abdullah, Shah and Hassan, (2008), Kang and Kim, (2011) state that the independence of audit committees is measured through the ratio of non-executive members in the committee. These studies note that audit committees composed mostly or entirely of independent directors are more independent than other committees. Independence is seen as the single most important element of audit committee characteristic, however the evidence is somewhat mixed. Klein (2002) found out that having outside directors on the audit committee promotes and enhances corporate performance and the return to shareholders. Likewise, Swamy (2011) stated that outside directors in the committee plays an important role in ensuring that corporate governance practices of auditing are adhered to that affect financial reporting. This was supported by Abdullah et al (2008) who noted that firms with majority executive directors and lacking an audit committee are more inclined to commit fraud. According to Sommer (1991) the presence of independent audit committee indicates the commitment of the firm’s corporate governance practices. In the same vein Kirkpatrick (2009) found that audit committee contributes to better share price if it has non executive director because they have better understanding of financial risk. Similarly Lona, (2008), Kyereboah, Coleman (2007) and Aanu, Odianonsen and Foyeke (2014) proved that there was a positive relationship between the independence of audit committee members and quality of financial reporting.

According to DeFond and Francis (2005), independent directors are better monitors of management than inside directors. Similarly Chan and Li (2008) find evidence that the presence of independent and expert members on the board increases firm value. This view was also supported by Rosenstein and Wyatt (1990) who find the inclusion of outside directors on the committee as being associated with abnormal stock returns. In the same manner Sandra, Garba and Mikailu, (2011) states that outside directors are
seen as acting in the interest of shareholders which makes significantly excess return following the appointment of non executive directors.

Beasley, Carcello, Hermanson and Lipides (2000) found that firms with less independent audit committee members are likely to commit fraud. Moreover, Chen and Jaggi (2000) and Erickson et al (2003) provide a positive relationship between the proportion of independent audit committee members serving in the board and the comprehensiveness of financial disclosure.

Also Chan and Li (2008) states that high levels of independence and financial expertise on board and audit committees increases firm value. The reason being that the level of independence of audit committee members is associated with improved monitoring of the financial reporting process (Bronson et al. 2009). Anderson, Mansi and Reeb (2004) found that full independent audit committees bring about lower debt financing costs. Beasley (1996); Carcello and Neal (2003) and Abbott et al. (2002) are in agreement that independent audit committees lead to more effective monitoring of financial reporting.

Dehaena et al (2001), Omar (2003) and Rhodes et al (2002) found that proportion of non executive directors have a positive relationship with financial reporting. Similarly studies by Krivogorsky (2006), Lefort and Urzu’a (2008) and Limpaphayom and Connelly (2006) found a positive relationship between the proportion of independent directors and financial reporting. Hasnah (2009) also showed that non executive director is significantly related to firm performance that is measured by return on assets. In the same vein Bryan et al (2004) found that the independence of the audit committee has a positive impact on the quality of earnings. In addition, in a study on the main characteristics of audit committees, Keasley et al (1993) proved that independence of members of the audit committee was the most important criterion with effect on the reliability of annual reports or financial statements. Studies by Kirkpatrick (2009) found that independent members on the audit committee contribute to a higher market value because they have a better understanding of the risk appetite of firms and that shareholders value solid risk practices and reward firms with enhanced market value.
However, studies by Bhagat and Black (2002) find no significant relationship between the ratio of outsider versus insider board members and firm performance. In the same vein, studies by Coles et al. (2001) demonstrated that there is a negative relationship between outside directors and firm performance. This was also supported by Erickson et al. (2005) who could not find a positive association between the independence of the board and quality of financial reporting. Similarly, Shama et al. (2009) stated that independence has a downside risk as being completely separated from management could mean that the independent audit committee members see less industry issues which negatively impacts on the level of monitoring. In the same vein, studies by Sunday (2008) of non-financial listed companies in Nigeria could not provide a significant association between them.

Despite some of the findings that there is a negative relationship between audit committee independence and quality of financial reporting, the researcher supports the view that there is a significant positive relationship between audit committee independence and the quality of financial reporting. Very little research has been carried out in developing countries, especially Zimbabwe, on the relationship between audit committee independence and quality of financial reporting.

Based on the foregoing, the following hypothesis is proposed:

H1: A positive relationship exists between audit committee independence and quality of financial reporting of State Owned companies in the transport sector.

2.1.6 Audit Committee Financial Expertise and Quality of Financial Reporting.

Zabihollah (2003) defined financial literacy as the ability to read and understand fundamental financial statements including balance sheet, income statement and cash flow statements. According to Yang et al. (2005) and Carcello et al. (2006), audit committees must have the necessary expertise primarily on accounting and financial predictions for them to fulfill their responsibility of oversight, internal control and financial reporting. Dezoort (1998), Kalbers and Fogarthy (1993) view knowledge and experience in accounting and finance as some of the most important elements for the effectiveness
of the audit committees. Similarly Carcello et al (2002) states that experience in accounting, audit and finance, and professionally qualified or certified accountants are the most important characteristics to be considered as an expert. In the same vein De Zoort et al (2002) showed that audit committee members’ oversight experience and knowledge in accounting, auditing and finance make judgments more similar to external auditors than less experienced audit committee members.

Hollingswork, Klein and Neil (2006) opined that having a member of an audit committee that possesses a financial expertise would likely reduce earnings management for firms where the corporate governance mechanisms are weak. In the same vein Qin (2007) found that firms with higher quality of earnings are more associated with audit committee members with financial expertise. According to Sezoort and Salterio (2001) and Mc Daniel et al (2002) financial expertise impacts audit committee members’ judgments and financial reporting related outcome. Likewise Agrawal and Chadha (2005) found that the probability of restatements of financial statements is significantly lower when the committee possesses financial expertise. In addition Bouaziz (2012) found that audit committee financial expertise has a significant impact on return on assets and return on capital employed. Krishnan and VisVanathan (2008) states that recent researches confirm that accounting expertise within boards that are characterized by strong governance contributes to greater monitoring by the audit committee and leads to enhanced conservatism. Similarly studies carried out by Dechow et al(1996); Raghunandan and Rama (2007) suggests that having experienced members on the audit committee contributes significantly to less misreporting and more effective monitoring. This was supported by Yang and Krishman (2005) who found that independent audit committees with financial expertise are significantly less likely to be associated with the incidence of internal control problems.

Burrowes and Hendicks (2005) state that audit committees with financial expertise are very important as they show support for the credibility of financial statements and the quality of reported earnings (Qin, 2005). In the same vein Zhuang et al (2007), Hoitash et al (2009), and Naiker and Sharma (2009) find that the presence of director with accounting expertise is associated with a lower likelihood of internal control problems.
Studies by Raghanandan and Rama (2007) proved that there was a significant positive association between the proportion of accounting experts and the number of audit committee meetings, but that there was no such relationship for non accounting experts. In Zimbabwe no studies have been carried out to find the relationship between audit committee financial expertise and financial performance. This leads the researcher to hypothesize the following:

**H2:** The expertise and experience of the members of the audit committee in accounting and finance positively impacts on the quality of financial reporting of state owned enterprises in the transport sector in Zimbabwe.

### 2.1.7 Audit Committee size and Quality of Financial Reporting

Cadbury Committee (1992) note that the size of audit committee is also one of the attributes considered to have an impact in the carrying out of its duties. It suggests that the audit committee should have three members as a minimum. Al- Sa’eed and Al-Mahamid (2011) note that it is the requirements of some stock exchange that the audit committee for the listed companies must be made up of at least three members. A number of corporate governance reports (Blue Ribbon Committee, 1999; New York Stock exchange, 2002; Capital Market Authority, 2006) proposed three (3) audit committee directors. It is argued that a larger committee has greater organizational status and authority (Braiotta, 2000; Kalbers and Fogarty, 1993) and a wider knowledge base (Karamanou and Vafeas, 2005). Sunday, (2008) argue that large audit committee size provides more skilled members serving on the committee leading to improved firm reporting. In the same vein Pincus et al (1989) prove that firms with larger audit committee members are expected to devote significant resources to monitor the process of reporting accounting and finance. Studies by Kyereboah and Coleman (2007) and Yasser et al (2011) also find a positive relationship between audit committee size and firm performance. To support this Felo, Krishnamurthy and Solieri (2003) also find a positive relationship between audit committee size and quality of financial reporting.

Similarly Anderson et al (2004) find that committees with a large number of directors ensures the protection and control of the financial reporting process compared to small
audit committees by bringing in more transparency with respect to stakeholders thereby positively influencing the quality of financial reporting in organizations. This was supported by Chtourau and Courteau (2004) who argue that when the audit committee is large, the control and oversight functions over the accounting and financial processes increases. In agreement to this Mansi and Reeb (2004) observe that committees that are large have the potential to protect and control the process of accounting and finance by bringing greater transparency. This view was supported by Pfeffer (1987) and Pearce and Zahra (1992) who argue that audit committees that are small does not have the diversity brought about by larger committees with regard to knowledge and skills thereby making them less effective. This therefore demonstrates that they will review the internal audit programme (Read and Raghunandan, 2001) which significantly reduces the potential for misappropriating company assets (Mustafa and Youssef, 2010).

On the other hand, Vafeas (1999) state that larger audit committees can also lead to the inefficient governance by yielding more frequent audit committee meetings. Likewise Lin et al (2008) stated that smaller audit committee size improves quality of financial reporting because large audit committee size may reduce cooperation in the committee. This was again supported by Yermack (1996), Kalbers and Fogarty (1996) who report that a large number of members in the audit committee may lead to unnecessary debates and delay in decision making.

Lipton and Lorsch (1992) also state that the board might become less effective in monitoring if the audit committee size increases. In the same vein Jensen (1993) confirmed that the smaller committee size is more correlated with the quality of monitoring. Wright (1996); Abbott and Parker (2000); Klein (2002) and Carcello and Neal (2003) suggest that smaller rather than larger audit committees are associated with higher financial reporting quality. The results of Klein’s study indicate that smaller audit committee size is preferred to bigger audit committee size because it leads to reduce the earnings management. MakandKushnadi (2005) in his study of firm performances in Malaysia and Singapore could not provide any relationship between the size of audit committees and quality of financial reporting. There have been very few
studies in developing countries that examined the effect of audit committee size and quality of financial reporting. The researcher strongly believes that there is a positive relationship between audit committee size and quality of financial reporting.

This brings the researcher to ask for a third hypothesis:

H3: There is a positive relationship between the size of the audit committee and quality of financial reporting.

2.1.8 Frequency of Meetings of the Audit Committee and Financial Performance.

According to Poonam and Yaspal (2014) the audit committee should meet at least four times in a year and not more than four months should elapse between two meetings. They argue that the quorum should be either two members or one third of the members of the committee whichever is greater, but there should be a minimum of two independent members present. The number of audit committee meetings is regarded as an important attribute for their effectiveness in monitoring (Lin, Li, and Yang, 2006). Jackling and Johl (2009) and Lipton and Lorsch (1992) also believe that the more frequent the audit committee meetings are, the more likely they will result in superior performance of the firm.

Xie et al (2003) consider audit committee meetings as a proxy for audit committee activity. They argue that audit committees that meet more regularly with internal auditors are better informed about auditing and accounting issues. The audit committee can direct the proper level of internal audit function to address an important auditing or accounting issue that arises if it meets frequently. Prior research suggest that audit committees that meet frequently are more likely to be informed of current auditing issues and are more diligent in fulfilling their duties. The code of best practice recommends that the audit committee meets not less than three times a year. Chen and Zhou (2004) find that audit committee meetings serve as an important tool for improving and promoting corporate governance in firms. Stewart and Munro (2007) states that financial fraud would be reduced if the audit committee meets frequently and carry out its duties as required. Similarly Abbott et al (2004) and Raghunandan et al (1998)
argued that audit committees that meet frequently can reduce the possibility of fraud. To support this Beasley et al (2000) find that fraudulent firms with earnings misstatements have fewer audit committee meetings than non-fraud firms. In the same vein inactive audit committees with fewer numbers of meetings are unlikely to effectively supervise management (Menon and Williams, 1994). An active audit committee which meets frequently has sufficient time to superintend over the accounting and financial reporting process, monitoring the internal controls and identifying company risks. Hsu (2007) find that there is a positive relationship between audit committee meeting and quality of financial reporting. Similarly Carcello et al (2002), and Goodwin-Stewart and Kent (2006) found a positive relationship between the number of audit committee meetings and audit fees.

Price Water House Coopers (1999) finds out that audit committees among European countries met on average three to four times a year. According to findings from a survey carried out by Menon and Williams (1994) audit committee meetings increase as the percentage of outside directors increase. Attwood (1986) states that in practice the timing of meetings of audit committees need to be scheduled well in advance in order to fit in with the time table for the production of the company’s interim and final accounts.

However studies by Al-Matari et al (2012) and Mohd (2011) find an insignificant or no relationship between audit committee meeting and firm performance. The researcher is of the view that the number of meetings may be beneficial to the company if the benefits outweigh costs incurred. There have been very few studies that examined the influence of audit committee meetings on the quality of financial reporting. Hence the researchers’ fourth hypothesis:

H4: The frequency of meetings of the audit committee members positively influences the quality of financial reporting of state owned companies in the transport sector in Zimbabwe.

2.2.0 Conceptual Framework

The figure 4 below presents the relationship between audit committee characteristics namely: audit committee size, audit committee financial expertise, audit committee
independence and the frequency of audit committee meetings and quality of financial reporting.

**Figure 4: Conceptual Framework**

<table>
<thead>
<tr>
<th>Independent Variables</th>
<th>Dependent Variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Audit Committee Size</td>
<td>Quality of Financial Statements (Audit Opinion Report)</td>
</tr>
<tr>
<td>Audit Committee Independence</td>
<td></td>
</tr>
<tr>
<td>Financial Expertise of Audit Committee Members</td>
<td></td>
</tr>
<tr>
<td>Frequency of Audit Committee Meetings</td>
<td></td>
</tr>
</tbody>
</table>
In order to measure the quality of financial statements external audit reports were used. There are four different types of audit opinions issued by the external auditors namely;

1. Disclaimer of opinion report is issued when the auditor is unable to gather certain relevant facts regarding the financial condition of an organization.
2. Adverse opinion report is issued on the financial statements of an organization when they are materially misstated and such misstatements have a pervasive effect on the financial statements.
3. Qualified opinion report is issued where the auditor encounters one of two types of cases which do not comply with generally accepted accounting principles but the rest of the financial statements will be fairly presented.
4. Unqualified opinion report is expressed by the auditor when he/she concludes that the financial statements gives a true and fair view of the financial position of a company in material respects in accordance with generally accepted financial reporting framework.

2.2.1 Chapter Summary

In this chapter the researcher has touched on the introduction and importance of literature review, overview of corporate governance, theoretical basis of the audit committee, roles and responsibilities of the audit committee, audit committee independence and financial performance, audit committee members’ financial expertise and firm performance, audit committee size and financial performance, frequency of meetings of audit committee and financial performance and the proposed conceptual framework. The next chapter will deal with the research methodology.
CHAPTER THREE

RESEARCH METHODOLOGY

3.0 INTRODUCTION

The previous chapter focused on literature review of audit committee characteristics and financial performance of the firm. This chapter examines the methodology used by the researcher and the justification for the chosen methodology. The chapter will examine the philosophical basis of the research used to collect and analyze data during the study. This chapter will therefore discuss the research design, target population, research instruments, sample and the technique and methods used to collect, process and analyze data. The chapter will also detail measures to be taken during conducting the research process so as to obtain accurate and effective results. A detailed account of the data sources and the types of data collected from different organizations will also be presented in this chapter.

3.2 Research Design

A research design links the empirical data to the questions of the research up to the conclusion, Yin (2003). According to Saunders et.al (2009) a research design is a plan on how the researcher wants to obtain answers to the research questions and this plan should contain objectives that are clear which are derived from the research questions, identify the sources of data to be collected and the constraints encountered by the researcher.

The researcher used a descriptive survey research design to find the opinions of individuals in the target population regarding the impact of Audit committee characteristics on quality of financial statements. Collins and Hussey, (2003:66) define a descriptive survey as a technique used to gather statistical information about attributes, attitudes or actions of a population by administering standardized questions to some, or
all of its respondents. Surveys include personal interviews, postal and self administered questionnaires.

To assess the quality of financial reporting of companies surveyed the external audit reports were used. As discussed in the previous chapter, there are four different types of audit opinions issued by the external auditors namely;

1. Disclaimer of opinion report is issued when the auditor is unable to gather certain relevant facts regarding the financial condition of an organization.
2. Adverse opinion report is issued on the financial statements of an organization when they are materially misstated and such misstatements have a pervasive effect on the financial statements.
3. Qualified opinion report is issued where the auditor encounters one of two types of cases which do not comply with generally accepted accounting principles but the rest of the financial statements will be fairly presented.
4. Unqualified opinion report is expressed by the auditor when he/she concludes that the financial statements gives a true and fair view of the financial position of a company in material respects in accordance with generally accepted financial reporting framework.

Preliminary survey by the researcher found that most of the State Owned Enterprises in the transport sector submit their audited accounts to the parliament of Zimbabwe were they can be accessed easily by the public. Data was subjected to statistical tests such as correlation using the SPSS version 20 package in order to get a clear picture of the relationship.

3.2.1 Research Philosophies
Research work is based on some underlying assumptions on what a valid research should contain and the most appropriate methods. Knowledge of these assumptions is therefore necessary in order to carry out a valid research. There are two major philosophies that have been identified according to Galliers (1991). These philosophies are the interpretivist and the positivist. As explained by Bhattacherjee (2012) the positivist methods have the intention of testing theory whereas the interpretivist
methods are focused on establishing the theory. This research study adopted the positivist research paradigm. This paradigm goes well with the research constructs expounded in chapter one of this study because it is the researcher’s intention to understand whether Audit Committee characteristics impacts positively or negatively on financial performance of State Owned Enterprises in the transport sector. This paradigm was selected because the data collected by the researcher from the different organizations was largely quantitative and also the need to provide a quantitative interpretation of the research findings from the sampled population.

3.2.2 Research Approaches

White (2000) note that there are two approaches to conducting a research and these are the quantitative and qualitative. The quantitative approach uses what is termed deductive reasoning where a hypothesis is formulated first and then collects data whilst the qualitative approach uses the inductive reasoning where data is collected first and then arrive at possible explanations. This research study used the quantitative approach. The use of the quantitative approach was justified by time and financial constraints on the part of the researcher. The quantitative approach was also justified because the data was collected from many sources and used to determine the frequency of observations from the relevant management levels. According to Kothari (2004) qualitative research is used mainly to explain possible associations between gathered data and the theory. Advantages of using the quantitative methods are that it relies on mathematical analyses and is objective and also the fact that the findings can be replicated. However the weakness of the approach is that it may not always measure social phenomena and this reduces the validity of findings.

3.3 Population and Study Area

State Owned Enterprises in the transport sector in Zimbabwe were used as the population and eight firms were used in the sample selected on the basis of availability of secondary data and other required variables. The research study covered the major State Owned Enterprises players in the transport sector in Harare which is the capital city. Harare was chosen because most of these companies are headquartered in the capital city and also because that was where the researcher had access to the key
study participants. The research was also limited to Harare due to both financial and time constraints. As such State Owned Enterprises in the transport sector formed the study population of this research. The transport sector has nine (9) players. The transport sector was chosen because some of these firms in this sector were identified for restructuring by the Minister of Finance and Economic Development as there was evidence of malperformance.

3.3.1 Sampling Procedure
A sample size of eighty (80) respondents from the six transport sector players were selected as indicated below in table 1. A sample of six out of nine players was selected so that the sample become more representative of the study population as the larger the sample the more representative it becomes.

Figure 5: Target Sample

<table>
<thead>
<tr>
<th>Company</th>
<th>Target Group</th>
<th>Number Sampled</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air Zimbabwe Holdings</td>
<td>Middle Management</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>Senior Management</td>
<td>8</td>
</tr>
<tr>
<td>NRZ</td>
<td>Middle Management</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Senior Management</td>
<td>4</td>
</tr>
<tr>
<td>CMED</td>
<td>Middle Management</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>Senior Management</td>
<td>4</td>
</tr>
<tr>
<td>ZUPCO</td>
<td>Middle Management</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>Senior Management</td>
<td>6</td>
</tr>
<tr>
<td>CAAZ</td>
<td>Middle Management</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>Senior Management</td>
<td>4</td>
</tr>
</tbody>
</table>
Sampling procedures can either be probability or non-probability sampling. The sample was arrived at by using stratified random sampling procedure which made the researcher to randomly select holders of information essential to the study at hand. Stratified random sampling was used because the population was heterogeneous (different levels of management). The population was divided into strata or groups in such a way that there was greater homogeneity within groups and differences between the strata. Simple random sampling was then used to draw a sample from each stratum. Respondents were drawn from two strata namely middle management and senior management. The following are some of the advantages of using the stratified random sampling procedure:

i. It ensures representation of all groups
ii. A random sample can be kept small in size without losing its accuracy
iii. Characteristics of each stratum can be estimated therefore comparisons can be made.

A major drawback of this sampling technique is that it is costly to prepare stratified lists of all members.

3.4 Data Sources

Two types of data that can be used in research are primary and secondary. Primary data is collected raw i.e. directly from the participants whereas secondary data is found from other sources which are not the participants. The researcher mainly used data collected directly from the participants in the form of questionnaires. For secondary data the researcher used mainly the published annual reports from the companies and articles from newspapers. According to Salant and Dillman (1994), internet and

<table>
<thead>
<tr>
<th>ZINARA</th>
<th>Middle Management</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Senior Management</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total Sample</strong></td>
<td></td>
<td><strong>80</strong></td>
</tr>
</tbody>
</table>
databases with data mining capabilities may also be included in secondary data sources.

3.5 Data Collection Procedure

In order for the researcher to receive information about the specified target group a descriptive survey strategy was used. This strategy is usually associated with the deductive approach which was used by the researcher. This is a technique used for gathering statistical information about attributes, attitudes or actions of a population by administering standardized questions to some, or all of its members (Collins and Hussey, 2003:66). The survey strategy allows one to collect quantitative data which can be analyzed quantitatively using descriptive and inferential statistics. The data collected using survey strategy was used to suggest possible reasons for particular relationships between independent and dependent variables and to produce models for these relationships. The use of survey strategy enabled the researcher to be in control of the research process and because a sample was used it was possible to generate findings that could be representative of the whole population at a lower cost than collecting data for the whole population.

With structured surveys same information about all the cases in a sample is collected; questions are standardized and the objective is to get consistent answers to consistent questions. Structured surveys use formal lists of questions asked of all respondents in the same way. Surveys include self administered or postal questionnaires or personal interviews. The researcher personally delivered the questionnaires and e-mailed some to respondents who could not be contacted easily. Prospective respondent were first given notices in writing.

A letter proving that the researcher was from the Graduate School of Management carrying out a research signed by the Director was used to obtain required information from the different organization. This letter was presented to the human resources department which in turn consulted with the Chief Executive Officer for approval and permission was granted. With some of the organizations the researcher had to get a letter of authority from the permanent secretary of the Ministry of Transport and
Infrastructure Development for them to grant the researcher permission to carry out the research on the company because of the sensitivity of some of the information required.

The researcher designed a close ended questionnaire which was administered to the target population in the surveyed State Owned Enterprises in the transport sector in order to address the research questions. The administered questionnaire consisted of three sections (Appendix 1). The appendix was designed in accordance with the requirements of the study. The questionnaire was made short enough to retain the attention of the respondent but long enough to capture all the necessary information. Section A was an introduction section where the researcher introduced himself indicating the purpose of the study. The second section (section B) was a general information section where the demographic information was collected. The last section (section C) collected data that was pertinent to the subject under study.

Close ended questions have the advantages of ease of response by the responded, can be administered to a large number of people at the same time and respondents will respond to the same questions. Questionnaires are completed privately and this gives the respondents the leeway to truthfully answer the questionnaire without fear of being exposed. This proved to be cost effective, convenient in collecting data and ensured anonymity and uniformity.

The major disadvantage of the questionnaire is that respondents may show lack of interest to fill the questionnaire resulting in low response rate. Another disadvantage of the questionnaire is that the researcher will not be available to elucidate further issues were it is not clear to the respondents and this may lead to participants providing incorrect information.

3.5.1 Pre-piloting the questionnaire

Two and half weeks were spent pre-piloting the questionnaire to check the questionnaire in terms of understandability by participants, presentability, whether it achieves objectives or not and also the nature of the results expected. Changes after the pre-test were noted and effected on the questionnaire. The pre-pilot study was carried out by consulting at the work place and Graduate School of Management.
3.6 Data analysis

Analysis of data was carried out using the SPSS V20. Data was also presented on the basis of tables/graphs, frequency counts and correlation analysis.

The correlationship analysis was done between audit committee characteristics (independent variables) and quality of financial reporting as way of determining the relationship between the variables. Correlation gives a measure of the strengths of the relationship between variables. Correlations closer to +1 implies a perfect positive relationship and correlations closer to -1 means that there is a perfect negative relationship. A correlation of zero (0) implies that there is no relationship.

3.7 Research Limitations

The researcher had limited time to carry out the research due to overwhelming work commitments. However the researcher had to ask for some leave days so as to carry out the research. In some cases the researcher was at first denied access and was asked to get permission from the permanent secretary’s office in the Ministry of Transport and Infrastructural Development.

A letter to the permanent secretary seeking permission to carry out the research in those organizations was written and was duly responded to giving the researcher the go ahead to carry out the research. With most of the organizations only the letter from the Graduate School of Management signed by the Director was suffice to be granted permission to carry out the research as it clearly stated that the research was purely for academic purposes and that the institution values confidentiality and integrity.

3.8 Research Ethics and Data Credibility

The research design was designed in such a way that it did not subject participants to embarrassment, harm or any other material disadvantage, Anonymity of actual participants was ensured as no names were asked for in the questionnaire. In the introductory part of the questionnaire it was made clear that participation was voluntary and participants were free to withdraw or not to answer any question which they find objectionable. Confidentiality issues were also guaranteed as can be shown in the introductory remark of the research instrument shown in the annexure.
Reliability and validity are the two main issues on credibility of the research. Reliability is about the extent to which the researchers’ data collection techniques or analysis procedure will yield consistent results (Saunders at al 2009). Care was taken by the researcher to ensure that results will be reproducible and repeatable.

Validity is concerned with the accuracy of the results. The research instrument was designed to ensure that it measured what it was suppose to measure. In the research instrument (questionnaire) participants were asked to participate honestly as the information obtained from the study was very important to the researcher, policy makers and business practitioners.

3.9 Chapter Summary

The chapter touched on the research design, research philosophy used and the reasons for choosing the research design. The chapter also looked at the research approaches, population and sampling technique used, sources of data, data collection, research instruments, data analysis, research limitations and research ethics and data credibility. The next chapter discusses the research findings.
CHAPTER FOUR

RESEARCH ANALYSIS, PRESENTATION AND DISCUSSION

4.1.0 Introduction
Chapter 3 dwell on research methodology and this chapter deals with research findings, analysis of data and discussion conducted on the investigation of the relationship between audit committee characteristics and quality of financial reporting in state owned enterprises in the transport sector. This chapter will deal with the findings of the research study and objectives are addressed. The findings are from the returned questionnaires distributed to respondents from the six organizations sampled.

4.1.1 Response Rate
The table below shows the responses obtained from the survey

*Figure 6: Responses*

<table>
<thead>
<tr>
<th>Company</th>
<th>Target Group</th>
<th>Number Sampled</th>
<th>Responses</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air Zimbabwe Holdings</td>
<td>Middle Management</td>
<td>12</td>
<td>10</td>
<td>83.33</td>
</tr>
<tr>
<td></td>
<td>Senior Management</td>
<td>8</td>
<td>6</td>
<td>75.00</td>
</tr>
<tr>
<td>NRZ</td>
<td>Middle Management</td>
<td>8</td>
<td>7</td>
<td>87.5</td>
</tr>
<tr>
<td></td>
<td>Senior Management</td>
<td>4</td>
<td>4</td>
<td>100</td>
</tr>
<tr>
<td>CMED</td>
<td>Middle</td>
<td>6</td>
<td>6</td>
<td>100</td>
</tr>
<tr>
<td>Management</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------</td>
<td>----------</td>
<td>----------</td>
<td>----------</td>
<td></td>
</tr>
<tr>
<td>Senior Management</td>
<td>4</td>
<td>3</td>
<td>75</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ZUPCO</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle Management</td>
<td>8</td>
<td>8</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Senior Management</td>
<td>6</td>
<td>5</td>
<td>83.33</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CAAZ</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle Management</td>
<td>6</td>
<td>5</td>
<td>8.33</td>
<td></td>
</tr>
<tr>
<td>Senior Management</td>
<td>4</td>
<td>4</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ZINARA</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Middle Management</td>
<td>10</td>
<td>8</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td>Senior Management</td>
<td>4</td>
<td>4</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Sample</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>80</td>
<td>70</td>
<td>87.5</td>
<td></td>
</tr>
</tbody>
</table>

A total of 80 middle and senior managers from the different organizations were selected to participate in the survey. Therefore a total of 80 questionnaires were distributed to the respondents and of these 70 were duly completed and sent back to the researcher. This represented a response rate of 87.5%. The response rate was high because the research topic aroused some interests from the respondents as the area of corporate governance has received wide attention. The fact that respondents were assured of confidentiality and anonymity also triggered the high response rate despite the sensitivity of the study. The higher the responses rate the more the chances of obtaining accurate results.
4.1.2 Validity and Reliability

Content validity test was carried out on the questionnaire by sending the questionnaire to experts in corporate governance and audit field. A pre-pilot was then carried out and adjustments to the questionnaire where the questions were not clear were made. This was done to ensure that the research instrument was measuring what it was suppose to measure. Before analyzing the data a reliability test of the data was carried out. This was meant to check whether items in the questionnaire are independent of each other. The Cronbach Alpha test was applied to check the reliability of data. The table below indicates the results of the reliability of the questionnaire.

From the table it can be seen that the Cronbach alpha values ranges from 0.883 to 0.926. The values are well above the recommended value of 0.7 indicating that the questions on the questionnaire were independent of each other.

*Figure 7: Cronbach Alpha Reliability Test for Individual Variables.*
<table>
<thead>
<tr>
<th>Item</th>
<th>Scale Mean if Item Deleted</th>
<th>Scale Variance if Item Deleted</th>
<th>Corrected Item Total Correlation</th>
<th>Cronbach's Alpha if Item Deleted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you agree that Audit committee that possess financial expertise impact positively on quality financial reporting</td>
<td>50.0000</td>
<td>34.870</td>
<td>.560</td>
<td>.895</td>
</tr>
<tr>
<td>High incidences of internal control problems in the organization can be traced to lack of financial expertise of audit committee members</td>
<td>50.1429</td>
<td>34.414</td>
<td>.709</td>
<td>.890</td>
</tr>
<tr>
<td>Restatements of financial statements in my organization is linked to lack of financial expertise by the audit committee members</td>
<td>50.1429</td>
<td>34.414</td>
<td>.709</td>
<td>.890</td>
</tr>
<tr>
<td>Failure to publish financial statements timeously in the organization can be attributed to lack of financial expertise by members of the audit committee</td>
<td>50.1429</td>
<td>34.414</td>
<td>.709</td>
<td>.890</td>
</tr>
<tr>
<td>Do you agree that large audit committee size provides more skilled members in the committee leading to improved quality financial statements</td>
<td>51.6714</td>
<td>39.093</td>
<td>-.006</td>
<td>.921</td>
</tr>
<tr>
<td>Audit committee of my organization is large enough to protect and control the process of accounting and finance by introducing greater transparency with respect to shareholders and creditors</td>
<td>50.5714</td>
<td>37.814</td>
<td>.286</td>
<td>.904</td>
</tr>
<tr>
<td>Outside directors in the audit committee promotes and enhances quality financial statements</td>
<td>50.1429</td>
<td>32.820</td>
<td>.883</td>
<td>.883</td>
</tr>
<tr>
<td>Fraud cases in the organization are high because the audit committee lacks independence</td>
<td>50.2857</td>
<td>31.424</td>
<td>.796</td>
<td>.884</td>
</tr>
<tr>
<td>Failure to produce annual reports timeously is linked to lack of independence of the audit committee</td>
<td>50.2857</td>
<td>31.424</td>
<td>.796</td>
<td>.884</td>
</tr>
<tr>
<td>Do you agree that the more frequent the audit committee meetings are the more likely they will result in quality financial reporting</td>
<td>50.0286</td>
<td>33.101</td>
<td>.858</td>
<td>.884</td>
</tr>
<tr>
<td>An audit committee which meets frequently has more time to oversee the financial reporting process, identify management risk and monitor internal controls</td>
<td>50.0286</td>
<td>33.101</td>
<td>.858</td>
<td>.884</td>
</tr>
<tr>
<td>Cases of financial fraud in the organization are a result of the audit committee meeting less frequently with both internal and external auditors</td>
<td>50.0286</td>
<td>33.101</td>
<td>.858</td>
<td>.884</td>
</tr>
<tr>
<td>Internal control problems in the organization are a result of the audit committee meeting less frequently</td>
<td>50.0286</td>
<td>33.101</td>
<td>.858</td>
<td>.884</td>
</tr>
<tr>
<td>For the financial years 2010 to 2013 indicate the auditor's opinion on the financial statements</td>
<td>52.0286</td>
<td>39.188</td>
<td>-.030</td>
<td>.926</td>
</tr>
</tbody>
</table>
Table 4: Reliability Statistics

<table>
<thead>
<tr>
<th>Cronbach’s Alpha</th>
<th>N of Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>.901</td>
<td>14</td>
</tr>
</tbody>
</table>

The threshold for reliability (internal consistency) is 0.7 and results obtained indicated 0.901 which is well above the threshold an indication that the data collected can be relied on.

4.2. Demographic Information

The tables below show the demographics of the respondents.

Figure 8: Age
From the table it can be seen that the majority of the respondents were in the range between 36 and 55 years as they have a combined total of 82.9%. Only 4.3% of the respondents were above 55 years. Those below 35 years were only 12.9%.

**Figure 9: Gender**

The results indicate that there are fewer females than men as they constitute only 31.4% compared to men who constitutes 68.6%. This shows the gender disparities in the different organization selected despite the fact that the constitution of Zimbabwe allows for equal opportunities between men and women.
The majority of respondents are married as they account for 92.9% of sampled population. Single and widowed respondents accounted for only 2.9% and 4.3% respectively.
From the table it can be seen that 47.1% of the respondents possess degrees, 11.4% post graduate whilst those with diplomas constituted 40%. This indicates that the organizations have qualified people in their management positions thereby enhancing the credibility of the responses.
Results indicate that more respondents are in the middle management level as they accounted for 64.3%. This is mainly because of the structures of the companies which have fewer positions at the top. This also ensures reliability of responses as middle level managers are the ones who work closely with the different committees of the board since they head departments.
The bulk of the managers have less than 10 years working for the company an indication that the staff turnover for such positions is high. They account for 51.4% of the respondents with only 12.9% being respondents having stayed for more than 15 years in their organizations. A high staff turnover is an indication that things may not be well within the organization.

Figure 13: Length of service
4.2.1: Financial Expertise and Quality of Financial Reporting

Figure 14: Financial Expertise and Quality of Financial Reporting question 1

From the graphs above it can be seen that about 89% of the people agree or strongly agree that audit committees that possess financial expertise impacts positively on the quality of financial reporting. This question wanted to probe the respondents on how they feel about the relationship between financial expertise and quality of financial reporting. It is encouraging to note that a very high percentage of the respondents feel that there is a significant relationship between financial expertise and quality of financial reporting.

Figure 15: Financial Expertise and Quality of Financial Reporting question 2
From the graph above it can be seen that about 89% of the people agree or strongly agree that high incidences of internal control problems in their organizations can be linked to lack of financial expertise by audit committee members. This is very disheartening to hear the majority of the respondents agreeing that incidences of internal control problems are a result of the committee lacking financial expertise. The responsibility of appointing board members is vested with the shareholder which is the government and it is incumbent upon it to ensure that the audit committees of organizations have financial expertise.

Financial Expertise and Quality of Financial Reporting question 3

The graph below shows that about 89% of the respondents agree or strongly agree that restatements of financial statements in the organizations are as a result of the audit committee members lacking financial expertise. This is a major area of concern when the majority of respondents agrees or strongly agrees to such a statement as it is an
indication that the responsible authority is not taking into account the financial expertise of members when appointing the audit committees.

**Figure 16: Restatements of Financial Statements and Financial Expertise**

![Bar chart showing restatements of financial statements](chart.jpg)

Restatements of financial statements in my organization is linked to lack of financial expertise by the audit committee members.

Fig 17 below again indicates that roughly about 89% of the respondents concur that failure by organizations to timely publish their financial reports was linked to lack of financial expertise. This is a worrying trend as cases of organizations failing to submit annual accounts to the department of the Comptroller and Auditor General are on the rise. If the audit committees were effective then we should be expecting such cases to be on the decline.
All the above responses are in line with what the theory says about the relationship between financial expertise and quality of financial reporting.

### 4.2.2: Audit Committee Size and Financial Performance

Fig 18 below shows that about 59% of the respondents disagree with the statement that audit committee size impacts positively on the quality of financial reporting whilst only 18.6% agree and 22.9% is uncertain. Whereas literature says that there is a positive relationship it can be said this is not correct as can be found from observations from respondents in the field.
Figure 18: Audit Committee Size and quality of financial reporting

Do you agree that large audit committee size provides more skilled members in the committee leading to improved quality financial statements

Whilst a high percentage of the respondent feel that there is no positive relationship between audit committee size and quality of financial reporting the majority of them which is about 70% concurred that the audit committee of their organizations were large enough to protect and control the process of accounting and finance. This is shown in fig 19 below.
4.2.3 : Independence of Audit Committee and Quality of Financial Reporting

From the graphs below about 86% of the respondents agree or strongly agree that outside directors impact positively on the quality of financial reporting whilst only 14.3% is uncertain (fig 11). Fig 20 and 21 indicates that 86% of the respondents agree that cases of financial fraud and failure to publish financial statements on time can be traced to lack of independence by members of the committee whilst 14.3% is uncertain and only 7.1% disagreeing with the statement. Literature states that there is a positive relationship between independence and quality of financial statements. About 86% of the respondents agree or strongly agree that cases of financial fraud
and failure to publish reliable financial statements were a result of the audit committee lacking independence.

**Figure 20:** Outside Directors and quality of financial statements.
Figure 21: Fraud Cases and Audit Committee Independence.

Fraud cases in the organization are high because the audit committee lacks independence.
Failure to produce annual reports timeously is linked to lack of independence of the audit committee.

4.2.4: Frequency of Meetings and Quality of Financial Reporting

Fig 23 -26 shows the results of the questions on frequency of audit committee meetings and the quality of financial reporting. Of the respondents 90% agree with the statements that the more frequent the audit committee meetings are the more likely they will result in quality financial statements and also the statement that an audit committee which meets frequently has more time to oversee the financial...
reporting process, identify management risk and monitor internal controls. It is however disheartening to learn that 90% of the respondents also feel that fraud cases and internal control problems in the organization were as a result of the committee meeting less frequently with both the internal and external auditors.

*Figure 23: Frequency of Audit committee meetings and quality of financial reporting.*

Do you agree that the more frequent the audit committee meetings are the more likely they will result in quality financial reporting?

![Bar chart showing the percentage of respondents agreeing with the statement.](image-url)
Figure 24: Audit committee meetings and overseeing of financial reporting process.

An audit committee which meets frequently has more time to oversee the financial reporting process, identify management risk and monitor internal controls.
Figure 25: Financial fraud and frequency of meetings with internal and external auditors.

Cases of financial fraud in the organization are a result of the audit committee meeting less frequently with both internal and external auditors.
Figure 26: Internal control problems and frequency of Audit committee meetings.

Internal control problems in the organization are a result of the audit committee meeting less frequently.

- Uncertain
- Agree
- Strongly agree

Internal control problems in the organization are a result of the audit committee meeting less frequently.
4.2.5 : Quality of Financial Reporting

Fig 27 below shows the quality of the financial statements resulting from the auditors’ opinion.

Figure 27: Auditor’s opinion on financial statements.

For the financial years 2010 to 2013 indicate the auditor’s opinion on the financial statements

The results show that 58.6% of the financial statements are given an adverse report, whilst 15.7% had a disclaimer of opinion. Only 14.3% of the financial reports were given an unqualified opinion and 11.4% getting a qualified report. This shows the extent to which state owned enterprises are managed. It is very worrying that about 75% of the financial statements in state owned enterprises in the transport sector get about 59% adverse reports. If the audit committee members were independent, had financial expertise and meeting frequently with both the internal and external auditors the
situation could have been improved. Indications are that these audit committee characteristics which impacts on quality of financial reporting were lacking in the audit committee thereby resulting in poor quality financial statements.

4.3.0: Correlation and Regression analysis.

Appendix 2 shows the correlation coefficients extracted from the SPSS. These values are ranging from 0.418 to 0.891. It shows there is a strong positive relationship between the items and therefore data questions were reliable and objective. The coefficient represents the strength of association between two variables. In this case most of the variables show a significant positive relationship.

A regression analysis had to be carried out to establish how each characteristic affect the audit opinion. The Plum ordinal regression was used as the researcher was working with ordinal data. The SPSS package has the Plum regression model to use when dealing with ordinal data hence the researcher had to use it. The researcher had to test the model for goodness of fit and the table below shows the results of the test.

**Figure 28: Goodness- of - Fit**

<table>
<thead>
<tr>
<th>Goodness-of-Fit</th>
<th>Chi-Square</th>
<th>df</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pearson</td>
<td>90.095</td>
<td>77</td>
<td>.0361</td>
</tr>
<tr>
<td>Deviance</td>
<td>55.636</td>
<td>77</td>
<td>.0498</td>
</tr>
</tbody>
</table>

The Goodness of fit is also called the Chi-Square test because it measures how well the observed distribution of data fits with the distribution that is expected if the variables are independent. It only tests the independence or association but does not tell how strong the relationship is. For values less than .05 the assumption of independence is met. We can therefore say the independent variable is significantly related to the dependent variable. This means that the relationship is not due to chance but it really exists.
Figure 29: Pseudo R-Square

**Pseudo R-Square**

<table>
<thead>
<tr>
<th></th>
<th>Estimate</th>
<th>Std. Error</th>
<th>Wald</th>
<th>df</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FE</td>
<td>1.281</td>
<td>.201</td>
<td>6.537</td>
<td>1</td>
<td>.011</td>
</tr>
<tr>
<td>IAC</td>
<td>.358</td>
<td>.112</td>
<td>.342</td>
<td>1</td>
<td>.359</td>
</tr>
<tr>
<td>ACS</td>
<td>.161</td>
<td>.105</td>
<td>.087</td>
<td>1</td>
<td>.568</td>
</tr>
<tr>
<td>FAC</td>
<td>1.534</td>
<td>.338</td>
<td>5.781</td>
<td>1</td>
<td>.016</td>
</tr>
</tbody>
</table>

The Pseudo R-Square above measures how responsive the dependent variable varies with changes in the independent variable. Taken as a set all the four independent variables account for 72.5% of the variances in the dependent variable which is the audit opinion or the quality of financial statements. This means that 72.5% of the variances can be explained by the variables in the regression equation and the 27.5% remaining is explained by other variables not include in the equation.

**Parameter estimates**

Figure 30: Parameter estimates

NB: Abbreviations above denotes the following

FE: Financial Expertise

IAC: Independence of Audit Committee members

ACS: Audit Committee size

FAC: Frequency of Audit Committee meetings.
The estimate column shows the beta coefficients of the audit committee characteristics. The higher the beta coefficient the more the variable influences the dependent variable. In this case frequency of audit committee meetings has a larger influence on the quality of financial reporting, followed by financial expertise and then independence of audit committee meetings and lastly the audit committee size.

4.3.1: Suggested Regression Model

The researcher made use of the following model to find out how audit committee characteristics affect the quality of financial statements.

\[ Y = D + \beta_1 \text{FAC} + \beta_2 \text{FE} + \beta_3 \text{IAC} + \beta_4 \text{ACS} + \epsilon \]

Where \( Y \) = the Audit opinion

\( D \) = Constant or the Y intercept (Disclaimer opinion)

\( B1-4 \) = regression coefficient.

\( \text{FAC} \) = Frequency of audit committee meetings

\( \text{FE} \) = Financial expertise

\( \text{IAC} \) = Independence of audit committee members

\( \text{ACS} \) = Audit committee size

\( \epsilon \) = Error term

FE, FAC, IAC and ACS are the audit committee characteristics.

Assumptions

1. Y intercept is the least value obtainable when everything is zero and this corresponds to our worst opinion which is a disclaimer.

\( Y \) is therefore equal to \( D \) which is the midpoint of the range 0 – 1

\( D \) is therefore equal to 0.5
Error term denotes other factors which may affect the audit opinion but were not captured in the model.

2. The estimate coefficients are representative enough.
3. Error term. Error term denotes other factors which may affect the audit opinion but were not captured in the model. The researcher is aware that there is an error term but for this purpose it is going to be ignored due to practical limits.
4. The researcher is stand bounded by the ranges of values that have been assigned to the dependent variable for example 0 is less than Disclaimer and Disclaimer is greater than 1; 1 is less than Adverse and Adverse is greater 2 and so on.

If all the other characteristics are held constant at zero (0) then the worst opinion that will be given will be a disclaimer. This disclaimer opinion will be the Y-intercept or the constant. As the organization improves any of the characteristics then the opinion will start improving from disclaimer.

Assuming all the characteristics are at their maximum the audit opinion cannot go beyond unqualified. The researcher took the opinions of respondents and assigned numerical values to work out the data. Figure 31 below shows the results of scenario modeling done on the regression equation.

**Figure 31: Scenarios**
In the first scenario it is assumed that there are no members with financial expertise, no independent director in the committee, no meetings being held and zero members in the committee. The result is that an adverse opinion will be issued.

In scenario two

\[ Y = D + \beta_1 \text{FAC} + \beta_2 \text{FE} + \beta_3 \text{IAC} + \beta_4 \text{ACS} \]

\[ Y = 0.5 + 1.53 \times 0.25 + 1.3 \times 0.25 + 0.36 \times 1 + 0.16 \times 0.75 \]

\[ Y = 1.68 \] which is in scenario 2. This shows that if we are to increase meetings to 1 per quarter and increase members with financial expertise by 1, and the size of the audit committee to 3 members and also increase the number of independent directors to 1 from the first scenario, the quality of financial statements will change from being a disclaimer to adverse. If we are to increase again the members and number of meetings as in scenario 3 then the audit opinion will shift from being an adverse to a qualified opinion. The results from this regression equation are consistent with what literature says. Literature states that there should be at least one member with financial expertise in the audit committee for it to be able to fulfill their responsibility of oversight, internal control and financial reporting. It also states that an audit committee should have a
minimum of two independent directors or two thirds of the committee members should be independent as this promotes and enhances corporate performance and return to shareholders. On the aspect of frequency of meetings literatures states that the more frequent the meetings are held the more likely the audit committee will be informed of the current auditing issues and are more diligent in fulfilling their duties. Literature also believe that large audit committee size provides more skilled members serving in the board leading to improved financial reporting.

4.4.0: Chapter Summary

This chapter analyzed and discussed the research findings. Information was presented using tables, graphs and figures. The following areas were looked at: response rate, validity and reliability of data, demographic information, financial expertise and quality of financial reporting, audit committee size and quality of financial reporting, Independence of audit committee and quality of financial reporting, frequency of meetings and the quality of financial reporting and the correlation and regression analysis. The next chapter will focus on conclusions and recommendations.
CHAPTER 5

CONCLUSIONS AND RECOMMENDATIONS

5.1: Introduction
The previous chapter presented the research findings. This chapter deals with the research conclusions, recommendations and suggested areas of further research.

5.2 Conclusions
The following conclusions were deduced from the research analysis and findings.

i. The results show that a weak positive relationship exist between independence of audit committee members and the quality of financial reporting because the significance level of 0.359 is greater than 0.05. Of the respondents 86% agreed that the number of outside directors in the audit committee promotes and enhances the quality of financial reporting and also more than 85% indicated that fraud cases and failure to produce annual financial reports on time were related to lack of independence in the audit committee by the committee members.

ii. Study findings show that a significant relationship exists between financial expertise and quality of financial reporting as the significance level is 0.011 which is less than 0.05. A positive relationship also exists since 89% of the respondents felt that audit committees that possess financial expertise impact positively on the quality of financial reporting and also the fact that majority of the respondents (about 88%) indicated that high incidences of internal controls, restatements of financial statements and failure to publish financial statements on time were as a result of the audit committee lacking financial expertise.

iii. Results from the research findings indicate that there is a weak positive relationship between audit committee size and quality of financial reporting since the regression coefficient from the SPSS is low at 0.16. 59% of the respondents
disagreed that the size of the audit committee matters with regards the quality of financial statements and 70% agreed that their audit committees were large enough to protect and control the process of accounting and finance. This did not happen as most of the organizations were given adverse reports hence the size of the audit committee does not influence the quality of financial reporting.

iv. The research findings show that majority of the respondents (90%) agreed or strongly agreed that the frequency of audit committee meetings has a positive impact on the quality of financial statements. A regression coefficient of 1.53 was obtained from the data analysis which indicates that the relationship is very strong. Respondents also agreed or strongly agreed that internal control problems and cases of financial fraud in their organizations were as a result of the audit committee members meeting less frequently hence a positive relationship exist between the two variables.

v. 74.3% of the respondents indicated that their organizations had an adverse or disclaimer opinion issued on their financial statements.

5.3 Validation of Research Hypothesis

i. H1: A positive relationship exists between independence of audit committee members and quality of financial reporting though the relationship is weak. This hypothesis has been validated by results obtained.

ii. H2: Financial expertise and experience of the audit committee members positively impacts on the quality of financial reporting. This hypothesis was proven correct by the results from the study.

iii. H3: There is a positive relationship between the size of the audit committee and quality of financial reporting though it is weak from the correlation relationship results.

iv. H4: Frequency of meetings of the audit committee members positively influences the quality of financial reporting of state owned enterprises in the transport sector. This hypothesis is valid as the respondents indicated that the cases of financial fraud and internal control problems emanated from the fact
that audit committee members met less frequently with both internal and external auditors.

5.4. Recommendations

i. An advisory panel on audit committee independence and financial expertise required by members of the audit committee should be put in place by the government so that people appointed in the board should be independent, informed, vigilant and have the requisite skills and knowledge so that the quality of financial reporting is improved.

ii. An audit committee should have a minimum of three members and the majority i.e. two thirds should be independent.

iii. A minimum of four meetings should be held within a financial reporting period. This will ensure that the audit committee members are well apprised of the goings on of the company’s operations and a deeper knowledge of the organizational internal controls.

iv. There should be informed dialogue between external auditors and the audit committee so that areas of concern are discussed and ironed out so that the audit committee makes follow-ups with the internal auditors.

v. Zimbabwean regulators and accounting bodies should address the importance of audit committees in the corporate governance process currently taking place before the national corporate governance code is launched so that issues to do with audit committee effectiveness are taken care of.

vi. A national commission on fraudulent financial reporting should be put in place to make recommendations on the attributes required to enhance the effectiveness of audit committees and improve the quality of financial reporting.
5.5 Study limitations
The researcher encountered the following limitations in carrying out the research:

i. The research had to be conducted during working hours and due to work pressures this proved to be a daunting task.

ii. Some organizations were reluctant to grant permission to carry out the research without a letter from the permanent secretary in the Ministry of Transport and Infrastructural Development and the researcher had to apply to the permanent secretary to be granted permission.

iii. Some respondents took long to complete the questionnaire and the researcher had to remind them through the human resources department which was dealing with the issue.

iv. There was no time to interview the shareholder and board members to see how they were dealing with the issues obtained from the research findings because of government bureaucracy.

5.6 Suggestions for further study

i. There is need to carry out a qualitative research to explore other issues that affect the quality of financial reporting.

ii. Due to limitations of time, scope, money and resources it was difficult for the researcher to calculate values for the four audit committee characteristics and had to assign arbitrary figures to represent those four characteristics hence the need for the topic to be further researched in order to come up with the values of the four audit committee characteristics.
References


Cadbury Committee (1992), The Financial Aspects of Corporate Governance. 


Goodwin-Stewart, J., & Kent, P. (2006): The Relation Between External Audit Fees, Audit Committee Characteristics and Internal Audit. Accounting and Finance 46, no. 4, 386-403


Appendix 1

SECTION A

Graduate School of Management

Email: pchigwena@printflow.co.zw

Cell: +263 772 759 430

29 December 2014

To Whom It May Concern

Dear Sir/Madam

RE: REQUEST FOR COMPLETION OF A RESEARCH QUESTIONNAIRE.

I am a final year Masters in Business Administration student working under the direction of Dr. Madzikanda in the Faculty of Commerce’s Graduate School of Management at the University of Zimbabwe. The purpose of my research is to establish the relationship between audit committee characteristics and quality of financial statements of State Owned Enterprises in the transport sector in Zimbabwe. You are being asked to voluntarily participate in this study by completing the attached questionnaire. Your honest participation is very important to the researcher and information obtained from this study will enhance the learning process and help the policy makers and business practitioners to make effective use of audit committees to improve and sustain business performance of State Owned Enterprises in the transport sector. Participation in this study is voluntary hence you can choose not to participate or to withdraw...
from the study at any time with no penalty. Your responses will remain confidential to the investigator. You are free not to answer any questions you may find objectionable.

**NB** The research will focus specifically for the period between 2009 and 2013

**SECTION B DEMOGRAPHIC DATA**

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5. Management Level (tick)

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6. How long have you been employed in this organization?

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<th>10 to Less than 15 years</th>
<th>Above 15 years</th>
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SECTION C: AUDIT COMMITTEE CHARACTERISTICS AND QUALITY OF FINANCIAL REPORTING

<table>
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<th>Disagree</th>
<th>Uncertain</th>
<th>Agree</th>
<th>Strongly Agree</th>
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</thead>
</table>

The Lickert scale is on a scale 1 to 5, where 1 stands for strongly disagree and 5 strongly agree

**Financial Expertise and Quality of Financial Reporting**

NB: Put an X on the appropriate answer

Qn 1 Do you agree that Audit Committees that possess financial expertise impact positively on quality of financial reporting?   (1) (2) (3) (4) (5)

Qn 2 High incidences of Internal Control problems in my organization can be traced to lack of financial expertise of audit committee members.   (1) (2) (3) (4) (5)

Qn 3 Restatements of Financial Statements in my organization is linked to lack of financial expertise by the audit committee members.  (1) (2) (3) (4) (5)
Qn 4 Failure to publish financial statements timeously in my organization can be attributed to lack of financial expertise by members of the audit committees. (1) (2) (3) (4) (5)

Audit Committee Size and Quality of Financial Reporting

Qn 1 Do you agree that large audit committee size provides more skilled members serving in the committee leading to improved quality financial statements? (1) (2) (3) (4) (5)

Qn 2 Audit Committee of my organization is large enough to protect and control the process of accounting and finance by introducing greater transparency with respect to shareholders and creditors. (1) (2) (3) (4) (5)

Independence of Audit Committee and Quality of Financial Reporting

Qn 1 Outside Directors in the Audit Committee promotes and enhances quality financial reporting. (1) (2) (3) (4) (5)

Qn 2 Fraud cases in my organization are high because the committee lacks Independence. (1) (2) (3) (4) (5)

Qn 3 Failure to produce reliable annual reports timeously is linked to lack of independence of the audit committee? (1) (2) (3) (4) (5)

Frequency of Audit Committee Meetings and Quality of Financial Reporting

Qn 1 Do you agree that the more frequent the audit committee meetings are the more likely they will result in quality financial reporting? (1) (2) (3) (4) (5)

Qn 2 An active audit committee which meets frequently has more time to oversee the financial reporting process, identify management risk and monitor internal controls(1) (2) (3) (4) (5)

Qn 3 Cases of financial fraud in the organization are a result of the audit committee meeting less frequently with both internal and external auditors (1) (2) (3) (4) (5)

Qn 4 Internal control problems in the organization are a result of the audit committee meeting less frequently (1) (2) (3) (4) (5)

Quality of Financial Reporting of the Firm

Qn For the financial years 2009 to 2013 indicate the auditor’s opinion on the organization’s financial statements in terms of the following:
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<th>Adverse</th>
<th>Qualified</th>
<th>Unqualified</th>
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**Notes:**

**Disclaimer of opinion** is issued when the Auditor could not form and consequently refuses to present an opinion on the financial statements.

**Adverse opinion** is issued when the financial statements are materially misstated and such statements have pervasive effect on the statements.

**Qualified opinion** is issued when the Auditor encountered one of two types of situations which do not comply with generally accepted accounting principles, however the rest of the financial statements will be fairly presented.

**Unqualified opinion** is expressed when the Auditor concludes that the financial statements give a true and fair view or are presented fairly in material respects in accordance with the applicable financial reporting framework.

**Thank you very much for your time, I greatly appreciate**
### Appendix 2

| Do you agree that Audit committee that possess financial expertise impact positively on quality financial reporting? | High incidences of internal control problems in the organization can be traced to lack of financial expertise of audit committee members | Restatements of financial statements in my organization is linked to lack of financial expertise by the audit committee members | Failure to publish financial statements timely in the organization can be attributed to lack of financial expertise by members of the audit committee | Do you agree that large audit committee size provides more skilled members in the committee leading to improved quality financial statements? | Audit committee of my organization is large enough to protect and control the process of accounting and finance by introducing greater transparency with respect to shareholders and creditors | Outside directors in the audit committee promotes and enhances quality financial statements | Fraud cases in the organization are high because the audit committee lacks independence | Do you agree that the more frequent the audit committee meetings are the more likely they will result in quality financial statements? | Audit committee which meets frequently has more time to oversee the financial reporting process, identify management, system, and control weaknesses? | Cases of financial fraud in the organization are a result of the audit committee meeting less frequently? | Internal control problems in the organization are a result of the audit committee meeting less frequently? | For the financial years 2010 to 2013 indicate the auditor’s opinion on the financial statements? |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1.000 | 0.846 | 0.846 | 0.846 | 0.810 | 0.524 | 0.436 | 0.552 | 0.682 | 0.602 | 0.781 | 0.506 | 0.623 | 0.671 |
| 0.846 | 1.000 | 0.859 | 0.796 | 0.611 | 0.891 | 0.537 | 0.658 | 0.735 | 0.416 | 0.581 | 0.682 | 0.601 | 0.671 |
| 0.846 | 0.859 | 1.000 | 0.765 | 0.713 | 0.691 | 0.537 | 0.579 | 0.654 | 0.819 | 0.706 | 0.492 | 0.564 | 0.652 |
| 0.846 | 0.796 | 0.765 | 1.000 | 0.687 | 0.587 | 0.537 | 0.601 | 0.499 | 0.812 | 0.593 | 0.618 | 0.506 | 0.623 |
| 0.870 | 0.611 | 0.713 | 0.867 | 1.000 | 0.494 | 0.617 | 0.644 | 0.514 | 0.650 | 0.638 | 0.509 | 0.587 | 0.552 |
| 0.524 | 0.891 | 0.691 | 0.58 | 0.484 | 1.000 | 0.430 | 0.485 | 0.567 | 0.815 | 0.565 | 0.755 | 0.854 | 0.680 |
| 0.436 | 0.533 | 0.537 | 0.537 | 0.611 | 0.435 | 1.000 | 0.789 | 0.705 | 0.834 | 0.739 | 0.741 | 0.801 | 0.726 |
| 0.552 | 0.656 | 0.579 | 0.601 | 0.644 | 0.465 | 0.789 | 1.000 | 0.821 | 0.769 | 0.858 | 0.741 | 0.743 | 0.653 |
| 0.862 | 0.735 | 0.684 | 0.496 | 0.514 | 0.587 | 0.789 | 0.821 | 1.000 | 0.896 | 0.810 | 0.565 | 0.546 | 0.435 |
| 0.506 | 0.263 | 0.452 | 0.876 | 0.550 | 0.726 | 0.741 | 0.741 | 0.555 | 0.712 | 0.801 | 0.819 | 0.815 | 0.700 |
| 0.823 | 0.807 | 0.564 | 0.505 | 0.587 | 0.854 | 0.601 | 0.743 | 0.546 | 0.763 | 0.875 | 0.655 | 1.000 | 0.671 |
| 0.812 | 0.871 | 0.652 | 0.623 | 0.552 | 0.689 | 0.726 | 0.654 | 0.433 | 0.889 | 0.700 | 0.559 | 0.871 | 1.000 |