

Institutionalizing Corporate Governance Reforms in Poland: External Auditors' Perspective¹

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Abstract

Purpose: The paper examines auditors' experiences with corporate governance (CG) in general and audit committees (ACs) in particular in the setting of a Polish two-tier board system and a capital market characterized by high ownership concentration, which therefore extends the research on CG practices of an economy beyond the well-researched Anglo-American model.

Methodology: This study adopts a qualitative research approach by using interview data from fifteen interviews with auditors working with large publicly-listed companies in Poland to examine the relationships among auditors, Audit Committees, and CG.

Findings: The auditors indicate that the CG environment has changed. However, the institutionalization of an AC in Poland generally is the subject of coercive isomorphic pressures, which lead to its decoupling and transition toward a ritualistic role. Moreover, auditors report only some reliance on CG information in the planning phase and none in the field-testing or review phases.

Originality: The findings differ from those of prior studies conducted predominantly in the USA and the UK, in which auditors reported far greater reliance on CG in all phases of the audit process. The two possible reasons for this difference in findings could be the different development stages between capital markets and different CG systems.

Keywords: audit committee, external auditors, corporate governance reforms, audit, Poland.

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Introduction

This study examines external auditors' perception of corporate governance (CG) reforms and, especially, the development of the importance of audit committees (AC) and their importance in the work of auditors. From the auditor's perspective, good governance is important to the conduct of an audit, as companies with good governance are less risky to audit (Gramling, Rittenberg and Johnstone, 2012). Moreover, CG views external auditors as important actors in its mosaic, as illustrated by Cohen et al. (2004). External auditors play a key role in ensuring the quality of corporate financial reporting and the mitigation of earnings management by corporate managers. Unsurprisingly, CG reforms tend to increase the role of auditors in the effective governance system. To ensure the integrity of financial reporting, auditors should not only present their opinions on the quality of financial reporting but also actively participate in dialog on the quality of financial reporting with AC, internal controllers, and company management (Gendron and Bédard, 2006).

Mainstream literature on triad management – audit committees – auditors shows that auditors followed the same trajectory as the early research on boards of directors, which has been criticized for its singular theoretical perspective – such as agency theory and resource dependency theory – and positivistic methodologies that do not capture the complexity of real-world experiences and behaviors. A summary of the literature is available in Bedard and Gendron (2010), Cohen et al. (2004), and DeZoot et al. (2002). As expected, numerous studies investigated the relationship between CG and auditing in other countries and settings with diverse research methods and approaches (Carcello, Hermanson and Ye, 2011); specifically, those settings that do not follow the Anglo-American governance model or the more regulated post-SOX environment. Bedard and Compennolle (2014) also call for more research leading to a better understanding of the relationships and communication between AC, management, and external auditors.

As a response to this call, there appeared a growing body of auditing literature on “governance in action” that focuses more on actual processes and interactions between managers, ACs along with external and internal auditors (Beasley et al., 2009; Brennan and Kirwan, 2015; Campennolle and Richard, 2018; Cohen et al., 2013; Cohen, Krisnamoorthy and Wright, 2002; 2010; Compennolle, 2009; Fiolleau et al., 2013; Gendron and Bédard, 2006; Gendron, Bedard and Gosselin, 2004; Spira, 2002; Turley and Zaman, 2007). The studies show a diversity of practices in relation to interactions among management, ACs, and auditors. Prior research indicates the divergence between the expectations of practice as described in regulation and the actual practice and interaction processes. In general, the CG environment is improving. However, the ritualistic

ceremonial behaviors and symbolic endeavors still dominate over substantive engagement by ACs (Beattie, Fearnley and Hines, 2015; Beattie, Fearnley and Hines, 2014; Beattie, Fearnley and Hines, 2011; Brennan and Kirwan, 2015; Cohen, Krishnamoorthy and Wright, 2008; Compernelle and Richard, 2018; Fiolleau et al., 2013; Salleh and Stewart, 2012; Sarens and Zaman, 2013).

The primary objective of this paper is to answer a simple question: what is the experience of Polish external auditors with efforts to strengthen CG in ensuring the effective monitoring of financial reports and ACs in particular in Polish companies?

The present study aims to extend prior research by analyzing the auditor's perception of their interaction with ACs and CG reforms in Poland after the regulation of ACs. The paper employs a qualitative research approach and research materials collected in semi-structured interviews. The article interprets the rich research material through the lens of neo-institutional theory. The study of Polish auditors allows us to get access to a unique, previously only rarely explored the setting of the continental model of CG with a two-tier board system. Another feature that distinguishes the Polish CG model from the Anglo-American setting is the high concentration of ownership and weak investor protections (Aluchna and Kołodkiewicz, 2010; Dobija, 2015). Poland is also an example of a country where CG standards develop simultaneously with the development of the capital market (Dobija and Klimczak, 2010). The recent report on audit market in Poland states that local models of governance often appear less effective than international models. Polish companies struggle more with effective independent governance arrangements than international companies (International Bank for Reconstruction and Development, 2016).

The remainder of the paper is divided into four sections. Section 2 provides an overview of existing literature and theoretical frameworks. Section 3 provides some insights into the context of the Polish CG system. Section 4 describes the research method used in this paper. Finally, section 5 provides an overview of the main findings. The paper ends with a discussion of results and a conclusion.

Literature Review and Interpretive Framework

Prior Studies: Audit Committees and External Auditors

A vast body of literature analyzes the effectiveness of ACs (Beasley et al., 2009; Brennan and Kirwan 2015; Campernolle and Richard, 2018; Cohen et al., 2013; Cohen, Krishnamoorthy and Wright, 2002; 2010; Compernelle, 2009; Fiolleau et al., 2013; Gendron and

Bédard, 2006; Gendron, Bedard and Gosselin, 2004; Spira, 2002; Turley and Zaman, 2007). The meta-analyses of DeZoot et al. (2002), Turtley and Zaman (2004), and Bedard and Gendrom (2010) provide a summary of research in relation to the AC. All three reviews of literature use a similar framework in analyses by scrutinizing the main elements that determine AC quality: composition, authority, resources, and diligence. However, Bedard and Gendrom (2010) include additional elements associated with the various actors who affect the effectiveness of ACs and, thus, CG. The two main types of actors are internal auditors (internal control) and statutory auditors (external control). These two are considered to have a substantial influence on financial reporting quality and, therefore, affect investors' perception of the firm's financial information, its reports, and the functioning of financial markets. Cohen et al. (2004) use a similar model to present a CG mosaic and the effects of various actors on financial reporting quality. One of the main responsibilities of the AC is to oversee the selection, compensation, scope of work, and level of independence of external auditors.

There is a growing body of literature on triad management – ACs – that shows auditors ensure the effective monitoring of management actions, which lead to a better quality of financial reporting (Beasley et al., 2009; Brennan and Kirwan, 2015; Campernolle and Richard, 2018; Cohen et al., 2013; Cohen, Krishnamoorthy and Wright, 2002, 2010; Compennolle, 2009; Fiolleau et al., 2013; Gendron and Bédard, 2006; Gendron, Bedard and Gosselin, 2004; Spira, 2002; Turley Zaman, 2007). These studies in particular observe expected practices – as set in regulatory frameworks – and processes in place, which are supposed to lead to improved monitoring along with the higher quality of financial and non-financial reporting. However, most research papers mainly deal with the Anglo-American model of CG concentrated on the issue of interaction among ACs, auditors, and processes in effective monitoring of management. The results of a study conducted on the American market (Cohen et al., 2010) show that the auditors find CG environment improved in comparison to the time of the Sarbanes-Oxley Act of 2002, whereas ACs appear more active and diligent while having more resources to perform their responsibilities in comparison to previous findings (Cohen et al., 2002). However, the literature generally portrays interactions between the management, ACs, and internal and external auditors as more ritualistic and symbolic than leading to a substantive engagement of ACs (Beattie, Fearnley and Hines, 2015; Beattie, Fearnley and Hines, 2011; Brennan and Kirwan, 2015; Cohen, Krishnamoorthy and Wright, 2008; Compennolle and Richard, 2018; Fiolleau et al., 2013; Salleh and Stewart, 2012; Sarens, Christopher and Zaman, 2013).

A more recent stream of literature also deals with the contribution of ACs to assurance services provided by audit firms (Cohen and Simnett, 2015; Al-Shaer and Zaman, 2018;

Al-Shaer, Salama and Toms, 2017), which reveals an increasing role of ACs in improving the quality of sustainability reports.

The Use of Corporate Governance Information in the Audit Process

A financial statement audit proceeds from planning through analysis (field-testing) to the integration of evidence in the form of a report (review; Gramling, Rittenberg and Johnstone, 2012). The planning stage involves communication with the AC or, in the absence of the AC, the board. Before accepting a new assignment or deciding to continue the audit engagement, an auditor would consider the risk of assignment. Once the decision is made to accept or continue an engagement, the auditor normally establishes an understanding with the client about the objective and limitations of the engagement and the management's responsibilities, preferably through an engagement letter. The next step, the audit planning stage, is to establish an understanding of the client's strategies and business. This stage also involves understanding the company's CG system.

Before conducting audit tests, the auditor engages in initial audit work. This step involves establishing an understanding of internal control, performing control tests, and assessing control risk. Moreover, the auditor evaluates audit risk, which includes not only control risk but also inherent and detection risk. Based on the risk assessment, the auditor decides on the necessary tests. Once the evidence is collected and analyzed, the auditor prepares a report to be communicated to the client.

CG information may be employed by auditors in all three stages of the audit process. However, the investigation of corporate controls embedded in the company's CG system is of particular importance in the earlier stages of an audit process: the planning and assessment of control risk at the initial stage of audit work (Gray and Manson, 2011). Additionally, information on ACs may also play an important part in the audit process (International Bank for Reconstruction and Development, 2016).

A study conducted in the Anglo-American context (Cohen et al., 2010) reported that auditors indicate changes in the planning and field-testing stages of the audit process in the recent years in terms of the use of CG information. Moreover, Cohen et al. identify changes at the level of manager's or partner's review of the use of CG information. Similarly, in a different study (Cohen et al., 2010), the auditors' control risk assessments were higher when the board was considered weaker in terms of agency and resource dependence roles.

Interpretive Framework

As suggested by Gendron (2009, p. 128), diverse theories can be employed to describe a given reality simultaneously. The literature reveals that researchers utilize a number of theoretical approaches to study and explain AC practices, such as traditional agency theory, institutional theory, resource dependence, managerial hegemony, and efficiency perspectives (Cohen, Krishnamoorthy and Wright, 2010; Beasley et al., 2009; Spira, 1999). Since this study investigates the auditors' perspective on the institutionalization of CG practices in organizations, the neo-institutional theory seems to be helpful in explaining the practice in question.

According to DiMaggio and Powell (1991), organizational practices are either a reflection of, or response to, rules and structures built into a larger environment. This environment acts as a source of behaviors, norms, and incentives, but also, from another perspective, sanctions and limitations of organizational activities. Thus, the organization does not determine its behaviors on its own, based on autonomous decision-making as a response to problems; instead, organizations "tend to pattern their strategies on models and procedures that are widely recognized, and thus 'institutionalized' in the societal environment or organizational field" in order to increase their chances of survival (DiMaggio and Powell, 1991).

Institutions can take the form of formal rules, but also informal norms and behaviors (DiMaggio and Powell 1983). Formal rules include regulations, policies, laws, economic rules, political rules, and contracts, while informal norms and behaviors refer to conventions, routines, codes, norms, and behaviors that may arise from cultural or societal traditions. Despite the fact that the two differ, they are interdependent, as one often results from the other.

DiMaggio and Powell (1983, p. 149) argue that organizations become homogeneous or *isomorphic* when they act under pressure. This is a process that leads units within "a population to resemble other units that face the same set of institutional conditions" (DiMaggio and Powell, 1983, p. 149) to avoid the risk of ostracism. Isomorphism within institutional theory is the result of an organization being a member of a similar organizational field, which may assume three forms: coercive, normative, and mimetic (DiMaggio and Powell, 1983; Najeeb, 2013). Coercive isomorphism emerges as a result of external regulatory-type pressures for organizational convergence. An example of coercive isomorphism is the obligatory existence of an AC as an element of a governance structure. Normative isomorphism suggests convergence through socialization. Mimetic isomorphism is a function of significant environmental uncertainty that leads organi-

zations to “follow the leader” regardless of whether or not there is evidence that the leader’s practices are effective. In this view, ACs may be coerced into becoming similar through regulation, by following the best practice model, or by simply mimicking other organizations to enhance their legitimacy (Cohen et al., 2010).

Decoupling, on the other hand, is an outcome when organizations adopt practices due to external legitimacy instead of improving efficiency. Through decoupling, companies expect to acquire legitimacy without an actual change in their practices through the deployment of formal structures “that meet institutional demands but are disconnected from actual practice” (MacLean and Behnam, 2010, p. 1500). Whereas the institutionalization theory assumes rooted behaviors within an organization, decoupling indicates a deliberate choice (Greenwood et al., 2008) rather than a “process that happens to the organization over time” (Scott, 2008, p. 22).

In CG context, in periods of ambiguous and uncertain environments, the boards and ACs may emphasize ceremonial and symbolic roles. The practices of AC may be more ceremonial in nature, with a focus on providing symbolic legitimacy but not necessarily vigilant monitoring (Spira, 1999). When the AC plays a more ceremonial role, the external auditor bears a greater responsibility for reliable financial reporting. Institutional theory also suggests that there is a tendency to attract homogeneous individuals into institutions (Tuttle and Dillard, 2007). Therefore, it is important to consider the relevance of social culture and environment for the practice of accounting and the use of accounting practices to rationalize and maintain legitimacy. Institutional theory emphasizes how governance and especially board mechanisms fulfill ritualistic roles that help legitimize the interactions among the various actors within the CG mosaic (Cohen et al., 2008).

Establishing Context

Corporate Governance and Audit Committees in Poland

EU has also been active in reforming the CG system of European companies. Since the introduction of the ACs into EU regulation (Official Journal of the European Union, 2006), ACs evolved from a purely voluntary initiative into an essential and mandatory element in all European countries (Bohm et al., 2013). However, despite isomorphic pressures imposed by the regulation, AC practices vary among EU member states (Collier and Zaman, 2005; Böhm et al., 2013). The existing research illustrates substantial cross-national differences in the scope, responsibilities, and diversity of ACs (Böhm et al., 2013; Hassan and Hijazi, 2015).

The Polish governance system exemplifies the continental EU CG system. Weimer and Pape (1999) discuss the main differences between the EU CG model and the Anglo-American CG model. The main differences relate to ownership concentration, investors activity on the capital market, main stakeholders of firms, and the board system. The Polish CG is characterized by significant ownership concentration with dominant shareholding (Aluchna, 2007), weak investor protection (Aluchna and Kołodkiewicz, 2010; Kołodkiewicz, 2011), and moderate activity of investors on the capital market. One additional feature of the Polish CG system is the low enforceability of external monitoring mechanisms and transparency rules (Aluchna and Kołodkiewicz, 2010; Kołodkiewicz, 2011).

The internal CG mechanisms rely on the board and its committees. The board is organized along a two-tier model, which consists of a management board (executive directors) and a supervisory board (non-executive directors). The supervisory board is in charge of monitoring the management board in the interest of the company (Słomka-Gołębiewska and Urbanek, 2016).

Before 2009, the existence of ACs was one of the recommendations included in subsequent CG codes (CGCs). In 2009, ACs became mandatory and was stipulated by the Polish Auditing Act (Journal of Laws, 2009). The responsibilities listed in the act included the oversight of financial reporting, internal control systems, internal audits, risk management, and external audits, in addition to establishing the independence of the auditor. The Auditing Act also specified that the AC recommends an auditing firm.

Since the new regulation allowed an option, in practice, companies could react in different ways. Companies with more than five members on the supervisory board were required to have an AC, but companies with five or fewer members on the supervisory board could but did not have to form an AC. The reaction of companies to the regulation changes was twofold. One group of companies decided to form an AC, according to the existing laws. However, a bigger group of companies decided to take advantage of the exemption and not form ACs (Adamska et al., 2017).

Since the 2009 regulation proved ineffective in relation to the establishment of ACs in Polish supervisory boards, a new Parliamentary Act on Certified Auditors, Audit Firms, and Public Supervision was passed on June 21, 2017 (Journal of Laws, 2017). The new regulation changes the rules regarding the need for AC formation for stock listed companies, making it compulsory for larger companies. When an AC is created, it should consist of not less than three members, with the majority of the AC remaining independent, including its chairman/chairwoman. Moreover, the act defines in

detail the notion of independence. The new regulation also stipulates that at least one of the members must be an expert in financial audit or accounting.

Qualitative research on AC effectiveness illustrates that ACs play a more ceremonial role in Poland (Dobija, 2015). In general, ACs play an important role in the monitoring of financial reporting in companies with dominant foreign shareholding. Local companies are slower in using ACs as an effective monitoring mechanism. Effective oversight of financial reporting quality can be secured with an appropriate mix of resources, which includes not only the presence of an independent AC member but also one with international experience (Dobija and Kravchenko, 2017; Dobija and Puławska, 2019).

This paper seeks to understand the institutionalization of CG reform in Poland, with special attention to ACs, from the perspective of one of the important actors of CG: the auditors. The introduction of ACs changed the interaction and communication channels between auditors and management. The paper also investigates how CG information is considered and used by auditors in the auditing process.

Statutory Auditors in Poland

Audit requirements in Poland date back to 1928 when the Polish President issued a resolution requiring audits of joint-stock companies' annual financial statements and founders' statements. This requirement was subsequently implemented in the Commercial Code of 1934. In 1945–1991, the audit function was preserved. The annual audit of financial statements was required while “state-authorized accountants” were granted the right to perform audits and control functions similar to those exercised by today's statutory auditors (Jaruga, 1993; Schroeder, 2007).

With the transition to a market-based economy, a modern model of auditing emerged. In 1992, the first Audit Act was introduced. As a result, the National Chamber of Chartered Accountants was established, and temporary auditing standards were issued. The next important step in the development of accounting and auditing was the implementation of the Act of Accountancy in 1994. This Act regulated accounting rules along with the fundamentals of auditing, which led to the creation of new and more stable auditing standards in 1996. A number of papers outline the development of statutory audit in Poland (Kosmala, MacLulich and Sucher, 2004; Krzywda et al., 1998; Schoreder, 1999). Staszkiwicz (2017) summarizes current research on the financial audit in Poland.

Audit firms and auditors must be authorized to perform audits in Poland. They must be registered with the PIBR (Polish Chamber of Auditors), and are subject to quality control inspections by the PIBR (overseen by the Audit Oversight Committee) for non-public interest entities and by Audit Oversight Committee for public interest entity auditors. Auditors must hold audit qualifications set by the PIBR and perform regular continuing professional development. As in many other European countries, the audit market is shrinking, with 1784 audit firms operating in 2011 and 1622 audit firms operating in 2015 (International Bank for Reconstruction and Development, 2016). According to the report, four international network firms (the Big Four) have the largest market share. The Big Four have audit fees in the range of PLN 80,000–100,000, while audit fee incomes for the next seven largest firms are in the range of PLN 7,000–16,000. The audits of 1,254 public interest entities are covered by thirteen audit firms (International Bank for Reconstruction and Development, 2016).

Methodology

We use a qualitative study to understand how CG reforms are institutionalized in Poland. Qualitative methodology is appropriate for several reasons. Triad management, ACs, and auditors operate in a complex social setting, in which the dynamics are not immediately apparent. Second, experiences that involve social interactions and conversations are best studied through qualitative techniques like interviews (Silverman, 1985; Patton, 2002). Contextualization, description, and in-depth understanding of actors' perceptions are of critical importance (Compennolle and Richard, 2018). For that reason, an explanatory approach in order to understand the research phenomenon is the most suitable.

We used interviews as our technique for collecting data. We selected the semi-structured interview method because it enabled us to gain in-depth knowledge of research subjects' views about the existence and extent of the information gap in auditing, but also possible improvements. No access to private archival sources was authorized by the auditors. However, we consider these interviews a relevant means for accessing auditors' thoughts and the "meanings they attach to what is going on in the world" (Patton, 2002, p. 341).

We conducted fifteen interviews in Polish with experienced auditors (audit managers) involved with auditing financial statement of companies listed on the Warsaw Stock Exchange. It was a convenience sample of auditors. We consulted the annual reports of selected companies for 2011 to make a list of auditors who signed the audit opinion

Table 1. Summary of conducted interviews

Participant	P1	P2	P3	P4	P5	P6	P7	P8	P9	P10	P11	P12	P13	P14	P15	
Gender	Female	Female	Male	Male	Male	Female	Female	Female	Male	Male	Male	Male	Male	Male	Male	
Age group	40–50	50–60	40–50	40–50	50–60	40–50	40–50	40–50	30–40	40–50	40–50	40–50	40–50	40–50	30–40	
Date	September 2012	September 2012	September 2012	September 2012	September 2012	October 2012	October 2012	October 2012	October 2012	October 2012	October 2012	October 2012	October 2012	November 2012	December 2012	January 2012
Duration (h)	2	2	1.5	1	1	0.75	0.75	1	1.75	.75	1	1	1	1	1	
Method of recording	Notes, partial transcription	Notes, partial transcription	Notes, partial transcription	Notes, partial transcription	Notes, partial transcription	Notes	Notes	Notes, partial transcription	Notes, partial transcription	Notes	Notes, partial transcription	Notes, partial transcription	Notes	Notes	Notes	

Source: own elaboration.

for selected companies and contacted them to request an interview. Only fifteen auditors agreed to share their experiences and opinions. More details on the interviewees can be found in table 1. The interviews were conducted in September and October 2012.

The research instrument included a set of sixteen questions (Appendix 1). To ensure construct validity, the questions were designed to reflect the key theoretical constructs of the study (Silverman, 1995; Patton, 2002): specifically, the perception of CG reforms in Poland in general, the experiences and interactions with ACs, and the use of CG information in the audit process. In accordance with the standard practices of qualitative research, the interview questions were refined during the fieldwork period based on the existing professional and academic literature, proposals for regulations, and discussion papers (Yin, 2003). Prior to the interview, the interviewees were informed that the interview's purpose was to collect their own experiences and so they should not be concerned about providing "wrong" answers to the questions. The interviewed auditors were assured that their responses would be used in strict confidence. They were also asked permission for the interview to be recorded. In order to provide a reasonable comfort level related to sensitive data, the interviewees who allowed for the recording of the session were also instructed that – in the event of disclosure of sensitive information – they would be permitted to ask the interviewer to temporarily switch off the recording device at any time. When such a request was made, the interviewer took notes and recorded a report on the unrecorded portion following the interview.

A draft report was presented to the interviewees to allow for comments on the reliability, validity, and overall credibility of the observations and conclusions (Patton, 2002).

Once the data was collected, collated, and transcribed for each stage, they were manually coded using key theoretical constructs: definition of CG, interactions with AC, interaction with management/supervisory board/internal auditors, decision of audit appointment, nature and extent of CG information use in the audit process, and the importance of CG mechanisms in audit engagements (Ahrens and Dent, 1998). Patterns and exceptions in the coded data were identified (Ahrens and Dent, 1998). Two coders read all materials independently, coded them into the same summary table, and then discussed and resolved any coding differences. The patterns that emerged from the data were then compared to prior research on the interaction of auditors and CG. The results were documented after the completion of this process. This process is consistent with the pattern matching process described by Ahrens and Dent (1998).

Findings

External Auditors' Experiences with Corporate Governance in General

After the financial scandals at the beginning of the century, both businesses and academics stressed the importance of CG. However, after a long debate, there are still no widely accepted definitions of CG and good governance practices. Similar to the findings of Cohen et al. (2010), when asked about the most important agents of CG, the auditors interviewed in this study identified management, ACs, and supervisory boards; only one interviewee mentioned shareholders and stakeholders in general. The interviewees provided mixed responses when asked about their own definition of CG. However, all the provided definitions shared one common feature: the interviewees understood CG in a narrow sense as internal regulations (procedures or rules) established to help organizations conduct business. The following are some examples of definitions given by auditors in both large and small firms.

An auditor in one of the big audit firms defined CG as, “a certain way of managing an organization, which focuses on the matters related to the relations with shareholders and the protection of owners and shareholders.”

A different auditor in an international audit firm defined CG as, “a set of internal procedures related to internal control. CG means the existence of an AC and a set of external procedures that help to enforce the application of all of the requirements and rules set forth to be used by a company.”

An auditor in a local audit firm provided a similar definition: “Corporate governance means certain structures and procedures that help to maintain a corporate order.”

Besides their interaction with management and ACs and the use of CG information in their work, we were also interested in the auditors' experiences with other governance mechanisms, their assessment of the changes in CG in the last five years, and their perspectives on future developments. Among different CG mechanisms, we asked about the certification of financial statements by the management, the impact of the supervisory board independent members, whistleblowing procedures, and the implementation of codes of ethics.

One of the important elements of CG mechanisms is the certification of financial statements by the management, but also the supervisory board. The efficiency of this mechanism is still debated, and the evidence on its effectiveness is mixed. In a study by Cohen et al. (2010), the majority of auditors confirmed the positive impact on finan-

cial reporting quality, while only a fifth of the auditors stated that this mechanism had an impact on their work. In this study, the auditors also confirm that the certification of financial statements has a positive impact on the financial statements' quality and reduces manipulation risk. Some auditors see the certification process as a clear message to the management and the supervisory board about their ultimate responsibility for the preparation of financial statements. One of the auditors said:

A person who signs a document is more careful about the content of the financial statements. For instance, the requirement of signing the internal affirmation letter stating that the content of the financial statements is free from misstatements and omissions and so on, for the purpose of an audit, is very often the subject of discussion with an auditor. When the letter contains phrases like "the management confirms that there is no case of fraud" or "the internal control system protects the company from all fraud," the management does not want to sign it. Even if it is explained that the letter is the result of procedures introduced by them to avoid fraud, the management is still resistant to sign such a document. So, a requirement of certification makes people think twice about their responsibility for the signed document.

The auditors see the importance of codes of ethics and whistleblowing procedures for the functioning of the efficient CG system. If they are efficiently implemented, the auditors see these as tools for risk reduction in the planning stage. However, in practice, companies rarely develop such procedures, and even if they are written on paper, they are rarely used in practice. In most cases, codes of ethics and whistleblowing procedures are used more as PR tools than effective governance mechanisms.

We also asked auditors about their opinions on the impact of the independent member on the CG system and the effective monitoring of financial reporting quality. Most of their assessments were positive. An independent member is considered to be more inquisitive and less afraid to ask difficult and challenging questions. The auditors indicated that, in practice, real independence is difficult to achieve, but an independent member very often provides an additional impetus in the discussion of difficult matters and can direct other members of the committee to see a given problem from a different perspective. Independent members on ACs are also considered to be more knowledgeable and skillful in finance, thus better prepared for financial reporting oversight.

The Importance and Interactions with Audit Committees

One of the most important features of effective governance monitoring is the existence of ACs. CG regulations around the world place more and more responsibilities on the ACs to oversee financial reporting, the audit process, and internal controls. One of the hallmarks of an AC's effectiveness is its independence, but also the requirement that at least one member of the committee has financial expertise. Gendron et al. (2004) provide evidence that effective AC meetings have value beyond symbolism and that AC members ask diligent questions to establish their perceived effectiveness. Beasley et al. (2009) document that AC members perceive they take an active role in the monitoring of the financial reporting process and external auditors. Prior research on ACs shows that – in the Anglo-American context – their role has changed over time from only nominal oversight at the beginning of the century to a more substantial oversight ten years after the introduction of SOX. However, prior research on the effectiveness of ACs from the perspective of auditors shows a gloomier picture; for example, the auditors' experience was negative as reported by Cohen et al. (2010).

In the Polish context, it is interesting to observe that, despite the auditors' agreement that the AC is an important element of CG, the auditors also report that interaction with the AC does not have an impact on the way they conduct audits and the auditing process. The auditors in our study described the competencies of ACs as ranging from professional to very weak. However, all interviewees noted that the monitoring efficiency of ACs has increased with time. The competencies of AC members who represent investment funds – one of the majority shareholders on the Polish capital market – are usually assessed as very high. At the same time, the assessment of the power of the AC was somewhat weaker. As one of the auditors observed:

I think the competencies of audit committees, if they exist, are getting better and better. It is difficult to assess the power of the committees, but the committees with an independent member are much more competent. First of all, they can read financial statements. They can ask relevant questions, and they very often ask about matters not included in the financial statements or in the notes. They simply want to ask about additional information to get a better picture of the company's situation. One may think those questions are mean, but they are not... they are just inquisitive. It is clear that those people know what they are doing.

The frequency of meetings varies depending on the size of the company. For companies listed on various indices on the Warsaw Stock Exchange, the most frequently provided

number of meetings is four. For smaller companies, the number of reported meetings is smaller and varies from zero to two. The auditors also reported that some supervisory boards had not established an AC. Cohen et al. (2010) report an increased number of meetings in the post-SOX era in the American context. The numbers reported in this study are more in line with the results of Cohen et al.'s (2002) study of auditors' experiences at an early stage of the development of CG, before the introduction of SOX. Furthermore, what is striking in the Polish context is the discrepancy in the number of meetings identified by auditors and the number of meetings identified by AC members in another study (Dobija, 2015), in which the AC members reported meeting with the auditor on average at least four times a year. One of the auditors described the interaction with the AC and the management as follows:

In cases when an audit committee does not exist; we only meet with the management. In cases when an audit committee exists, the most frequent reason for a meeting is the selection of a new auditor at the time of the presentation of our offer for audit services. Other meetings depend on our needs. In some cases, we do not meet with the audit committees at all; in other cases, we meet about twice a year.

When contrasted with the regular and frequent meetings of auditors with company management, to whom auditors report with easy and constant access, the effectiveness of AC in the oversight of external auditors seems limited. This can be further confirmed by the analysis of issues discussed with ACs. In general, rather than active or proactive interactions, the auditors characterized their meetings with ACs as passive, during which they would merely report significant audit issues. The auditors reported that the most frequently discussed matters during meetings with ACs related to internal control weaknesses, risks related to financial statements, and the impact of important accounting transactions on the financial statements. However, the meetings were described primarily as informative, during which a discussion of specific issues was limited.

When asked a more general question regarding factors that affect the efficiency of contacts with ACs, all auditors stressed communication as the most important factor; another frequent factor was the availability of people interested in what the auditors had to say and the professional attitude characterized by a lack of emotions in discussions with the auditor. As one of the auditors described it:

The availability of people is the most critical, but also their willingness to solve problems and their curiosity; their interest in the situation of the company. It would be great if it were not a one-sided game. It is very often the case that an

auditor expects some action from an audit committee or the supervisory board, asks for additional information or data, and receives no feedback... So, availability is important but so is an understanding of what the auditor is trying to say, a proactive attitude, and a certain discussion around the issues raised by the auditor.

One of the important responsibilities of ACs is the proving recommendation to the supervisory board to appoint or terminate external auditors and to determine auditor compensation. Prior studies indicate that the management of the company still plays the most important role in auditor retention (Gendron and Bedard, 2006; Cohen et al., 2010; Fiolleau et al., 2013), while the AC takes a more distant or nominal role. The data collected in the study show a similar trend. We asked auditors to share their experience and perception regarding those parties that have the greatest influence on external auditor appointment decisions. Consistent with studies in the Anglo-American context, the interviewees mentioned two parties involved in the decisions: company management and the supervisory board. However, in the context of concentrated ownership, the auditors mentioned a third party: the dominant shareholder. Unsurprisingly, when asked to provide their assessments of the various parties' influence on the appointment decisions, on average, management was identified as most influential (70%, ranging from 80–60%) and the supervisory board was regarded as less influential (30%, ranging from 20–40%). However, the assessment depended largely on the role of the dominant shareholder. One of the auditors described the most influential parties as follows:

The owners. Of course, formally it is always the supervisory board, but very often it is actually the management of the company. The management of the company initiates the process, sends the call for bids, collects the bids, and prepares a shortlist of auditors, then recommends the auditor to the supervisory board. In some cases, the process is also initiated by the supervisory board; in this case, the decision depends greatly on the dominant shareholder. It is very often the case that the dominant shareholder is a bank or an investment fund. The representatives of the bank or the investment fund play an important role in the supervisory board, and they very often convince other members that a certain auditor should be appointed.

When asked to assigned percentages, another auditor said:

There are different cases. There are cases in which the dominant shareholder sits on the management board. I would say that the major voice is that of the (dominant) owner. On the other hand, the dominant owner can sit on the super-

visory board rather than the management board. So, it is actually difficult to give percentages. The decision will be made where the owner has a major voice. There are also cases when the owner is not really interested in financial matters. Then the decision is put in the hands of management with the following words: "If you have a good working relationship with this auditor, you can hire the one you like."

In general, the auditors assessed CG reforms as positive. They see the last five years as a period of significant changes in this area, during which CG has in fact been created in Poland. The change they identified as the most important was the formal requirement to establish an AC. In the opinion of the auditors, some companies now start to have a positive experience with ACs, and one may expect them to gain more such experience and, thus, also the quality of oversight.

The Use of Corporate Governance Information in the Audit Process

In this study, we asked auditors about the nature and extent of the use of CG information in various phases of the audit process (planning, field-testing, and review). Most of the interviewed auditors confirmed that they analyze CG information and use it in the planning phase, but none of the auditors reported that this information is used in field-testing and review phases. Asked whether CG information was used at various phases, one auditor answered as follows:

No. I personally look at those matters, but this is not what is being considered in general. I think my "no" was said too fast. We consider the general assembly minutes, the supervisory board minutes, or the minutes of the management board meetings. But we do not assess those documents from the perspective of corporate governance effectiveness. Instead, we use them to look for potential problems or issues that need to be considered but also to see whether those issues are reflected in the financial statements. We check if a supervisory board, for instance, paid attention to the difficult management issues, such as investment expenditures or special transactions. Those considerations may give us some hints about how to approach the audit.

Another auditor described the same issue as follows:

In general, we assess various risks at the stage of planning, and the fact that a company has an active audit committee or effective control influences the level of risk. If, for instance, we see that the management frequently communicates

with the supervisory board, that the supervisory board is an active monitoring agent, and that the procedures are verifiable because there is an active internal control, then this information will be reflected in the way we assess the risk and plan the other phases of the audit.

All the auditors confirmed that they consider internal control issues in the planning process. The auditors' assessments of the effectiveness of the internal controls influence their decision about the level of risk. In fact, the auditors consider corporate control to be the most important part of this stage of the audit, as later actions will depend on the result of this assessment. The auditors mentioned that they noticed improvements in the effectiveness of corporate control and changes in the quality of the control systems, especially in larger organizations with international capital. In the local companies, the auditors view the control systems as not as developed as those in the larger companies.

We also asked the auditors to assess the use of CG information across different engagements in order to give a sense of the nature of the use of governance information and how it affects the audit process. The responses suggested that larger companies with international capital have more effective governance mechanisms, while the application of those mechanisms becomes more problematic in smaller, local companies. As one of the auditors explained:

There are two types of companies: international companies and smaller, local companies. International companies have already introduced rules and procedures. These are not only on paper but are also applied in practice. In such cases, the companies want to be seen as transparent, and the management board appreciates the role of corporate governance. In the case of smaller companies, corporate procedures are not always applied, and some are only written on paper and not used at all in practice. So, to sum it up, the size of the company has a great impact on the corporate governance of the company.

One of the auditors also indicated that the financial sector is characterized by effective CG mechanisms due to the special supervision of the Financial Supervision Commission (Komisja Nadzoru Finansowego).

Discussion and Conclusion

This paper corroborates previous research on “governance in action,” which analyzed actual processes and interactions within the CG triad: management – ACs – auditors.

All of these actors influence the quality of financial reporting. So far, studies focused mainly on processes within ACs alone. Fewer studies investigated the issues of interaction between ACs and external auditors. In one of the first studies on this issue, Cohen et al. (2002) collect experiences of auditors in 1999–2000 in the USA. This study reports that the auditors include the quality and efforts of CG in their risk assessments and program planning. However, the auditors generally consider ACs to be inefficient. In a subsequent study of auditors' experiences with CG in the post-SOX era, again based on the USA market, Cohen et al. (2010) find a change in auditors' perception of CG. In the post-SOX context, auditors consider boards to be important actors in the governance structure, despite the still-significant role of management in the appointment of the auditor. Similarly, auditors notice the institutionalization of ACs as a governance practice. Auditors consider the knowledge and skills of ACs to be sufficient for the successful monitoring of financial reporting quality. Cohen et al. (2010) also find ACs to be more active and diligent than in the previous study.

The USA and the UK have been pioneers in the introduction of CG reforms. Europe has also addressed the need for CG reforms in order to raise stakeholders trust in the capital market, devastated after a series of financial and corporate scandals in the early 2000s. For instance, a new institution of AC has been introduced to the EU regulation (2005) with a recommendation to the member states to introduce reforms related to CG and, in particular, introduce a requirement of having an AC on boards into the local-country regulation. Böhm et al. (2013) and Hassan and Hijazi (2015) document the experiences of various EU countries with this new governance institution only to notice a rather coercive isomorphism of their practices. Many EU countries introduced the required regulation, which resulted in local companies forming ACs. However, many other view ACs as an alien institution, not invented here, so the actual practice decouples from the intended one, leading to a more symbolic and ceremonial role of ACs (Spira, 1999; Beattie, Fearnley and Hines, 2011). However, research of the UK data shows that – contrary to the earlier studies – ACs became institutionalized as a regular practice. AC is considered as an important element in client-auditor interactions (Beattie, Fearnley and Hines, 2014; 2015).

This study adds a new perspective on the relationship among management, ACs, and auditors. Conducted in Poland, this study deals with a different setting and CG model than the Anglo-American CG model. The results of this study show that external auditors notice some changes in the CG system in Poland, but also indicate management boards, supervisory boards, and company owners as the main actors of the governance system. Inclusion of owners as one of the main actors in the governance mosaic constitute the major difference between countries representing the Anglo-American model

of CG and the Polish data, yet not surprising one. This major differences may be a result from a dominating concentrated ownership structure on the Polish capital market, when it is the dominating owner who has the strongest and direct influence on the company's activities (Dobija, 2015).

Auditors generally recognize the importance of the institutionalization of governance practices, such as the certification of financial statements by the management or the introduction of the concept of independence, but also codes of ethics and whistleblowing procedures. Auditors considered those changes as an important element of CG reforms leading to increased financial reporting quality and, eventually, improved trust in the financial reports.

At the same time, the external auditors' evaluation of practice related to ACs is inconsistent. Surprisingly, external auditors see a limited role of ACs in their interactions with companies, as they observe coercive isomorphic processes in relation to ACs. In companies that decided to form an AC, the committee plays a minor role in the interactions between auditors and management. This finding agrees with a report on the audit market in Poland (International Bank for Reconstruction and Development, 2016). The actual processes of auditor-company interactions decouple from what was prescribed in the regulation. In such cases, the auditors believe that ACs play a more symbolic and ritualistic role. This finding can be compared with the findings in the context of Anglo-American CG model, coming from an early period of the introduction of CG reforms (Spira, 1999; Beattie, Fearnley and Hines, 2011).

However, the auditors also notice the increasing role of the AC in larger companies and when institutional investors are present on the board. In such cases, the auditors view the AC as stronger and leading to better oversight of the company. The auditors stress the importance of specific skills that allow the AC members to perform well. This finding is consistent with the findings of Dobija (2015) and the report of the International Bank for Reconstruction and Development (2016), which analyzed AC practices in Poland and concluded that monitoring is stronger in companies with international ownership than in smaller and family-owned firms. Moreover, research on ACs in Slovenia confirms the importance of ownership structure for the efficiency of AC (Zaman and Valentinčič, 2011). In the case of larger and foreign-owned companies, it is easier to observe isomorphic mimetic processes. AC's processes may mimic the processes used in the parent company, especially in cases when the parent company originates in countries with a stronger CG system. Furthermore, auditors report a rather limited use of CG information in the audit process, which they mostly limit to the planning stage.

One of the contributions of the present study is that it presents auditors' perceptions of CG in a setting that differs from the Anglo-American model. This is in line with a call made by Carcello et al. (2011) to explore the relations between CG and auditing in countries that do not follow the Anglo-American governance model. Moreover, the current paper offers additional insight into auditing and CG practices in Poland.

This paper has also some limitations. First, the paper investigated only experience of auditors working with companies listed on Warsaw Stock Exchange. Second, as being explorative in nature this research does not go deeply in its investigation of influences and interactions among various actors of CG.

What might future research look like? Additional research into AC practices might shed more light on the development of these practices over time. There are a number of issues worth investigating in more depth. We still need to know more about the processes, relationships, and communications, especially among ACs, the management, internal auditors, and external auditors (Bedard and Compernelle, 2014). Specific issues still worth investigating include: the process of external auditor selection; the process of reaching a consensus over a disagreement among the external auditor, the management, and the AC; and the process of communication among external auditor, AC, and management. Our research conclusion raises new questions and opens up a new agenda for research on the interaction process between the key players in the CG mosaic.

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Appendix

Interview questions

1. How would you define corporate governance (CG)?
2. How do you evaluate the role of audit committees (AC) in ensuring the effectiveness of CG systems?
3. Could you describe your interaction with ACs?
4. What is your opinion of the level of expertise and knowledge of AC members?
5. How would you describe the nature and extent of your interactions with:
 - 5.1. the management board?
 - 5.2. the supervisory board?
 - 5.3. internal auditors?
6. How often do you meet with the management board/supervisory board/internal auditors?
7. Who has, in your opinion, the most influence in hiring/firing auditors? Specifically:
 - 7.1. Who has *the real* and *the largest* influence?
 - 7.2. What is the percentage of influence of various agents (managers/supervisory board/ ACs)?
8. What factors influence your interaction with:
 - 8.1. the management board?
 - 8.2. the supervisory board?
 - 8.3. internal auditors?
9. How do you assess the impact of financial statement certification requirements on the management's behavior?

10. How do you assess the new trends in CG and its likely influence on your work in the future?
11. How would you describe the role of CG in the audit process?
12. Do you consider CG issues in planning and conducting audits? What is the nature and extent of these considerations in:
 - 12.1. audit planning?
 - 12.2. field testing?
 - 12.3. review?
13. In your opinion, how important is the existence of a corporate code of ethics and whistleblowing procedures in planning and conducting an audit?
14. Has the scope of those considerations changed over last five years? Is it likely to change in the next five years? If so, how?
15. Describe any differences in your consideration of CG aspects with regard to the following:
 - 15.1. Different risk profile clients;
 - 15.2. National and international clients;
 - 15.3. IPO and long-standing public companies;
 - 15.4. Across industries.
16. What is the nature and extent of your reliance on the work of internal auditors?