Audit Committee Characteristics as Determinants of Non-Audit Fees in UK FTSE 350 companies

Abstract

This study examines trends in audit committee characteristics of companies and associates characteristics subject to major change with a fee-based proxy for audit committee effectiveness.

The research adopts an empirical approach. Using descriptive and inferential statistics, observations for 253 Financial Times Stock Exchange (FTSE) 350 companies' audit committee characteristics gathered from annual reports at the beginning and end of a five-year period are evaluated against averaged non-audit fees (NAF) as a proportion of total audit fees.

Audit committee composition shows increased incidence of female membership and of members with previous audit experience. The increase in members with previous audit experience is more marked where this is gained with the incumbent auditor. An increase is also shown in Chief Financial Officers (CFOs) with previous audit experience. Previous audit experience is associated with reduced NAF as a proportion of total fees. This is marked where audit experience has been gained with the incumbent auditor. These results suggest that the benefits of financial expertise gained from audit experience outweigh impairments to independence due to social ties. Nevertheless, other studies indicate concerns about independence are still well-founded.

This paper's original contribution is to evaluate the potential effect of previous audit experience on those involved in audit committees in the light of concerns raised in the literature and by regulators that external auditor independence should be maintained. The innovative fee-based proxy for audit committee effectiveness facilitates an evaluation as to which influence prevails.

JEL Classification: M42

Keywords: audit committee, corporate governance, financial expertise, incumbent auditor, non-audit service fees

Paper type: research paper

Introduction

Expectations regarding corporate governance of UK Financial Times Stock Exchange (FTSE) 350 companies are set out in the UK Corporate Governance Code of the Financial Reporting Council (FRC) (2018). In principle, the company board appointments are expected to be based on 'merit and objective criteria and, within this context, should promote diversity of gender, social and ethnic backgrounds, cognitive and personal strengths'. An audit committee of at least three independent non-executive directors should be established, of which at least one should have recent and relevant financial experience. The detailed provisions for the audit committee, which should be followed on a 'comply or explain' basis, do not contain further requirements for audit committee composition, but do specify appropriate duties. The audit committee is expected to include in its duties 'approving remuneration and terms of engagement of the external auditor', 'reviewing and monitoring the external auditor's independence and objectivity' and 'developing and implementing policy on the engagement of the external auditor to supply non-audit services, considering the effect this may have on independence'.

Previous empirical studies have considered the characteristics of effective audit committees. Effectiveness of the external audit has been variously linked to the level of audit fees (Aldamen *et al.*, 2018; Beck and Mauldin, 2014; Ghafran and O'Sullivan, 2017; Sellami and Cherif, 2020; Zaman *et al.*, 2011), and the propensity to issue modified audit reports (Basioudis *et al.*, 2008; DeFond *et al.*, 2002; He *et al.*, 2017; Wu *et al.*, 2016). Effectiveness of the audit committee has also been linked to financial reporting timeliness (Abernathy *et al.*, 2015), lower incidence of restatements (Oradi and Izadi, 2020), lower incidence of earnings management (Gull *et al.*, 2018; Mardessi, 2022), lower incidence of internal control weaknesses (Lisic *et al.*, 2016) and the reaction of market returns (Chahine and Filatotchev, 2011; DeFond *et al.*, 2005).

Whether or not financial expertise has been gathered in an accounting role or a non-accounting role has been given significance by studies such as DeFond *et al.* (2005) in which market returns reacted positively to the appointment of a non-executive with accounting experience (a financial expert in a narrow sense), but did not react to the appointment of non-accounting financial experts (financial experts in a broad sense). Abernathy *et al.* (2015) associate financial reporting timeliness with accounting expertise of the audit committee chair and with a stronger link where public accounting experience in the US context auditing experience or a Certified Public Accountant (CPA) licence are present. 'Narrow sense' financial experience has been shown to be a contributor to audit committee effectiveness.

This study took place in the context of the FTSE 350, representing the 350 largest companies listed on the London Stock Exchange (LSE). Previously, Zaman *et al.* (2011) have related effective audit committee characteristics positively to audit fees and non-audit service fees in the UK. Ghafran and O'Sullivan (2017) have related effective audit committee characteristics, particularly accounting-related and non-accounting financial expertise, to audit fees as a proxy for audit quality; Daemighah (2020), based on a meta-analysis of 162 studies, shows that audit quality and fees are positively associated. Wu *et al.* (2016) associated a higher proportion of non-executives and financial experts on the audit committee with audit quality. The proxy for audit quality used by Wu *et al.* (2016) was an increased propensity for the external auditor to give going-concern-modified audit reports prior to company failure. Still, this study differs from previous studies and adds to the existing knowledge and various contributions. While, as indicated earlier, this study approach overlaps with Zaman *et al.* (2011), Wu *et al.* (2016) and Ghafran and O'Sullivan (2017), it differs from the angle related to the incumbent auditor, which makes this study different and contributes to the knowledge as further illustrated throughout the paper. While it will be addressed later in the paper, it is worth noting that the required data for the audit experience were collected manually by a Chartered Accountant to allow the creation of the database needed for further analysis. To the knowledge of the authors, this study is the first in this regard where two stages of data collection took place and then merged in an innovative way to allow generating the results of the study where both emerging and emerged markets should reflect upon the findings to enhance the professional practice moving forward.

Amongst others, former external auditors may be considered to have recent and relevant financial experience to support the duties of an audit committee member. To the best of the authors' knowledge, previous UK studies have not distinguished the characteristics of accounting financial experience gained through auditing or otherwise, and whether or not accounting experience from auditing was gained with the incumbent auditor. Therefore, characteristics of the audit committee have been evaluated, in particular whether members had previous audit experience and whether or not this was gained with the incumbent auditor.

Where previous studies outside the UK have investigated the presence of former auditors on the audit committee, these have been associated with decreased levels of audit and non-audit service fees by Naiker *et al.* (2013) in a US context. Ittonen *et al.* (2019) found an increased proportion of non-audit service fees as compared to audit fees in a banking context, although this was associated with reduced levels of audit fees. However, Ittonen *et al.* (2019) suggested banks including alumni of the incumbent auditor on the audit committee and procuring a larger proportion of non-audit services compared to audit fees were associated with earnings management; Shubita and Shubita (2010) discussed earnings management in further detail. In a different context based on emerging market data, Salehi *et al.* (2019b) address the audit fees association with audit quality in the presence of the financial crises where the conclusion is that there was no significant relationship where their results stayed the same while controlling for the potential impact of the financial crises. Further, Salehi *et al.* (2019a) try via a meta-analysis approach to explore reasons behind various outcomes about audit quality, where the study concludes that the audit firm size and auditor impendence are positively associated with audit quality. Prima facie, appointing an audit committee member with previous external audit experience may appear to pose both an opportunity and a threat to corporate governance of a company. On the one hand, it is an opportunity to gain a non-executive with recent and relevant financial experience in the particular area of financial reporting and internal control which concerns the committee. When the audit experience has been gained in the company making the appointment, the technical context of the financial reporting may be particularly well supported. On the other hand, a former external auditor may pose a threat to the independence of the external audit. A former external auditor, particularly one whose experience was gained with the incumbent auditor, may have social ties with the external auditor. He *et al.* (2017), in a Chinese context, found social ties between the engagement auditor and audit committee were linked to lower quality audits, based on the reduced propensity to issue modified audit reports on financial statements which subsequently needed restatement. Further, again prima facie, social ties might influence a former auditor to favour the current external auditor in policy decisions on awarding non-audit work. This could pose an indirect threat to external audit quality resulting from increased financial reliance on the client. The potential for this risk may be especially clear in the case of an audit committee member whose audit experience was gained with the incumbent auditor.

This report uses the relationship between non-audit service fees and total audit fees as a value against which to evaluate audit committee characteristics, after Ittonen *et al*. (2019). DeFond and Zhang (2014) recognise proxies for audit quality may typically be output based, such as external auditor opinions, or input based, such as auditor size, characteristics or contractual relationship such as fees. The report uses the input-based measure relating to audit and NAF because of its link to the possible concerns which might be raised about the independence of audit committee members with previous external audit experience. A a broad range of audit committee characteristics have been used to evaluate against the measure of audit and NAF. In particular, whether an audit committee member has previous audit experience and whether this was gained with the incumbent external auditor has been identified. In doing this, this study responds to the need identified by DeFond and Zhang (2014) for more research on auditor and client competency in driving audit quality.

The impact of the characteristics of audit committee composition on UK corporate governance depends both on the results identified with the characteristics and the extent to which these characteristics appear in the composition of UK audit committees. Therefore, the descriptive statistics trends in the characteristics of audit committee board membership in the UK FTSE 350 are considered.

Indications of a perception that auditor independence may be threatened by NAF are evident in the FRC (2018) provisions requiring audit committees to be responsible for 'developing and implementing policy on the engagement of the external auditor to supply non-audit services, considering the effect this may have on independence'. Such provisions may be traced back to concerns expressed in the second report of the House of Lords Economic Affairs Committee, 'Auditors: Market concentration and their role' (House of Lords (2011), which nevertheless considered there was no justification for a complete ban on the provision of non-audit work by auditors to their clients. Within empirical studies, Basioudis *et al.* (2008) associate the magnitude of NAF with a reduced propensity to issue going-concern-modified audit reports. This suggests perceptions that auditor independence may be compromised by NAF can be well-founded. However, DeFond *et al*. (2002) found no such association between NAF and going-concern-modified audit reports in the context of US companies. The effect of non-audit service fees on auditor independence is thus unclear from empirical studies, as noted by Tepalagul and Lin (2015). Surveys of investor perceptions such as Dart (2011) and Onulaka *et al.* (2019) have identified that NAF are widely viewed as a threat to auditor independence. Experimental research carried out by Meuwissen and Quick (2019) also indicated concern amongst members of German company supervisory boards about the effect of non-audit service fees on their level of trust in the auditor.

This research contributes to the literature on corporate governance and audit committees by identifying trends in the characteristics of member and CFO appointees. Associations are made between the characteristics which have most significant upward trends with a fee-based proxy for audit committee effectiveness. In particular, this study distinguishes audit experience gained with the incumbent audit firm from experience gained with other external audit firms. This allows conclusions to be drawn on whether the favourable impact of relevant financial expertise or the unfavourable effect of compromised independence through social ties dominates. This information is of relevance to company boards making appointment decisions and to regulators formulating guidance on best practice.

The report investigates the composition of audit committees for FTSE 350 companies in 2010 and 2015. The percentage of audit committees including members with previous audit experience increased by one-third, from 30% to 40% of the boards reviewed. Audit committees including members with previous experience gained with the incumbent auditor doubled, from 7% to 14% of the companies. The increase in representation on the audit committee of members with previous audit experience gained with the incumbent auditor is striking. Audit committee members with previous audit experience were associated with reductions in non-audit service fees as a proportion of total audit fees, although this was more marked where experience was gained with the incumbent auditor. CFOs with previous audit experience were present in 29% of the companies in 2010, rising to 35% in 2015. CFOs with audit experience were associated with a more significant reduction in NAF as a proportion of total audit fees than for previous auditors on the audit committee. Companies with female members present on the audit committee increased dramatically, doubling from 40% in 2010 to 80% in 2015.

The innovative contribution of this paper is to differentiate the association between the presence on audit committees of the FTSE 350 companies of experienced auditors who are and who are not alumni of the incumbent auditor, and audit quality measured by the proxy of NAF as a proportion of total audit fees. In addition, the necessary data were collected by examining the annual reports and then results linked over a longitudinal analysis to offer an additional layer to the ongoing debate about this critical topic that is essential to academics and professionals.

This distinguishes the study from work such as Lee and Mande (2005) and Rani (2018), in which members of the audit committee have previous audit experience, as the analysis was extended to whether or not this gained with the incumbent auditor is not differentiated.

The proxy measures in percentage, extracted from the DataStream, where the computations are done in harmony across the FTSE 350 companies; the study ends by combining primary data from the annual reports with secondary figures from the DataStream to drive results based on actual data as shared with the public.

In considering the implications of the study's results it is important to bear in mind the importance of the context in which an audit committee operates. Compernolle (2018) has observed the extent to which the audit committee holds the CFO to account. Thus, interpersonal transactions and power balances in addition to formal audit committee attributes may influence financial reporting and the effectiveness of corporate governance. In an Australian context, auditor risk assessments were found to be affected by auditor-chosen indicators of audit committee effectiveness and unaffected by the criteria set out by regulations (Contessotto and Moroney, 2014). Recently, McGregor and Carpenter (2021) have raised the issue that direction by regulation may impede those charged with corporate governance in carrying out their statutory duties. Lisic *et al.* (2016) observed that where Chief Executive Officer (CEO) power is relatively low and there is more audit committee financial experience (in the narrow sense), this is negatively associated with internal control weaknesses, but, as CEO power increases, this negative association is lost. Beck and Mauldin (2014) observed in the context of declining fees that smaller fee reductions occurred when audit committee tenure exceeded CFO tenure and larger fee reductions where the CFO tenure exceeded the audit committees. Thus, a relatively powerful CFO became more influential in decision-making that should lie with the audit committee.

The next section of the study sets out the choice of audit committee characteristics investigated and the fee-related measure against which they are evaluated. This is followed by details of the sample and the descriptive statistics and analysis of the findings. Finally, conclusions are discussed.

Theoretical background and hypothesis development

Social ties between external auditors and audit committee members were investigated by He *et al*. (2017) and found to be linked with reduced quality in audit reporting. The propensity to issue modified audit reports in cases where financial restatements were required was taken as a measure of audit quality. The context of the study were companies taken from the China Stock Market and Accounting Research Data Base where social ties identified were school ties, teacher-student relationships and employer affiliation. Employer affiliation with respect to audit firms has been investigated for banks included in the S&P Composite 1500 index (Ittonen *et al.*, 2019). Banks with audit committees chaired by alumni of the incumbent audit firm received an increased level of non-audit services, as a proportion of total fees, from their auditor. This was found to result from lower levels of audit fees rather than increased NAF. An earlier study (Naiker *et al.*, 2013) investigated the composition of audit committees of US companies listed in the Corporate Library database. The presence of former audit partners on audit committees was associated with lower purchases of non-audit services. Furthermore, appointments of former audit partners to audit committees which had not previously had such members was associated with a reduction in the purchase of non-audit services. The importance of social ties is also featured by adopting an impression management viewpoint of interview responses by participants in French company audit committee activities (Compernolle, 2018). Fung *et al.* (2022), based on US data, found that the competitive advantage of the incumbent auditor in the local market influences the audit quality in the context of client corruption culture. While this study approach is different, Fung *et al.* (2022) illustrate the value relevance of the incumbent auditor on the audit quality, which this paper argues from a different perspective.

This study also evaluated audit experience of audit committee members while separately identifying those with audit experience gained from the incumbent audit firm, as in Naiker *et al*. (2013) and Ittonen *et al*. (2019). This study is distinguished from Naiker *et al.* (2013) through the investigation of UK companies rather than those of the US, and from Ittonen *et al.* (2019) through the consideration of the whole UK FTSE 350 rather than a sector base in banking. Furthermore, CFO audit experience is evaluated. The potential importance of this link is demonstrated by the findings of He *et al.* (2017) and Compernolle (2018) on interpersonal relationships. Beck and Mauldin (2014) have demonstrated the significance of CFO influence on the level of external audit fees.

Gender of audit committee and other supervisory board members has also been investigated in relation to decision-making. Lai *et al.* (2017) investigated gender diversity on boards and audit committees in US firms taken from the Corporate Library and Audit Analytics databases. The presence of female directors was associated with 6% higher audit fees and the presence of female audit committee members with 8% higher audit fees. A study of non-financial companies on the Swedish NASDAQ OMX (Sellami and Cherif, 2020) also found female audit committee membership associated with higher audit fees. Audit committee members' board membership or industry experience was also found to be influential. Female audit engagement partners were associated with significantly higher audit fees in a study across Nordic NASDAQ OMX exchanges in Finland, Denmark and Sweden (Ittonen and Peni, 2012). However, in an examination of S&P 500 firms, Ittonen *et al.* (2010) found firms with female audit committee chairs had significantly lower audit fees. In an Iranian context, Oradi and Izadi (2020) associated the presence of at least one female audit committee member with a lower incidence of financial restatements and reduced financial restatements were taken as a proxy for audit quality. However, in the same study, it is worth noting that female audit committee membership was associated with both higher and lower levels of audit fees. In an investigation of companies listed on the Australian Securities Exchange, Aldamen *et al.* (2018) identified a positive link between the presence of female audit committee members and higher audit fee levels. It was, however, possible to distinguish a positive relationship in situations of large firms and high risk, from a negative relationship in small firms and low-risk situations. Such effects are described as 'demand side', where the diligence of female audit committee members was associated with a requirement for more advanced audit effort to increase assurance. 'Supply-side' effects were found where the diligence of female audit committee members resulted in a lower audit risk assessment and a reduced requirement for audit work to provide sufficient assurance. However, the Aldamen *et al.* (2018) study produced contradictory results in the case of complex audit engagements where female audit committee membership dampened the relationship between complexity and audit fees. Further, in a study of Canadian firms listed on the Toronto Stock Exchange (Deslandes *et al*., 2020), a gender diverse audit committee was not found to lead to less tax aggressiveness. The categorisation of directors by gender was challenged by Tremblay *et al.* (2016) in a study of perceptions of board members of government-controlled, commercially focussed companies in Quebec. Two strands of positive argument in support of female directors emerged from the thematic analysis of a survey by interviews. One strand of argument promoted female directors by attributing them with attitudes and abilities less prominent in males. This argument could be challenged as a stereotypical view of males and females which denied their individuality. The other argument in support of female directors 'disgendered' them through justifying their presence based on relevant skills and experience regardless of gender. However, the acquisition of relevant skills and experience was historically relatively difficult for women to obtain in a discriminatory environment. Thus, both supportive arguments above could be interpreted as 'symbolic violence' unfairly denying the value of an individual.

The attribution of characteristics to committee members based on male or female gender may now be seen to be controversial. However, the presence of female audit committee members in this study has been evaluated as Ittonen *et al.* (2010), Ittonen and Peni (2012) and subsequent studies produce a variety of findings. Financial expertise and quality of corporate governance were considered by Deslandes *et al.* (2020) in their examination of the association between audit committee characteristics and tax aggressiveness. Financial and accounting expertise, audit committee tenure, service on other audit committees, frequency of attendance and size of the audit committee were all found to reduce or curb tax aggressiveness. In an emerging economy context (Zhou *et al.*, 2018), little association was found between audit committee foundation and firm performance for companies listed on the Athens Stock Exchange. Firms with large boards were associated with better performance and more independent boards with poorer performance. Board independence was not related with future poor performance, indicating there was not a causal relationship between board independence and poor performance. The conclusion drawn was that expertise was more important than independence in the context of an emerging economy. A key contribution of this study is to review the extent and effect of audit committee membership of financial experts with previous audit experience. This study, therefore, evaluated financial experience of audit committee members, whether members had previous audit experience and whether this was gained with the incumbent auditor.

Given the importance of the quality of governance as demonstrated by Deslandes *et al.* (2020), this study evaluated the size of audit committees and level of attendance at audit committee meetings.

An experimental investigation of supervisory board members in Germany was undertaken by Meuwissen and Quick (2019). Supervisory board members' perceptions were that reduced levels of trust in auditor independence were demonstrated for all categories of service: tax consulting, financial information consulting and human resource consulting. While tax consulting and financial information consulting are not allowed by auditors in Germany, surprisingly, human resource consulting was demonstrated to have the most negative effect on perceived independence. In the Naiker *et al.* (2013) study on the association of audit committee composition and the purchase of non-audit services, a reduction was found when a former audit partner served on the audit committee. This was found to be the case regardless of whether the former audit partner serving as an audit committee member was affiliated with the incumbent audit firm. Al-Okaily and BenYoussef's (2020) study addressed the potential impact of the audit committee effectiveness on NAF but only within the context of family versus non-family firms. Whereas Ali *et al.* (2018) is based on Australian data.

The studies above took a variety of approaches to evaluating audit quality. An increased level of audit fees may be taken as an indicator of external audit quality from the 'demand-side' effect of a requirement for increased assurance (Aldamen *et al*., 2018; Lai *et al*., 2017; Sellami and Cherif, 2020). Alternatively, higher audit fees may be seen as an indicator of external audit quality from the 'supply-side' effect of a more diligent or risk-averse auditor (Ittonen and Peni, 2012). However, a reduced level of audit fees may be taken as an indicator of audit committee effectiveness resulting from the 'supply-side' effect of lowered external auditors' risk assessments (Ittonen *et al*., 2010). Audit committee effectiveness has also been linked with reduced tax aggressiveness (Deslandes *et al*., 2020) and reduced requirements for financial restatements (Oradi and Izadi, 2020). An increased propensity for financial restatements following the issue of an unmodified audit opinion was taken as an indicator of impaired audit independence by He *et al.* (2017).

In line with studies such as Naiker *et al*. (2013), this paper evaluated relevant characteristics of audit committees from those identified above against the relationship of NAF to audit fees. This measure is particularly appropriate for this study as its use contributes to considerations of whether independence may be compromised, for example, as indicated by a propensity to directly increase non-audit service work to the external auditor.

As per the earlier argument, the analysis of the study will address the earlier points by presenting the corresponding figures for each audit committee characteristic throughout the discussion to show related trends, mainly about each element. In addition, this study added one central hypothesis about the potential relationship of previous audit experience with the NAF. This was done to keep the focus on a specific goal aligned with the earlier discussion.

The association with audit effectiveness of a range of audit committee characteristics is of interest to, and considered by, this study as per the earlier argument. Financial expertise is associated with effectiveness of audit committees, with some studies finding financial reporting or auditing expertise particularly valued (DeFond *et al.*, 2005; Abernathy *et al.*, 2015). Of particular interest is membership of the audit committee by those with previous audit experience gained with the incumbent auditor. A concern over independence arises in such cases: it is at least possible personal ties could influence audit committee independence such that the incumbent auditor is favoured with the award of non-audit services.

This study raises the question: "Does the presence of members on audit committees who are alumni of the incumbent audit firm, reduce the benefit to committee effectiveness of their expertise?" This may be used to develop a hypothesis below to complement the earlier argument around this element.

Following the findings of studies such as Naiker *et al.* (2013), it would suggest previous relevant audit experience could be more influential than perceived threats to independence. So, the hypothesis is formulated as follows:

The presence of previous audit experience in the FTSE 350 companies expects to have an impact on the ratio of non-audit fees to total fees.

Data and methodology

This study adopted an empirical approach to investigate links between audit committee characteristics and non-audit services. The study performed descriptive and inferential statistics to explore and examine audit committee membership characteristics' association with the relative value of non-audit services to total audit firm fees.

The sampled companies were the larger companies from the LSE listing. The FTSE 350 listing was used. FTSE 350 is a UK market index that includes FTSE 100 and 250 indices; FTSE 100 represents the highest market capitalisation companies listed on the LSE, and it consists of 101 companies considered the first tier of companies listed on the LSE, while FTSE 250 includes the second tier of companies per the market value. So, FTSE 350 is a combination of both FTSE 100 and 250. Still, however, there is a third index named FTSE SmallCap, which is the third and final index that forms the FTSE Allshare index. However, the FTSE SmallCap is unstable compared to FTSE 350 and it is a fluid index compared with FTSE 350 (which reflects on FTSE 100 and 250). Therefore, it was concluded that the study would be based on FTSE 350 since it is more stable compared to the FTSE SmallCap, representative of the LSE as it includes 351 companies (101 plus 250) and allows variation among the 350 companies rather than being limited, for example, to the FTSE 100 index.

The study used hand collection from the financial reports for 2010 and 2015 to gather data on the following seven variables about the audit committee:

- Number of members
- Financial experience
- Previous audit experience

- Previous audit experience with the incumbent auditor
- Attendance
- Chief Financial Officer – previous audit experience
- Number of female members

Of the characteristics identified above, previous audit experience, previous audit experience with the incumbent auditor and CFO previous audit experience are explicitly linked with contact with audit practitioners. These were taken to be key characteristics against which to evaluate NAF as a percentage of total fees.

After collating, the hand collection covered two years: 2010 and 2015; only companies where valid data about the variables were available for both 2010 and 2015 were used. The number of companies declined to 253 companies, of which 91 companies were from FTSE 100 and 162 companies from FTSE 250.

For the 253 companies remaining in this study, NAF was collected as a percentage of total audit fees from DataStream. NAF was averaged as a percentage of total audit fees for the years 2016 to 2018, creating a value NAF for use in analysis of the above variables. As part of the robustness tests, all the analysis was replicated per the raw NAF figure where the trend of the results stays the same. While confidence is high regarding the robustness of the variable measurement based on the DataStream parameters, it is worth noting that other studies – like Lai (2023), based on US data – differentiate between various elements of NAF in nearing its impact on the audit report lag, which is worth mentioning here as a potential extension for future studies in this context.

Variables Management

Table 1 presents the study's variables and the relevant information. The following tables 2-7 present further information about variables, and table 8 shows the results for the NAF variable concerning different variables, mainly about the previous audit experience.

Table 1: Variables and their definitions

Panel A: Audit Committee Characteristics		
Variable	**Description**	**Source**
Number of members	Size of audit committee	Published annual reports
Financial experience	Number of members with financial expertise	Published annual reports: Bio of audit committee members
Previous audit experience	Number of members with audit experience	Published annual reports: Bio of audit committee members
Previous audit experience with the incumbent auditor	Number of members with audit experience in the same auditing company	Published annual reports: Bio of audit committee members
Attendance	Percentage of attending audit committee meetings	Published annual reports
Chief Financial Officer – previous audit experience	A binary variable to capture the previous audit experience	Published annual reports:

	for the Chief Financial Officer	Bio of the Chief Financial Officer
Number of female members	Number of female members in the audit committee	Published annual reports
Panel B: Audit and Non-Audit Fees		
Non-audit fees (ratio)	Non-audit fees divided by the audit and audit-related fees paid to the auditor	DataStream – Code ECSLO16V
Audit fees (amount)	For robustness tests – amount paid to the auditor	DataStream – Code WC07800

Descriptive Statistics

The distribution of size of the audit committee measured by the number of members is presented in table 2.

Table 2: Number of Members in Audit Committee

Size of Audit Committees	**Year**		**Total**
	2010	2015	
2	6	5	11
3	115	89	204
4	98	100	198
5	25	41	66
6 & above	9	18	27
Total	253	253	506

Table 2 presents the size of the audit committee measured by the number of members, showing that the overall average is around four members as mean and median. The size shows a slight increase in 2015 compared with 2010 figures. Audit committees with three or fewer members decreased in number, while those with four or more members increased in number. The mean size of audit committees increased by 5% from 3.7 to 3.9 members from 2010 to 2015. Results in table 3 show that the number of audit committee members with financial experience tended to increase from 2010 to 2015.

Table 3: Financial Experience for Audit Committee Members

No. of members with financial experience	**Year**		**Total**
	2010	2015	
2	115	76	191
3	100	110	210
4 & above	27	53	80
Total	253	253	506

Results in table 3 show increases in members in the audit committee with financial experience. Percentage of audit committees' members with financial experience was computed. It was found that around 50% of the audit committee had earlier financial experience where this percentage was around 47% in 2010, increasing to reach 53% in 2015. While the number of audit committees with one member having financial experience reduced from 2010 to 2015, the number of committees with two or more members increased.

Audit committees having more than one member with financial experience increased from 138 companies in 2010 to reach 177 companies in 2015.

Table 4, panels A and B, presents figures related to previous audit experience of audit committee members.

Table 4: Audit Experience for Audit Committee Members

Panel A: Previous Audit Experience for Audit Committee Members			
Presence of previous audit experience	**Year**		**Total**
	2010	2015	
Yes	77	100	177
No	176	153	329
Total	253	253	506
Panel B: Previous Audit Experience with the Same Auditor			
Presence of previous audit experience with the same auditor	**Year**		**Total**
	2010	2015	
Yes	18	35	53
No	235	218	453
Total	253	253	506

Results as presented in table 4, panel A, show that members without audit experience declined from 176 in 2010 to 153 in 2015, a total of 329, representing 65% of the observations for the whole sample. Companies with audit committee members with previous audit experience increased in total from 77 in 2010 to 100 in 2015. The total of 177 represents 35% of the companies from the firm year observations. There was an increase in companies with members of the audit committee having previous audit experience from 30% in 2010 to 40% in 2015. Of the companies with audit committees with members having audit experience, those with more than one member with audit experience increased from 8% in 2010 to 20% in 2015. There was clearly an increase in representation in absolute terms on FTSE 350 company audit committees of members with previous audit experience.

Panel B in table 4 shows that in companies with audit committee members with previous audit experience gained with the incumbent auditor, the number of audit committee members who had experience with the same auditor almost doubled, jumping from 18 for 2010 to 35 for 2015. The total of 53 represents 10% of the companies from the firm year observations. There was an increase in companies with members of the audit committee having previous audit experience with the incumbent auditor doubling from 7% in 2010 to 14% in 2015. In 2010 only one of the companies with an audit committee with members having audit experience with the incumbent auditor had more than one such member, and in 2015 there were no companies with this level of committee membership. Nevertheless, a striking increase was found in representation in FTSE 350 company audit committees of a member with previous audit experience gained with the incumbent auditor.

Table 5 presents results on the level of attendance at audit committees.

Table 5: Attendance Reports

Year	Mean	N	Std. Deviation
2010	97.03%	253	6.113%
2015	98.37%	253	4.000%
Total	97.70%	506	5.204%

As per figures in table 5, levels of attendance at audit committee meetings were found to be high and remained largely consistent between 97% in 2010 and 98% in 2015.

Table 6 presents previous audit experience of Chief Financial Officers.

Table 6: Previous Audit Experience for Chief Financial Officer (CFO)

Presence of previous audit experience for the CFO	Year		Total
	2010	2015	
Yes	74	88	162
No	179	165	344
Total	253	253	506

Results, as presented in table 6, show that the number of CFOs with previous audit experience increased from 74 in 2010 to 88 in 2015. The total of 162 represents 32% of the companies from the firm year observations standing for 32% of the whole sample. This is consistent with earlier results about audit committee members in terms of trend and percentage. There was an increase in companies whose CFOs had previous audit experience from 29% in 2010 to 35% in 2015. This study explored the names of previous auditor firms where the CFO served before to find the vast majority within the Big Four auditing firms; detailed results are available from the authors. It is not surprising that most CFOs who were previously auditors came from Big Four firms when the great majority of FTSE 350 companies are audited by the Big Four. In 2019, only 15 of the FTSE 350 were audited by three smaller firms (FRC, 2020).

Table 7 presents results on representation of females on audit committees.

Table 7: Distribution of Audit Committee per Gender

Presence of female members in the audit committees	Year		Total
	2010	2015	
Yes	102	203	305
No	151	50	201
Total	253	253	506

Results in table 7 show the female presence in audit committees almost doubled from 2010 to 2015. Companies with female audit committee members increased in total from 102 in 2010 to 203 in 2015. The total of 305 represents 60% of the companies from the firm year observations. Of the companies with female audit committee members, those with one female decreased from 85% in 2010 to 66% in 2015, while those with two or more females increased from 15% to 34%. There was a striking increase both in FTSE companies with female audit committee membership and in audit committees including more than one female. Further analysis, which is not reported, reveals increases in female presence by two members and even three members as we move from 2010 to 2015. This leads to an increase in the mean of the overall female percentage to 28% in 2015 compared to 12% in 2010.

Analysis

As per the earlier discussion, which addressed various variables as informed by the literature to highlight the characteristics of the periods used, investigations were conducted to explore the potential drivers for NAF.

As a starting point, as illustrated earlier, the percentage of NAF of total fees as presented by DataStream was picked up as the variable for NAF; please refer to table 1 for further details about this variable. By selecting this variable based on percentage, the study mitigated the size impact and reduced drivers for noise. The study also excluded companies where either this variable is missing, or where the percentage of the NAF exceeded 100%. The number of valid observations after considering the new variable declined to 192 companies.

The way this variable is measured is by combining the NAF over three years from 2016-2018. This is, therefore, not allowing one year to dominate the outcome and it incorporates a more comprehensive approach to present results based on reality and rule out any chance to allow unusual years to dominate results.

At this stage, a new dataset was created in the analysis to account for the new dimensions that added to a link between the NAF and other variables.

The overall percentage of the NAF equals 22.04% for 192 valid observations; this figure was not run per sector since the aim was to explore this practice among FTSE 350 companies.

Table 8: Previous Audit Experience and Non-Audit Fees

Panel A: Audit Experience			
Factors	Previous Audit Experience	Non-Audit Fees %	Observations
Chief Financial Officer	Yes	0.2078	80
	No	0.2293	112
Audit Committee member(s)	Yes	0.2138	96
	No	0.227	96
Panel B: Audit Experience with the Same Auditor			
Factor	Previous Audit Experience with the same auditor	Non-Audit Fees %	Observations
Audit Committee member(s)	Yes	0.199	33
	No	0.2248	159

This study hypothesis is testing using various factors, and will examine the multiple elements similarly to maintain harmony in the analysis and offer a holistic view of the hypothesis. Table 8 presents the results related to the hypothesis as per each element; the comments will take place in this section and then move to the discussion and conclusion section as the last section of the paper.

- The first factor considered is the earlier experience of the CFO:

Mean non-audit fees were compared as a proportion of total audit fees (NAF) against composite values representing the audit committee and CFO characteristics above.

Where a CFO of a company having previous audit experience was present in either 2010, 2015 or both years, it was found, as per results in table 8, the mean non-audit fees as a proportion of total fees (NAF) lowered to 0.2078 with 80 companies (valid observations) as compared to 0.2293 with 112 companies, where a CFO with audit experience was not present. Such a trend suggests that companies are saving NAF where the CFO has earlier audit experience, but this study – while showing a clear trend – did not support such a trend with significant evidence and shows the running of the Analysis of Variance (ANOVA) to explore the significance level results, were insignificant. Still, this study offers the first indication where it may vary among sectors suggesting further studies in this field to explore this dimension. Beck and Mauldin (2014), in a US context, have previously demonstrated the significance of CFO influence on the level of external audit fees. This study extends this by initiating an investigation into influence and levels of NAF. The one-way ANOVA was selected as the best inferential statistical tool to compare between different groups given the measurement scale used in measuring the variables as listed in table 1. Timming (2022; p. 56) provides further discussion that supports this standing.

- The second factor is about earlier audit experience for one or more from the audit committee members:

Where at least one member of a company's audit committee who had previous audit experience was present in either 2010, 2015 or both years, it was found that the mean non-audit fees as a proportion of total fees (NAF) lowered to 0.2138 as compared to 0.2270 where no audit committee member with previous experience was present. The number of observations was equal for both (96 each); the same trend suggests the same idea in the same manner for the CFO, and the ANOVA test shows that results are not significant.

Where at least one member of a company's audit committee who had previous audit experience with the incumbent auditor was present in either 2010, 2015 or both years, this study found the mean non-audit fees as a proportion of total fees (NAF) lowered to 0.1990 with 33 companies as compared to 0.2248 with 159 companies where no audit committee member with previous audit experience with the incumbent auditor was present. These results are consistent with those of Naiker *et al*. (2013) who investigated the composition of audit committees of US-listed companies and found the presence of former audit partners on audit committees associated with lower purchases of non-audit services. This study argues that the results provide a clear trend in variation with NAF when one or more audit committee members has earlier audit experience with the same auditor. However, due to the subsample sizes, this trend was insignificant per the ANOVA test.

The earlier findings in table 8 show a decline in the percentage of NAF in the same expected manner at the hypothesis development. At the same time, the ANOVA results suggest more work to take place via future studies to establish a more robust statistical inference of the trend of the results.

As robustness tests, earlier tests were replicated using the total NAF by collecting the total audit fees and multiplying the percentage of NAF to find the raw figures of NAF; table 1 presents further details about this variable. All results show the same trend where there is a decline in NAF when there is an earlier audit experience in general or with the same auditor. The analysis of the total audit fees per earlier variables was not completed as it is beyond the scope of this study.

Discussion

The descriptive statistics indicate a trend towards the inclusion of members with previous audit experience on FTSE 350 companies' audit committees. This was particularly striking in respect of the doubling of members whose experience was gained with the incumbent auditor. Equally striking was the increase in female membership of FTSE 350 companies' audit committees. Although less marked, an increase was found in FTSE 350 companies' CFOs with previous audit experience.

Overall, the analysis showed all involvement of those having audit experience in the workings of the audit committee was associated with lower levels of NAF compared to total audit fees. This applied both to audit committee members and CFOs, and both to experience gained with the incumbent auditor or elsewhere. The study found that the presence of CFOs with previous audit experience associated with 9.38% lower overall NAF compared to total fees, the presence of audit committee members with previous audit experience with 5.81% lower NAF and the presence of audit committee members with previous experience gained with the incumbent auditor with 11.48% lower NAF.

With respect to audit committee members being associated with lower NAF as a proportion of total fees, the findings for the UK FTSE 350 are in line with those of Naiker *et al.* (2013) for US-listed companies.

On the basis of the data and analysis in this study, previous audit experience has a positive relationship with a lower level of NAF relative to total fees. This is most marked where the CFO has previous audit experience, which is suggestive of a powerful CFO role after Beck and Mauldin (2014). However, a lower level of NAF relative to total fees is also observed where audit committee members have previous audit experience. It was found that the lowering of the proportion of NAF associated where the audit committee members' audit experience was gained with the incumbent auditor.

The impact of the previous audit experience on the ratio of NAF to total audit fees was considered as another illustration of the lack of independence. The demonstrated effects of the prior audit experience, mainly when audit committee members are alumni of incumbent auditors, raise further concerns about the independence of such members. This study joins the debate raised by He *et al.* (2017) and Ittonen *et al.* (2019) that took place in other contexts and countries. These results support Naiker *et al.'s* (2013) findings about the decline of the NAF ratio to the total fees and extend that in addressing this impact on various elements as illustrated earlier.

In relevant literature, such as Naiker *et al.* (2013), the lower proportion of NAF as a proportion of total fees may be seen as indicative of strong corporate governance. The trend towards increased representation of individuals with previous audit experience on audit committees and as CFOs may therefore be seen as a positive development.

These results suggest that the appointment of audit committee members who are alumni of incumbent auditors has an increased impact on the reduction of the NAF ratio to total audit fees compared to those from other firms.

Conclusion and direction for future studies

In conclusion, this paper appeals to contemporary auditing issues, both in practice and academically. An interesting discussion took place on BBC4 demonstrating the relevance of this topic, provided in the following link: https://www.bbc.co.uk/sounds/play/m0002mg6, entitled 'In the wake of accounting scandals, does the audit business need to be overhauled?' The same also applies in many professional and governmental contexts.

This study flagged the presence of audit committee members who are alumni of incumbent auditors on the NAF as a proportion of the total fees, which is a new trend given capturing the alumni of incumbent auditors was not something available via secondary published figures where the current study manages to measure this variable via a manual approach that took a lot of time and effort. So, in this regard, the outcome of this study came to offer support to the white paper issued by the UK government entitled 'Restoring trust in audit and corporate governance' in 2021, followed by a collection of articles and white papers published by the government on 19 July 2023 as published in this link: https://www.gov.uk/government/news/business-secretary-launches-major-overhaul-of-uks-audit-regime-in-wake-of-big-name-company-collapses where the relevant extract below states:

"*A new regulator, the Audit, Reporting and Governance Authority (ARGA), which could oversee the largest unlisted companies as well as those on the stock market, will also have the power to impose an operational split between the audit and non-audit functions of accountancy firms, to reduce the risk of any conflicts of interest that may affect the standard of audit they provide*."

The current study is the first to illustrate a relevant relationship. It should influence the improvement action to restore the trust in auditing provision within the UK context, along with future impact moving forward on other markets.

In addition, this study's in-depth exploration of audit committees by reviewing all annual reports, mainly information about audit committees published in the annual accounts and establishing relationships via another database, came in the same direction from the UK government findings as announced on the collection in the link: https://www.gov.uk/government/news/business-secretary-launches-major-overhaul-of-uks-audit-regime-in-wake-of-big-name-company-collapses. At the same time, the relevant extract is copied below:

"*New powers for the regulator to set and enforce standards for FTSE 350 companies' audit committees; new powers to impose an operational split between the audit and non-audit functions parts of accountancy firms; and new powers to monitor the resilience of the largest audit firms, together with improved powers to monitor the broader audit market*."

With the same call to pay attention to the NAF in the same manner, this study addressed this topic with an innovative approach. Hence, this study contributes to a merging issue relevant to the policy-making process. This paper opens the door for further studies in this field where further explorations are recommended to cover more years and examine the findings per sector. This study offers academic and professional evidence about the impact of NAF on auditor independence.

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