

Separate Auditing or Not? The Impact of Relational Concern on Board of Director's Choice of Auditor in Chinese Public Listed Companies?

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Abstract

This paper was aiming to address an in time research question: why Chinese public listed companies showed differences in terms of the number of auditors they used to audit internal control over financial reporting and financial statement under new regulations on security exchange. Integrating theoretical perspectives from both intra and inter organization studies, the author explained the influence of relational concern brought by the directors who held multiple functions on board's choice of auditor. The author pointed out that the multifunctional directors were prevalent in Chinese firms and the presence and proportion of such directors in the board would make the concern about the internal and external relationship salient during the choice of auditor. A series of propositions regarding to the influence of board-top management team relationship, the relation with other companies' boards, and the enterprise-government relationship brought by the multiple function directors have been proposed. This conceptual paper enriches our understanding about the influence of intrapersonal diversity on team decision making process, and has implication for Chinese regulators on how to boost separate auditing.

Keywords: Decision making, Inter-group relationship, Interlocking ties, Enterprise-government relation, Intra-personal diversity

1. Introduction

The current study is conducted in a background when China's Ministry of Finance, Securities and Futures Commission, Audit Commission, China Banking Regulatory Commission, China Insurance Regulatory Commission have jointly issued the first "basic norms of internal control" (hereafter refer to NORM) in China at the end of June, 2008. The issue of NORM is a major reform initiative in the security exchange in China, and the NORM is known as the Chinese version of the Sarbanes-Oxley Act (SOX). The aim of the NORM is the same as SOX, which is to ensure the credibility of the financial statements. According to the NORM, "from the July of 2009, Chinese public listed companies are required to self-evaluate the effectiveness of their internal control and disclose annual internal control over financial reporting (ICFR). They may engage with the securities and futures business qualified accounting firm to audit the effectiveness of internal control." As a result, Chinese listed companies have to disclose both annual internal control over financial reporting and annual financial statement.

The internal control over financial reporting could be treated as the complement evidence for the credibility of financial statement. One phenomenon observed so far is that before the formal implementation of NORM (July 2009), Chinese firms have already shown differences in terms of the number of auditors they used to audit the internal control over financial reporting and financial statement. The NORM hasn't specified whether the internal control over financial reporting must be audited, by the same or different auditors for the financial statement auditing. Therefore, some firms only disclose rather than audit internal control over financial reporting, some firms use the same auditor for both financial statement and internal control over financial reporting, and other firms choose different auditors to audit the two reports separately (hereafter refer to *separate auditing*). Zhang and Wang (2009) manually collected 1543 annual reports of companies listed in Shanghai and Shenzhen stock market in the year of 2008, and found that in total 113 companies voluntarily disclosed and audited their internal control over financial reporting.

Among these, 71 companies used the same auditor for both internal control over financial reporting and financial statement, and while 42 companies used separate auditing (37%). The author suggests that from the regulators' perspective, separate auditing is ideal and commendable since using different auditors for two reports' auditing could reduce information asymmetry between the stakeholders and companies and thus protect the rights of the investors. Zhang and Wang (2009) also found that separate auditing could enhance the quality of auditing opinion and help the firm reduce the probability of penalty. They pointed out that separate auditing could be a substitute for the punishment mechanism and reduce the regulation cost. However, from the organizational perspective, the decision of separate auditing seems to be irrational because it's costly and risky. Obviously, looking for two different auditors takes more time and money than using the same auditor or no auditor at all. Moreover, using different auditors will increase the difficulty for companies to conspire with auditors in order to get the consistent and standard auditing opinion for the two reports. Therefore, it's unclear why there are some Chinese firms using separate auditing and while some others are not under the new regulation. This research question is important for the Chinese regulators to examine the effectiveness of the NORM, and also conducive for member of boards to reflect upon their decision making process.

The current paper is aiming to address the above question, and suggests that the presence and proportion of the multifunctional directors in the board may have influence on the decision about separate auditing. In Chinese companies, auditing committee is responsible for proposing the appointment of external auditor, but the board is the locus where final decision to appoint auditors is made. As the key decision makers, the behavioral characteristics of the directors could have substantial influence on board's decision making process as shown in the past research about board effectiveness (Hillman, Nicolson, and Shropshire, 2008; McNulty et al. 2005). In this paper, it is posited that the relational concern brought by the directors who have multiple functions will influence board's choice of auditor. Multiple function directors refer to those directors who hold different positions and thus have various cross-cutting identities. It is suggested that the multiple function director will influence the board decision making in a way that relational concern would become salient during the choice of auditor. The multifunctional directors are serving as the intergroup contacts between the two groups (e.g., board and the top management team), and the presence and proportion of such multiple function directors would make the board realize the various relations they are embedded in.

As suggested by prior research about managerial decision making (e.g., Xin and Pearce, 1996; Fu, Tsui, and Dess, 2006), Chinese managers tend to be sensitive about the relationships they have and put more weight on balancing relationships during their decision making. It is thus expected that, multifunctional directors would bring internal and external relationships into consideration during the board's choice of auditor. In general, three types of multifunctional directors are common in Chinese enterprises: director and top manager, director and also other companies' director, and director and government official. Accordingly, this paper would mainly focus on the influence of three relational concerns on boards' decision about separate auditing: 1) the relation between the board (BOD) and top management team (TMT), 2) the relation between the board with other companies' boards, and 3) the relation between company and the Chinese government. Multiple theoretical perspectives would be used to explain the role of relational concern during choice of auditor, which include intergroup relation (Pettigrew, 1998), social network (Lorsch and MacIver, 1989; Davis, 1991; Haunschild, 1993), and enterprise-government relationship (Agrawal and Knoeber, 2001). A series of propositions are proposed in the following sections, enclosed with a discussion of the contribution and managerial implication.

The Impact of Relational Concerns on Choice of Auditor

Effect of inter-group relationship between BOD and TMT on separate auditing

Based on prior inter-group relationship research (Allport, 1954; Brewer, 1996; Pettigrew, 1998), the author argues that the presence and proportion of the directors who have the cross-cutting memberships in both BOD and TMT will influence the inter-group relationship between BOD and TMT, which further have effect on board's decision about separate auditing. It is suggested that the inter-group relationship between BOD and TMT will be characterized by a lack of mutual understanding and distrust when there is no multifunctional director cross-cutting the two groups. Leaders of the firm are significantly divided into separate groups in this case: decision managers (TMT) and decision controllers (BOD), where they are previously common members of a mutually supportive and inner circle of elites (Useem, 1982). The literature on intergroup relations has found that group categorization will foster distrust toward out-group members while also creating the perception of intergroup conflict (Miller and Brewer, 1996; Labianca, Brass, and Gray, 1998).

Moreover, Kramer (1996) and others (Fenigstein and Venable, 1992) have found evidence that when individuals are subjected to control by out-group members, “a pattern of exaggerated mistrust” may develop. As a result, the perception of a division between insiders and outsiders can reinforce “a generalized sense of distrust” across groups and lead to “escalating cycles of distrust” when out-group members are exercising control (Sitkin and Stickel, 1996: 199). A behavioral manifestation of distrust is to reduce cooperative efforts of all kinds (Brewer and Kramer, 1985; Gaertner et al., 1989), and here, BOD may be critically cautious about the truthfulness of the financial statement as well as the internal control over financial reporting made by TMT. It is expected that the board will be more likely to use separate auditing in order to ensure the credibility of the two reports when there is no membership cross-cutting between BOD and TMT. The author points out that an increase in the proportion of the directors who have the cross-cutting memberships across BOD and TMT should enhance the trust between the two groups by reducing the salience of the group boundary. Intergroup boundaries can be weakened in many ways, including, for instance, by cross-cutting category memberships so that an out-group member in one categorization is an in-group member on another (Vanbeselaere 1987), by reducing cues to category membership (Worchel 1979), by disrupting the assumed belief dissimilarity to the out-group (Wilder 1986), and by highlighting superordinate categories (Kramer 1988).

It is suggested that the directors who have cross-cutting membership across BOD and TMT serve the function as the intergroup contacts and could promote a decategorization process between the two groups. Prior research has revealed that when intergroup boundaries are blurred or weakened, intergroup relation will be improved which is characterized by trust and cooperation (Allport 1954; Brewer & Miller 1984; Miller and Brewer, 1986). For instance, Gaertner (1985; cited in Messick and Mackie, 1989) reported a study in which the seating pattern of A and B group members was varied from segregated (AAAABBBB), through partially integrated (BAABABBA), to fully integrated (ABABABABM). Members of the more integrated groups experienced their merged groups as a unit, showed less intergroup bias in leader choice, expressed more satisfaction with group membership, and cooperated more than members of segregated groups. This paper suggests that the improved relationship between BOD and TMT through the multifunctional directors will enhance BOD’s trust towards the quality of the financial statement and the internal control over financial reporting. Directors who are also top managers can inform and help the board to grasp the details about TMT’s activities and performance. Accordingly, there will be less incentive for the BOD to choose different agencies to audit the two reports separately.

Based on all the above discussion, it is proposed that:

Proposition 1: the degree of BOD-TMT cross-cutting will be negatively related with the likelihood of the separate auditing.

In particular, the author suggests that it is unlikely for the board to use separate auditing when the chief executive officer is also the chairman of the board (i.e., CEO-chairman). It is highlighted that CEO-chairmen will experience the most internal conflict and pressure from the cross-cutting groups they belong to because of their significant duties and responsibilities. Cross-pressures arising from multiple group affiliations have long been of interest in political sociology (cf. Mutz, 2002). Cross-cutting identities create the need to be accountable to conflicting constituencies. The need for social accountability creates anxiety because interpersonal disagreement threatens social relationships, and there is no way to please all members of one’s network and thus assure social harmony. Those exposed to a variety of cues about appropriate social and political attitudes are found to experience discomfort as a result, though arguments about how people resolved this discomfort vary.

According to this social psychological mechanism, the problem is not that CEO-chairman is internally conflicted over which side to support, but rather that he/she feels uncomfortable taking sides in the face of multiple competing constituencies. On one hand, CEO-chairman is in charge of delivering financial statements as well as internal control over reporting. On the other hand, the CEO-chairman is responsible to monitor the quality of the financial reports in order to align the top management team’s activities with the rights of stakeholders. If fail to meet requirements of any sides, the CEO-chairman will be blamed as malfeasance. As Green, Visser, and Tetlock (2000) suggest, “The decision maker is caught in the middle, pushed one way by part of the group, and pulled the other way by an opposing faction. The individual is forced to defend a position in what may be perceived as a ‘no win’ situation, in which one side will inevitably be alienated”. Therefore, it is indicated that CEO-chairmen tend to reduce such pressure through advocating the decision of using the same auditor for both financial statement and the internal control over financial reporting. As mentioned in the beginning of the paper, choosing one auditor has much higher chance to get consistent and standard auditing opinion of two reports compared with separate auditing, because it is relatively easy for the firm to conspire with one auditor.

Obviously, getting consistent and standard auditing opinion is the easiest way for the CEO-chairmen to get both parties satisfied and to maintain their reputations. Accordingly, it is proposed:

Proposition2: the presence of CEO-chairman in the board will be negatively related with the likelihood of separate auditing.

Effect of the relationship with other companies on separate auditing

Based on research about interlocking networks (e.g., Lorsch and MacIver, 1989; Davis, 1991; Palmer, Jennings, and Zhou, 1993), all boards are virtually interrelated with each other in a dense network (i.e., interlocking network), and the board-to-board ties is created by directors sitting on multiple boards. The companies within the interlocking network are influencing and influenced by each other through these boundary spanning directors who serve the function as the conduits conveying the beliefs, preferences, and rationales of certain practices or actions (Galaskiewicz and Wasserman, 1989). These interlocking directors bring ideas with them when they move across firm boundaries, and a director's experiences in other boards shape the range of actions she or he will consider at the focal board. Directors who have participated in various strategic decision-making on other boards bring those beliefs and the various, more specific scripts associated with them to the focal board, ultimately "negotiating" or advocating changes in board decisions consistent with their beliefs (Bettenhausen and Murnighan, 1985). Interlock ties thus can help spread fundamental belief systems about corporate strategy, organizational structure, or the board's role in the organization within the interlocking network, providing the foundation for a variety of organizational changes. Empirical support for this argument has been found in studies investigating the likelihood of adopting poison pills (Davis, 1991), adopting the multidivisional form (Palmer, Jennings, and Zhou, 1993), making specific kinds of corporate acquisitions (Haunschild, 1993), or making campaign contributions to particular political candidates (Mizruchi, 1992).

It is thus posited that, besides the internal relationship concerns discussed in previous section, directors who are sitting on multiple boards will also bring the concerns over external relations with other companies into the board's decision about the choice of auditor. In particular, the author suggests that the normative pressure, the information exposure, and the generalized norm of reciprocity, engendered by the relationship with other companies will have substantial influence on board's decision about separate auditing. Firstly, it is suggested that the external connections with other companies by multifunctional directors will bring normative pressure into the board and thus influence board's choice of auditor. Normative pressure is usually operationalized as the subjective norm which is the perceived social pressure to engage or not to engage in a behavior (Fishbein and Ajzen, 1975). Much research in psychology theorizes subjective norm to be an important determinant of intention (Mathieson, 1991). People tend to adjust their beliefs according to the group they are in. Individuals are also influenced by the majority: when a large portion of an individual's referent social group holds a particular attitude, it is likely that the individual will adopt it as well (Asch, 1951). The strength of the normative pressure will be influenced by the degree of the connections the focal actor has in the network, which could be described as its centrality (Useem, 1984; Davis and Greve, 1997).

More central actors are opinion leaders whose actions are more likely to be imitated (Davis and Greve, 1997), while they are also more susceptible to normative pressure in the social system (Useem, 1984). It is argued that the degree of centrality of the boards in the interlocking network will influence the extent of normative pressure on the board's decision about separate auditing. By definition, a more central board is composed of directors who sit on numerous other boards, and have extensive connections in the interlocking network. Centrality indicates a firm's status and the degree to which it is integrated into the corporate elite (Useem, 1984). The more extensively connected into the corporate elite, the more normative pressure to maintain reputation and set an example the firm will feel. Since the NORM is aiming at enhancing the quality and creditability of financial reports, separate auditing is a kind of normative pressure on the firm even though there are no mandatory or articulated rules requiring firms to do so. In other words, it is expected that firms who are central in the interlocking network should take a lead to use separate auditing and be a role model of disclosing credible financial reports. Therefore, by maintaining ties to a large number of other boards, more central boards are vanguard for new policies adoption or innovation initiation and thus are more likely to use separate auditing.

Proposition3: the centrality of the board in the interlocking network will be positively related with the likelihood of separate auditing.

Next, the author suggested that directors sitting on multiple boards help the board get more exposure to the information, rationales, and experiences of the separate auditing from alternative companies.

Such exposure will encourage the board to adopt separate auditing as indicated in the research about network diffusion (e.g., Valente, 1996; Fiss et al, 2004; Shropshire, 2010). The boards may have skepticism before they decide to use different auditors to audit financial statement and internal control over reporting because of the novelty and uncertainty of such action. Given the separate auditing is a relatively new and distinct option, the board is more likely to make such choice when they get enough information about the rationale of such choice, the trend of the auditing practices, and the news of government policies etc. The information may allow for board's reflection on points that could prove beneficial or detrimental to the firm as well as on ideas relevant to decision-making but not previously considered. Directors who are also members of other boards where they have already decided to use separate auditing can offer valuable insights in this case. Communication with one's contacts helps to resolve the ambiguity surrounding the value of a decision: to the extent that one's contacts have made a decision and communicated their reasoning, the perceived value of such choice will increase.

In the case of the auditor choice, directors who sit on other boards that have already used separate auditing can help the focal board learn vicariously from the experiences of these other firms by providing first-hand expertise in evaluating and promoting separate auditing. Lorsch and MacIver (1989) assert that interlocking of CEOs of other firms on the boards is desirable because they have hands-on experience and credibility as peers that others do not. Furthermore, 'serving on a board is a way to see how somebody else is doing the same thing you're doing' (Lorsch and MacIver, 1989, p.27). The central concept of the above argument is the notion of exposure. Exposure of a node in a network at a certain point in time is the proportion of its neighbors who have already adopted certain practice and may provide information and influence with regards to some behavior (Valente, 1996). From a diffusion point of view, exposure can be defined by the proportion of adoption in the surrounding network partners, either directly or indirectly connected. The larger the exposure is on the node, the more likelihood of adoption of the same practice as its neighbors the node has. In the current case, the focal board is more likely to use separate auditing when there is larger proportion of the boards choosing separate auditing whom the focal boards have ties with.

Proposition4: The degree of the focal board exposed to the interlocking boards that choose two auditors will be positively related with the likelihood of separate auditing.

In addition, it is proposed that the generalized norms of reciprocity among directors who also serve as the chairman or CEO in alternative companies may represent a primary social psychological mechanism opposing the separate auditing. The principle of reciprocity refers to the mutual reinforcement by two parties of each other's actions, and the more commonly used phrase "norm of reciprocity" highlights the social obligation underlying the principle or a rule of behavior in social exchange situations (Gouldner, 1960). Ekeh (1974: 48) further noted that generalized norms of reciprocity refer to the situation in which "an individual feels obligated to reciprocate another's action, not by directly rewarding his benefactor, but by benefiting another actor implicated in a social exchange situation with his benefactor and himself." In such generalized social exchange relationships, reciprocations are also generalized, involving multiple actors (rather than just two) and indirect (rather than direct) benefits (Westphal and Zajac, 1997).

This paper suggests that the interlocking director network is an arena likely to be characterized by a generalized reciprocity among interlocking directors. Given that corporate chairmen or CEOs are a relatively homogenous and cohesive group (Useem, 1984; Westphal and Zajac, 1997), they may feel a generalized obligation to support fellow chairman or CEOs in board meetings. Given the high cost and potential risk of nonstandard auditing opinions of separate auditing, those chairmen or CEOs enjoying minimal cost and risk aversive at their home companies may, as directors in the focal board, hinder any attempts to choose different auditors. The preceding discussion suggests the following proposition:

Proposition5: The ratio of directors whose home companies (where they are CEO or chairman) have chosen separate auditing will be negatively related with the likelihood of separate auditing.

Effect of the enterprise-government relationship on separate auditing

Finally, this section will discuss about the influence of the relationship with government brought by the directors who are at the same time government officials. It is suggested that the government official-directors is prevalent in Chinese enterprises, and have substantial influence on board's decision making because of the special enterprise-government relationship in China. While China's economy has made great strides over the past 30 years, the transition from the planned economy to a market economy is far from over and continues to have profound social, political and strategic effects.

Through the large scale reform after Deng Xiaoping's southern tour in spring 1992, the Chinese economy today has a far more diverse ownership structure compared to before, when all equity interest were property of the state (cf., Chio, and Zhou, 2001). While the current Chinese economy has many characteristics of a market economy, it is still in transition, and the government largely remains a dominant force in economic activities. The main characteristics of the Chinese government's role in the transition economy could be summarized in the following ways (refer to Chio, and Zhou, 2001 for a detailed review):

First, government still controls an enormous amount of resources including land and market entry, as well as supervision for investment activities above certain limits, despite a series of reforms to change policies as a guide. China is undergoing a transformation period, when a mature legal system is not well established and so proper involvement from the government could improve the efficiency in certain situations. The government controls the macro-economy through legal and economic means, focusing on public products and social service. Second, local government has the power to allocate resources, mainly through the tax and the dividends from state-owned enterprises. The economic reforms since 1978, by way of decentralization, have motivated local officials to engage in economic activities. This reform has launched a restructuring of rent distribution. Local officials, with a political mandate for development and acting upon a mixed economy of plan and market, now possessed a great deal of power to create exclusive rights for local public revenues and personal welfare within their administrative jurisdictions. Last but not least, the political structure of the current government, which is a top-down centralized system, has direct influence on the appointment of the key positions. In comparison with a democratic government such as that in the U.S., the central government alone is responsible for appointing the next level in command, such as ministers and bureau chiefs and they in turn appoint their subordinates such as the officials in local government, creating a long chain of command that is not very responsive to popular opinion.

On the contrary, the U.S. local government is not appointed by the central government but by local election, hence they are directly responsible to popular opinion and not subjected to the opinion of their superior for promotions and rewards. The hierarchy of power that is created by the appointment system in China means that the officials tend to act with self-interest and not devise and execute policy in a market-oriented manner. These special characteristics of Chinese government lead to a unique government-enterprise relationships in China. Governments tend to appoint certain directors into boards as an intervention and control of the policies and strategies in the companies. In particular, the director appointment in Chinese SOEs is determined by state-owned asset supervision and administration commission of the state council (SASAC). Government are external to the firm, as they are based in state bureaus, but they maintain a direct tie to it through their participation in corporate governance as members of the board of directors representing state-owned shares in it. As such, these directors are entitled to represent the state's interests in the firm's strategic decisions, albeit within the framework of an advisory capacity as stipulated by the rules of corporate governance of the Company Law (1994). Thus while the firm's top executive has full control over its management, the state has a voice and votes on strategic decisions. This leads to a prevalence of government official-directors in Chinese enterprises.

The above discussion indicates the *mutualism* between government and enterprises in China: on one hand, many local Chinese officials are ready to deliver policy goods to "friends" who know how to express "appropriate gratitude" in return. On the other hand, conceiving such a relationship to be crucial to the success of business in a transition economy, businesspeople invest a great deal of time and energy in establishing ties to the officials. For example, Xin and Pearce (1996) showed that *guanxi* (the Chinese terminology for social relationship) is an important method of acquiring institutional support for private companies in emerging economy of China. Good relationship with government offices and financial institutions might help a firm obtain access to such valuable information as government policy on future economic development, taxation and import and export regulations.

Similarly, partnership with financial institutions can provide a firm with a competitive edge in obtaining benefits such as low interest rate loans. Therefore, the cultivation of good enterprise-government relations is important since effective bridging relationships with these power groups can provide the firm with a unique competitive advantage in securing scarce resources for firm survival (Pearce and Robinson, 2000). It is suggested that such cultural and institutional context makes the role of the government official-directors important because they will bring in the issue of cultivating good relationship with government into board's decision making process. The enterprises, knowing the advantages of good relationship with governments, tend to have various alternatives ways to develop it. Directors who are also government officials play a key role in helping the board to formulate strategy of building good relations with government.

Several prior studies examine the roles of directors with experience in politics in western countries, and show evidence consistent with the view that political directors provide insight and advice to firms dealing with governments (e.g., Agrawal and Knoeber, 2001; Helland and Sykuta, 2000). In the current case, the author suggests that the government official-directors will make the board to pay more attention to the government policy (esp, the NORM). The board will recognize the importance of showing positive response towards government policies as a necessary step in building good relations with government. They will notice that separate auditing is in line with the main purpose of the issue of NORM which is to enhance the credibility of firms' financial reports. At least, separate auditing is a symbol to show that the focal firm is highly concerned about government policy and supports the issue of NORM. It is also expected the government official-directors will act on behalf of the government and advocate the separate auditing in the board. Therefore, it is proposed that:

Proposition 6: The proportion of directors who are also members of government will be positively related with the likelihood of separate auditing.

Concluding Remarks

This conceptual paper has proposed an explanatory model to interpret the differences in the number of auditors Chinese enterprises use to audit internal control over financial reporting and financial statements when the first basic norms of internal control has been issued by Chinese regulators. Based on prior research about inter-group relationships, interlocking network, and enterprise-government relations, this paper suggests that multifunctional directors will bring the concern over both intra and inter organization relationships into board's decision making process, which will influence board's decision whether to use different auditors to audit the internal control over financial reporting and financial statement. A series of propositions regarding the influence of the BOD-TMT relation, the relationship with other companies, and the relation with Chinese government have been proposed. In general, the author suggests that the presence of CEO-chairman, an increase in the proportion of directors who are also top managers in the focal firm, or CEO and chairman in alternative companies tend to hinder the separate auditing. On the other side, an increase of the proportion of the directors who are sitting on multiple boards where they use separate auditing or government officials are more likely to boost the separate auditing.

The paper has contributed to the research about board effectiveness by proposing that the intrapersonal functional diversity—the multifunction of the individual directors-- could influence board's collective decision making process through bringing in relational concerns. Most of prior research about the board effectiveness focuses on impact of the board composition in terms of the diversity in the gender, nationalities, inside/outside directors, and functional backgrounds among the directors. However, the influence of the intrapersonal functional diversity of the directors---focuses on the extent to which the individual directors in the board are narrow functional specialists with experience in a limited range of functions, or broad generalists whose work experiences span a range of functional domains --- has been overlooked and understudied. As suggested by Bunderson and Sutcliffe (2002), the conceptualization of intrapersonal functional diversity can have significant implications for management team process and performance. For instance, they found that intrapersonal functional diversity was positively associated with information sharing among team members. They suggested that teams composed of functionally broad individuals would be more strongly motivated to exchange information and would be less susceptible to the stereotypes and in-group/outgroup biases that restrict the open sharing of information. In sum, the significance of intrapersonal functional diversity for management team process and performance is a largely unexplored phenomenon in organizational research.

Consequently, we do not know how this form of functional diversity compares with more traditional forms in its effect on team process and performance. The current paper argues that the multifunctional directors will make the relational issue salient in the board which will influence board's decision making about the choice of auditor. In particular, it is proposed that, directors who are also top managers in the firm will bring the concern over the intra organizational relationships especially the relationship between the board and the top management team into the decision making process. In addition, the directors who are sitting on multiple boards in alternative companies will bring in the inter-organizational relationships into consideration during making decision about separate auditing. Finally, directors who are government officials will influence board to make decisions based on a consideration of the relationship with government. The author points out that the multifunction of the directors as a kind of intrapersonal functional diversity is also indicating the various relationships the boards have. The presence and proportion of such multifunctional directors would help the board to realize the social networks they are embedded in.

The characteristics of these social relationships constitute crucial criteria for the board to make a decision such as whether to separate auditing of internal control over reporting and financial statement or not. Accordingly, it is indicated that the intrapersonal diversity of the team member may have influence on group decision making process through bringing in the relational concern into consideration. Furthermore, this paper proposes that the multifunction of the directors deserves more in-depth study because it serves as the important intermediary through which the micro and macro level factors influence each other. Future research could examine the antecedents, consequence, and conditions of the existence of multifunctional directors. For instance, the author suggested that the existence of multifunctional directors may subject to the influence from the institutional and cultural context. Multiple function directors are common in Chinese enterprises where the directors could be appointed by the government, invited to a number of alternative companies as independent directors, and engage in top manage team functions etc. The prevalence of multiple function directors could be due to the underdeveloped corporate governance in China.

The concept of corporate governance has been introduced to China only since the early 1990s. Before that, the nepotism was governing the personnel selection in Chinese enterprises because of the traditional culture which emphasized on cultivating relationship, giving face, and keeping harmony (Bian, 1997; Xin & Pearce, 1996; Yang, 1994). After a decade's development, Chinese enterprises have made stupendous progress in corporate governance but still ranked almost last in Asia as shown in the annual "CG Watch" survey by CLSA Asia-Pacific Markets in association with the Asian Corporate Governance Association (2007). Therefore, it's possible that the cultural and institutional context may confine the impact of multifunctional directors. The current paper has several practical implications for Chinese regulators about how to boost separate auditing among firms. Firstly, Chinese regulators could target at the role modeling firm which has the most central position in the interlocking network, and intervene their board's decision making process through appointing government official directors. Then Chinese regulators could promote such separate auditing through strengthening other firms' exposure to such role modeling firms where they use separate auditing. In addition, Chinese regulators should realize the potential hindrance for the separate auditing from the directors who are also top executives in the firms. Appropriate interventions, such as the issue of policies aiming to reduce the proportion of the directors who are top executives in the focal firms or CEO in alternatives firms, could be conducive to mitigate the impedance of the separate auditing.

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