AUDIT COMMITTEES AND CORPORATE GOVERNANCE

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Abstract: In order to define the strategy and to improve the internal audit activity, audit committees ensure the independence of the internal audit and the reliability of the information that the organization puts at the shareholders' disposal and at the same time appreciate the quality and professionalism of top management, as well as possibilities for the future development of the organization. Audit committees in economic organizations focus their actions on the reliability and assurance of internal and external reporting, on the quality of internal control systems and risk management processes. To achieve these requirements they count on internal and external audit. However, the establishment of audit committees represents in many cases a complicated problem, because their role is misunderstood, which leads to the fact that their effectiveness to formulate independent recommendations to management, on the activities supervised, is far limited. In such conditions, the risk is that these audit committees to become superficial, creating a false impression of security. In these circumstances the result is materialized by increasing expenditure with committees operation, but without them to bring extra value to the organization.

Keywords: internal audit, audit committee, organization management, corporate governance, risk management.

Implementation of corporate governance involves changing the traditional way of organization and administration of economic organizations. The top management is responsible for the introduction of good governance.

The role of audit committees

Given that at the level of economic organizations there are a multitude of risks associated with corruption, incompetent management, lack of clarity in defining and setting goals, concentration on certain interests, bureaucracy, concentration of power in the hands of a single person or a limited group of persons, inefficient internal control and internal audit, ineffective reporting, good governance cannot achieve its goals, if no appropriate precautionary measures are taken.

The key element of corporate governance of economic organizations that can provide to their management a professional independent assurance of the effectiveness of managerial decisions, of financial statements reality and of financial management and internal audit is the audit committees.

In carrying out duties, audit committees rely on the findings and recommendations of the external audit, internal audit quality and the extent to which the management of functional structures of the organization are implementing the recommendations of the internal audit.

The proper functioning of audit committees is a measure of insurance for the management of economic organizations. However, their effectiveness depends on the ability of management to accept independent recommendations of the committee's members and initiate actions to implement them.

At the same time, the responsibilities of audit committees should be also expanded beyond the improvement area of the internal audit activity, as follows:

- analyzing the reality of financial reporting provided by the organization, as well as other financial statements issued;

- assessing the internal control system and risk management system put in place and implemented by the organization;

- assessing the independence and objectivity of external audit, considering the legal regulations in the field.

An audit committee can add value to the organization in circumstances where there is an operational environment where it can be organized and function, to exist requirements set concerning the independence, impartiality and integrity of the members and set out conditions in which they can exercise their responsibilities.

The operational environment of audit committees

The audit committee as an instrument of corporate governance has the role to ensure the proper management of risks, proper functioning of internal control, internal audit and its relationship with the management of the entity, as well as financial reporting reality.

The audit committee activity is determined by the manner of formation and level of subordination, the requirements of autonomy, transparency of activities, and by the way they maintain the collaboration relationship with internal auditors and management, in other words it depends on the environment within which it operates.

In order to be effective, an audit committee must operate in an organizational environment characterized by the following:

- the existence of clear and measurable strategic objectives, with specific deadlines. In many cases these objectives are defined generally and do not have associated targets, to clarify managers what is expected of them over a certain period of time;

- adequate organizational structure to ensure the achievement of strategic objectives. It must be characterized by clear operational objectives, which are to be linked to the performance indicators and to be developed effective reporting systems to meet the needs of senior management;

- effective risk management system. An insufficiently developed financial management allows the emergence and maintain of risks at high levels. The audit committee shall ensure the existence and effectiveness of risk management process. Attention should be focused on the management of strategic risks in order thus to ensure the implementation of policies and achievement of activities with existing resources;

- focusing on the existence of a quality financial management. The quality of the operations and financial transactions, financial reporting and financial control depend largely on the effectiveness of the financial management process. In turn, it depends on the competence, experience and ability of the personnel responsible for financial and accounting activity. For ensuring quality financial reporting, the audit committee must also ensure the proper application of accounting standards and policies;

- internal/managerial control system. Internal/managerial control encompasses all forms of controls established by management and exercised at the level of the public entity in order to ensure the management of funds in an economic, efficient and effective manner. Thus, the management has the responsibility to ascertain the deviations of the results obtained compared with the objectives set, to analyze the causes that gave rise and dispose the corrective or preventive measures to be taken. The implementation of the internal/managerial control system involves the adoption in practice of internal control standards that represent **reference systems**, in comparison with which are evaluated/self-evaluated internal control systems, risk areas and possible corrective action are identified;

- managerial responsibility. Management, regardless of the position occupied, is responsible for achieving the objectives set, having the freedom to make decisions appropriate for achieving them. In this respect, the responsibility for a good financial management occurs, the efficient and effective use of public funds and public patrimony. Managerial responsibility cannot be committed without the appropriate corresponding authority/competence, and its operation requires transparency and responsibility. The audit committee shall ensure that the financial statements are properly prepared and signed by the persons responsible;

- efficient, known and applicable anti-fraud and anti-corruption policies. Fraudulent financial reporting may involve acts of deceit, intentional omission or misinterpretation of events, transactions or operations, wrong or intentionally application of accounting policies. In many situations, the financial reporting are skewed as a result of internal and external pressures, which is subjected to the leadership to fit within certain spending levels or obtain a specific performance, but without the necessary levers to achieve those targets. Under these conditions, the internal/managerial control system is the main lever in the prevention and detection of fraud related to the financial and accounting activity. The audit committee can act only if the organizational and management structure are organized so as to ensure achievement of the objectives set.

The independence of audit committee members

The independence of audit committee members requires that they have no obligation towards the organization's leadership, to carry out their duties impartially, to be fair in formulating opinions and avoid prejudices regardless of personal interest.

The objective of the audit committee is to ensure the organization's leadership, as well as people with interests towards the organization, that the information it provides, both indoors and out, is accurate and true in all relevant respects and that they can rely on it. Members of the audit committee shall provide independent opinions on the quality of this information and risk management and internal control systems.

The quality of audit committee members is determined by the effectiveness and efficiency of the information the organization provides and for which they guarantee a certain level of insurance.

The audit committee which is organized and functions properly is a specialized support for the internal audit in the organization, helping to improve the quality of the activities developed by this function and ensuring the leadership about its importance and necessity.

The independence and objectivity of the audit committee is ensured by appointing members not holding executive leadership positions. The appointment of persons who are "favourable" to leadership does not ensure the achievement of the purpose for which it is established, because the audit committee should ensure that executive management do not mislead top management and that top management does not mislead stakeholders outside the organization.

The relationship between the audit committee and the persons responsible for financial management, internal/managerial control system, internal and external audit must be clearly established at the level of the organization. The internal auditor should have a close and constant liaison with the members of the audit committee, which should provide an assurance about the strategy risks and their degree of management, the annual plan of internal audit, the effectiveness of its internal control and the quality of financial reporting provided by the organization. The internal auditor shall have regular discussions with the members of the audit committee with respect to most aspects it assesses, in particular with regard to the periodic financial statements.

However, the current practice has highlighted the fact that there is a certain reluctance of top management with respect to the requirements that must be fulfilled in order to ensure the functioning of an audit committee. The reluctance is manifested mainly by limiting the area of action and responsibility of the internal audit committee to only supervise the internal audit activity carried out at the level of the organization.

Also, operational or functional independence based on professional integrity is still not recognized and applied in most organizations, which may lead to the appearance of difficulties in the relationship between the audit committee and executive management and even top management.

The key conditions that an audit committee must meet in order to be active for the organization can be set as follows:

- top management's acceptance of opinions and solutions to audit committee members, even in the situation of administrative changes;
- the appointment of a chairman of the audit committee with professional experience, who can improve the quality of financial and accounting activity of the organization and to provide practical solutions that are acceptable to management;
- the designation of at least half of the members of the audit committee from outside the organization, with specialized experience, which does not have obligations towards the entity and whose interest is only to provide independent solutions to executive management;
- the capacity of the organization's management to accept reorganization of financial and accounting activities and financial management, on the basis of a sustained and accepted process also by the audit committee.

The consequence of disinterest in implementing and compliance with these criteria will be reflected in the existence of a formal audit committee, which will create a false impression of independent and objective analyses, which will mislead top management and shareholders of the organization.

The role of the audit committee in the context of corporate governance

The analysis carried out on the basis of corporate governance codes developed by some countries of the European Union has sought to obtain an overall picture of how the audit committees are organized and operate and guarantees good corporate governance. Thus, in most cases the codes of governance highlight the need for audit committees within economic organizations, but there are exceptions too, codes that do not require the existence of an audit committee, or situations in which the duties of the audit committee are accountable to other committees.

Taking into account the fact that the independence of the audit committee is assured by the level at which it is organized within the organization, the relationship of subordination differs from one type of organization to another. Thus, there are audit committees which are organized under the the Supervisory Board, as well as organizations that the audit committee is organized under the Board of directors or the general meeting of shareholders. In all cases, the audit committee is responsible on how it fulfilled the responsibilities in front of the organ under which it exists.

In most cases, audit committees assist the organs under which they exist in the monitoring of the activities of the entity. To carry out this responsibility they rely on the quality of the work carried out by the internal audit and on the assurance that this function provides to the management of the entity.

Audit committees are characterized by a diversity of responsibilities and tasks to be fulfilled in the context of corporate governance, such as: monitoring the financial reporting process, making proposals on the distribution of profit or financial auditor selection, monitoring the effectiveness of internal control system and the process of risk management, monitoring internal audit and non-audit services provided by the external audit and so on. From this analysis we can see the responsibilities of the most audit committees such as monitoring the internal audit and internal control system but also responsibilities that characterize only some audit committees such as ensuring investors from investments carried out within the organization.

The composition of audit committees differs from one country to another. Thus, there are audit committees made up of two director members without executive powers, committees consisting of three members without executive powers, but also committees consisting of 3-5 members with executive or non-executive powers.

Regarding the professional experience there is the existence of certain particularities, namely committees in which at least one person or more persons must have sufficient experience in finance and accounting or committees in which only the Chairman of the Committee must have relevant experience in the financial-accounting field. In other situations it is stated that Committee members must have relevant experience in the field of accounting, internal audit and risk management, but also situations that do not require a specific experience of audit committee members.

Conclusions

Audit committee effectiveness is ensured, on the one hand, by securing its independence, professional level and experience of its members, and on the other hand, the acceptance by the top management of opinions and solutions provided by the members of the Committee.

The audit committee's contribution to the creation of added value within the organization is significant in situations where its powers are extended, outside the relationship with the internal audit, and on how to manage risks, methods of implementation and operation of the internal control and the conformity of the financial statements.

Reports provided by the audit committee present the strengths and the weaknesses of the method of managing risks, internal/managerial control system, effectiveness of internal audit, as well as their views on the financial-accounting activity carried out by the organization and regular financial reporting.

The quality of the activities of the entity on which the audit committee has the responsibility of evaluating and expressing some opinions, can be highlighted in situations where executive management has regular meetings with members of the committee and accepts their proposals. Also, the participation of top management at the meetings of the Committee allows a better understanding of the work carried out by the audit committee and the results obtained.

Experience has shown that the existence and the effectiveness of the audit committee cannot provide the conditions under which it is responsible only for debating internal audit plans and audit recommendations. The role of the audit committee must be much wider, meaning to fulfil the responsibilities of supervision, evaluation of internal control and risk management, as well as to achieve a survey with special character, at the request of senior management of the entity.

Internal and external audit are the main functions of the entity with which the audit committee shall perform the duties and responsibilities. In this context, there must be an effective collaboration between the audit committee and the two functions. Members of the audit committee should support the independence of internal audit and to ensure that the function has sufficient resources to provide an appropriate level of quality information provided as a result of work carried out.

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