

CHARACTERISTIC ELEMENTS OF THE AUDIT COMMITTEE

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Abstract:

According to the Charter, the audit committee members must be people with experience, independent, and appointed by the Board.

The Audit Committee has similar powers from one organization to another, but regarding style and methods of operation, they are different and should be tailored to the objectives, needs and circumstances of the organization.

The article addresses the particular elements for the activity of audit committees, respectively: membership, independence, financial literacy, conditions of appointment of members and qualifications required for the election of the audit committee chairman.

The second part of the article addresses issues concerning the workings of the audit committee, referring to meetings planning, orientation and continuous training of members of the audit committee and the responsibility of the audit committee for its self-assessment.

In conclusion, evaluating the conditions for appointing the members and the characteristics of audit committees reveals the overwhelming importance of audit committees within the organizations in which they operate.

For these reasons, a deep analysis is required at the establishment of audit committees and a great depth in the selection of members.

Keywords: management, organization, fraud, internal auditors, internal control, external auditors, audit committee

THE CHARACTERISTIC ELEMENTS OF THE AUDIT COMMITTEE

While the tasks of the audit committee are fairly similar from one company to another, the style and methods of operation are different and they should be tailored to the objectives, needs and circumstances of the audit committee of the organization that it serves.

The internal environment and the directors' experience, increasing the businesses knowledge and the specific organization operating style of the company and management, the financial position and regulatory requirements typical for the industry are key factors that should determine the nature and the aim of the audit committee activities.

All these elements the must customize the audit work of the committees is characterized by:

1. THE MEMBERSHIP IN THE AUDIT COMMITTEE

Typically, the Charter of the audit committee requires that its members should be elected among the independent members of the board of directors. The members of the audit committee, in most cases, are appointed by the board of directors or by the committee which appoints the board and rarely by the president / general manager of the company.

The independence of the audit committee or at least its apparent independence could be compromised if the management would appoint these members. The president, typically, is a member of the directors board and he may make known his point of view when those appointments are made in the audit committee.

Many audit committees have found that it's highly effective if its members possess a diverse and complementary experience that could bring expertise in the company. The collective experience of the audit committee, as a group, must be appropriate to the size and situation of the company and also for its field of activity.

In addition, each member must have certain basic attributes, such as financial language knowledge, experience within the organization, the ability to take decisions and strategic thinking. Specific skills that the company needs including areas with major risks of its strategic plan which should be also part of the skills audit committee.

Normally, audit committees have 3-7 members. In practice, it is important that the size of the audit committee to be appropriate for them to fulfill their responsibilities.

Being a member of the Audit Committee calls for a greater commitment than other positions from the board of directors in terms of the time needed for fulfilling their responsibilities. The members must be committed to the tasks and allocate adequate time to the activity of the audit committee.

Therefore, the "Blue Ribbon" Committee recognizes this commitment and the time spent by the members of the audit committee and recommends to the directors' board that they may grant them additional compensation.

When new members are elected to the audit committee, the directors board may wish to submit written descriptions of the committee members expectations in order to submit the applications and to make the communication.

2. THE INDEPENDENCE OF THE AUDIT COMMITTEE MEMBERS

The independence is essential for the supervisory role of the audit committee. A member without family, financial or personal relations with the management is better able to evaluate, in an objective way, the accuracy of the managerial accounting, the internal control and the reporting practices. Taking into consideration the characteristic and defining character of the independence for the supervisory role of the audit committee and maintaining the objectivity of the management towards the Administrative Council are required consistent and clear requirements for independence of the audit committee members.

Therefore, the companies must disclose certain information regarding the audit committee members and their independence.

The management monitoring made by the audit committee relies on independent experts that give time and energy to their work. If the directors are neither independent nor experts, the audit committee may not have a reasonable chance to work effectively in monitoring the management.

The audit committee members should not have any relationship with the company which might interfere with their duties in an objective and independent manner, and these relationships include:

- financial arrangements or family relationship with the management;¹
- direct or indirect arrangements with the company, other than shares ownership or compensation as a director;
- compensation from the board of directors or from the audit committee which is a major source of income for the audit committee members.

The audit committee should implement procedures in order to be assisted in ensuring that audit committee members remain independent. Regarding this aspect, we present in Annex 3 a sample of a questionnaire that can be used for an assessment of the audit committee members' independence, based on the requirements stipulated in the Standards of general audit.

3. THE NEED TO KNOW FINANCIAL LANGUAGE

Members of the audit committee must have accounting and financial experience necessary to fulfill their responsibilities including a certain level of financial language knowledge. It provides the foundation needed to accomplish, effectively, its supervisory role on areas attached to accounting or to the reporting process, internal control and risk management practices.

Knowing the financial language is a key quality for the audit committee members and represents the ability to read and understand fundamental financial statements, like the balance sheet, income statement and statement of financial flows of the company.

At the same time, this experience allow the audit committee members to be able to ask questions and evaluate the effectiveness of the received responses regarding financial risks, accounting policies and explanatory notes.

In addition to this basic knowledge of the financial language that all audit committee members should have, the standards of good practice recommend that *at least one member of the audit committee should have expertise in accounting or in financial management.*

The expertise is defined as a previous engagement in accounting or finance field, accounting certification or other comparable experience to indicate

individual financial experience, including having the position of president or director with financial oversight responsibilities.

New York Stock Exchange and NASD have changed the standards for audit committees (Rules that NASD imposed on the listed companies) in order to ask each member of the audit committee *to be a connoisseur of the financial language or obtain it in a reasonable time after the appointment into the audit committee.*

In order to achieve the common goal - knowing the financial language, the audit committee members should prove they have *at least three of the following qualities:*

- basic understanding of the basic financial statements;
- an understanding of the specific company's financial statements;
- an updated domain knowledge and development of auditing and accounting that may affect the company's financial statements and operations.

4. THE QUALITIES OF THE AUDIT COMMITTEE PRESIDENT

The president selection for the audit committee is an extremely important task, because *the president should have the qualities needed to assume a leadership role within the group.*

The audit committee president qualities required include:

- Experience in leadership or experience as a member of the audit committee in other companies;
- Appropriate skills in working with their staff and in relationships with others;
- the characteristic of being proactive in addressing the specific responsibilities and tasks;
- Solid experience in finance, accounting and / or business field;
- A proper understanding of the different responsibilities that directors and management have.

The president of the audit committee should lead the talks, prioritize issues and determine how they should address important topics. Often, the president meets with the management, internal audit and external auditors before the meetings set in the agenda of the audit committee. For all of that,

he must allocate time to each topic and decide what materials will be included in emails sent prior the meetings of the audit committee.

In practice, the president of the audit committee must obtain a brief summary of the presentations that take place before the meeting of the audit committee and, in addition, he must be available to meet separately with management and auditors if necessary.

5. THE CONDITIONS FOR APPOINTING THE MEMBERS OF THE AUDIT COMMITTEE

The conditions for appointing the members of the audit committee varies from one organization to another. Most members are appointed for an unspecified period, their participation is closely linked to conditions imposed by the Board of directors. Also, the limits of the conditions may be optional.

The membership of the audit committee can be rotated while maintaining the objective of continuing the information and awareness of the Board of directors on the financial reporting process. The rotation process can also ensure a logical succession to the presidency of the audit committee. However, the rotation policies should be addressed to the Audit Committee in an appropriate time frame to allow the familiarization with the company or with the financial reporting process as well with fulfilling the objectives within the audit committee.

Whether the committee has or has not a policy of rotation, the audit committee may have a policy regarding a regular assessment of the members' performance and of taking any corrective measures so that only the dedicated and efficient members should be included in the audit committee.

6. PLANNING THE MEETINGS OF THE AUDIT COMMITTEE

A good practice that can be used by the Audit Committee to fulfill its responsibilities from *the Charter of the Audit Committee consists in creating a "plan of meetings."*

The meetings plan that can hold up to six meetings per year and may include provisions requiring these elements:

- Individual private sessions with internal and external auditors - minimum 1-2 meetings;

- Subjects and the time allotted for them to discuss the Committee's responsibilities;
- Specific meeting agendas that include presentations from the executive;
- Provisions for special meetings depending on the circumstances created.

On this line, we presented in Annex 4 a Plan of audit committee meetings, used for maintaining a permanent connection with the other involved "actors" like internal auditors, external auditors and the company's management.

The Audit Committee meetings usually involve the "actors" mentioned above and the topics discussed include, among others, financial risk, key controls, financial information and qualitative aspects of the financial reporting. Also, the meetings can include presentations from the responsible executive for these areas, mainly the financial manager or the director of the information technology.

The written agendas, along with the financial information and otherwise, focused on topics, facilitates an efficient flow of information and ensure the discussion on all subjects. Therefore, they must be distributed to members of the audit committee in order to study them before the meeting and to enable the information verification and formulating the questions, being at the same time focused on important topics.

Meanwhile, the agenda should be flexible so that other topics can be discussed unscheduled, if circumstances require so.

All these meetings should end with the drafting of a minute in order to record discussions and retain the assumed responsibilities by the audit committee.

To ensure a correct recording of these meetings, the minutes may move in the project to all members of the audit committee in order to include the proposals of all the members. The minutes will be supplemented with the required information by the internal and external auditors and by the management.

In practice there should be a clear and robust communication between auditors and the board of directors. The Audit Committee can fulfill the best this role and he must report to the board of directors regularly, preferably after each meeting. Normally, if a report is given orally, it can be supplemented by the audit committee meeting minutes.

7. THE ORIENTATION AND TRAINING OF THE AUDIT COMMITTEE MEMBERS

The new audit committee members should receive appropriate guidance when they are appointed in order to perform their responsibilities effectively. They also should understand the responsibilities and objectives of the audit committee; be familiar in the relations with the management, with the internal and external auditors; to be well informed about the company's operations and financial reporting process.

In addition, the audit committee should know and understand the beliefs, values, philosophy, the mission, the strategic and business plans of the company and to use this understanding to resolve the key issues during the year.

Basic information for new members of the audit committee

Depending on the level of knowledge on the company, on previous experience in the audit committee, a new member may consider reviewing:

a. The company:

- The Charter of the audit committee or the board of directors' resolution for the creation of the Audit Committee;
- The Code of Conduct of the company and the supervisory role of the audit committee on monitoring the management compliance with the code;
- The Audit committee and the meetings of the board of directors' minutes held within the past two years;
- The earlier reports sent to the shareholders, quarterly reports from the year, the company's statements from last year;
- the list of the planned meetings of the Audit Committee and the company's reporting requirements, as well as the corresponding data for the current year;
- Recent issues of interest for the Committee, including high-risk areas;
- Significant accounting policies and the reasons of their use;
- The company's involvement in litigation and the contingencies facing it;
- The experience and the qualifications of the senior executives and of the financial management.

b. The internal auditors

- The internal audit department plan, including information on its responsibilities and on the reporting relationships;
- The internal audit plan for the current year;
- The type and frequency of information that the internal audit department ensures to the audit committee;
- A summary or a copy of the internal audit reports over the last year;
- The size of the internal audit department and the internal auditors' qualifications.

c. The external auditors

- The committee communication and its expectations from the external auditors;
- The purpose of the external audit and other services provided by the external auditors;
- The type and frequency of information that the external auditors provide for the audit committee;
- The opportunity and the types of reports issued by the external auditors;
- A copy of the latest management letters and the management responses and also its plan for action addressing these problems;
- A copy of the letter of engagement from the external auditors.

Regularly, the audit committee members should receive continuing guidance on the recent developments in accounting, auditing and financial reporting, as well as on the current business practices in the field. When the company plans to adopt new standards for accounting / audit, the management and / or the external auditors should discuss with the audit committee about their effects on the company.

Similarly, the audit committee members should obtain an agreement from the management with reference to the effects of significant transactions on the company and to the new technologies used by the company.

In general, the companies should have implemented the processes to systematically ensure the audit committee members enough information on new developments in the field of activity and their impact on the financial statements and the company's operations. This process should be developed

by management together with the auditors by checking the financial reporting process, the purpose of the audit plan and the risk assessment.

8. THE RESPONSIBILITY AND THE SELF EVALUATION OF THE AUDIT COMMITTEES

The generally accepted Auditing Standards recommend the Board of directors to evaluate their performance regularly in order to ensure that it continues meeting the expectations of the Board of directors and of other stakeholders.

The NACD report contain guidelines for the exposure of the audit committee to legal liability and how it can be reduced. Therefore the audit committee members can reduce their legal responsibilities for their duties, including the types of activities, attending meetings, the verification of the management, external and internal auditors' reports and the implementation of appropriate questions.

Over time, the rules and regulations governing the financial reporting have grown in complexity. At the same time, it increased the supervisory role and responsibility of the Audit Committee. As a result, the audit committee members were exposed to a high degree of legal liability. The members of the audit committee should determine whether directors' compensation protects them through the adequacy of the assigned tasks depending on the circumstances.

As noted in the NACD report, the audit committee members must have the ability to listen and to redress the balance between skills and the courage to contest and to act when necessary. The NACD report said that the committee should set the tone of the organization to express the core values of ethical integrity and also the legal compliance for the control and for a solid financial reporting.

As a best practice, the audit committees should consider conducting periodic self-assessments of their own performance in comparison to other groups who have studied the effectiveness of the audit committee.

The evaluation should focus on activities conducted by the audit committee and on the efficiency of these activities as shown in the audit committees Self-assessment Questionnaire, developed by the NAO, which contains the following chapters:

- Relations and communication;

- The organization risks and internal control;
- Financial information and regulatory challenges;
- Membership, new members' appointments;
- Roles and responsibilities;
- Planning the meetings.

From the analysis of this questionnaire to assess the activities of the audit committee, results undoubtedly, the overwhelming importance of the audit committee members. Therefore, it is required that the organization and implementation of such a committee must represent a process of greater depth from the organizations Board of Directors, given the scale and complexity of the responsibilities that they have, but also to get additional insurance that this KEY PILLAR OFFERS THE CORPORATE GOVERNANCE - WHICH IS THE AUDIT COMMITTEE.

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