

THE RELATIONSHIP BETWEEN THE AUDIT COMMITTEE AND THE FINANCIAL AUDITOR IN ROMANIAN PUBLIC INTEREST ENTITIES

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Abstract: *The paper is based on the results of an empirical research carried out in 2009 on the topic of corporate governance of public interest entities in Romania. The paper presents aspects regarding the activity of the audit committee and its relationship with the financial auditor. On the background of a relatively recent legal framework regarding corporate governance, the research identified deficiencies in the structure and the functionality of the audit committee, in the communication of the financial auditors with the audit committee and in the extent to which respondents are informed of the fulfilment of the audit committee's tasks.*

Key words: *auditor, committee, public, empirical, Romania*

1. INTRODUCTION

The audit committee and the financial audit function are corporate governance mechanisms which are critical for high-performance management. The international literature comprises different studies regarding the audit committee as corporate governance mechanism in charge with monitoring (a) the financial reporting process, (b) the financial audit activity, and (c) the efficacy of the internal control, internal audit and risk management systems. Researchers analysed the effectiveness of the audit committee (DeZoort et al. 2002). Moreover, there are studies regarding the role of the audit committees in managing the relationships with the external auditors of the entity (Hoitash & Hoitash, 2009), as well as regarding the link between the characteristics of the audit committee and the termination of the collaboration with the financial auditor at the initiative of the entity (Carcello & Nea, 2003) or at the initiative of the auditor (Lee et al. 2004). However, the Romanian literature, although it contains studies on corporate governance mechanisms (including financial audit – Manolescu et al. 2010; Mocanu 2009), contains less research focused exclusively on the relationship between the audit committee and the financial audit. Empirical studies in this field are particularly scarce in the Romanian literature. This state of facts points out the originality of our research, which focuses on the relationship between the audit committee and the financial auditor in Romanian public interest entities.

Public interest entities are defined by the Accounting Law no. 82/1991 republished, in Art. 34², as being: credit institutions; non-banking financial institutions; insurance companies; entities authorized, regulated and supervised by the Private Pension System Supervisory Commission; financial investments services companies; companies for investment management and mutual shares funds; trade companies with shares traded on a regulated market; legal persons pertaining to a company group and which enter in the consolidation area by a mother company that applies the International Financial Standards. According to Art. 34¹ of the Accounting Law no. 82/1991, the annual financial statements of public interest entities must be audited. Moreover, through article 47, the Emergency Ordinance 90/2008 stipulates the compulsory character of setting up an audit committee in public interest entities.

2. RESEARCH DESIGN

The research on the corporate governance of public interest entities in Romania was carried out in the year 2009. The overall objective was to establish to what extent are the regulations on corporate governance known, understood and implemented by the public interest entities in Romania. Authors chose an empirical research approach. Questionnaires were sent to all categories of public interest entities and the answers were received mostly from qualified persons: managers, members of the audit committees, members of the board, executive directors etc. A number of 105 entities (see Table 1) answered the questionnaires, representing circa 20% of the total population.

National companies/national entities	6,67 %
Trade companies	51,48 %
Credit institutions	18,14 %
Insurance companies	3,81 %
Non-banking financial institutions	16,09 %
Other legal form	3,81 %

Tab. 1. Structure of the sample

3. RESEARCH FINDINGS

Answers were gathered, aggregated and processed. Thus, strengths and weaknesses of the process of assimilating the corporate governance principles in Romania were identified. The current paper points out only the results of the research that concern the relationship between the audit committee and the financial auditor.

First, it was investigated whether an audit committee operates within the entities. The number of the affirmative answers was approximately the same as the number of negative answers: 44.67% answer „yes” and 44.76% answer „no”, while a percentage of 8.57% state that do not hold information whether an audit committee exists or not. In some entities, the audit committee, although set up, is not yet functional. In the entities in which the respondents are informed on the existence of an audit committee, a percentage of 81.64% of the interviewed ones state that at least one member of the audit committee is independent and has accounting and/or auditing expertise (as article 47 of the Emergency Ordinance 90/2008 stipulates), while 16.32% say they do not know.

The respondents were also enquired whether the functions of the Audit Committee stipulated by the Government Emergency Ordinance no. 90/2008 are fulfilled in their entity. These functions refer to: (1) monitoring the financial reporting process, (2) monitoring the efficacy of the systems of internal control, internal audit and risk management, (3) monitoring the financial audit of the annual financial statements, and (4) checking and monitoring the independence of the statutory auditor and the potential situations in which he/she delivers additional services to the audited entity. Tables 2-5 show the received answers.

Yes	51.43 %
No	6.67 %
I don't know	41.90 %

Tab.2. The structure of the opinions regarding the monitoring of the financial reporting process by the audit committee

Yes	51.43 %
No	6.67 %
I don't know	41.90 %

Tab. 3. Opinions on monitoring the efficacy of the systems of internal control, internal audit and risk management

Yes	51.42 %
No	10.48 %
I don't know	38.10 %

Tab. 4. The structure of the opinions regarding the monitoring of the financial audit of the annual financial statements

Yes	49.53 %
No	8.57 %
I don't know	41.90 %

Tab. 5. The structure of the opinions regarding the checking and monitoring of the independence of the statutory auditor and the potential situations in which he/she delivers additional services to the audited entity

Another question addressed in the questionnaire referred to the reporting of the financial auditor to the audit committee: Do you know whether the statutory auditor reported to the audit committee the essential aspects that resulted from the statutory audit and that concern the significant deficiencies of internal control related to financial reporting? (see table 6).

Yes	32.38 %
No	32.38 %
I don't know	35.24 %

Tab. 6. Awareness of the communication between the financial auditor and the audit committee

With respect to the relationship between the financial auditor and the audit committee, other representative comments of the respondents are: (1) The financial auditor reports to the audit committee the aspects identified during the statutory audit without presenting the material deficiencies of internal control related to financial reporting; (2) In the absence of an audit committee, the statutory auditor sends a letter to the management with the purpose to inform managers on aspects found during auditing; (3) The statutory auditor reports to the board the essential aspects that result from the statutory audit regarding the material deficiencies of internal control; (4) The audit committee was set up and until the date of the questionnaire no reporting by the financial auditor was made.

4. INTERPRETATION OF RESEARCH FINDINGS

The research pointed out some flaws in how the audit committee runs and in its relationship with the financial auditor. A percentage of approximately 9% of the respondents state they are not even aware whether an audit committee exists or not. In some entities, the audit committee, although set up, is not yet functional. Moreover, some entities (approximately 2%) do not comply with the legal requirement that at least one member of the audit committee is independent and has accounting expertise.

Additionally, a rather high percentage of the respondents (varying from 38.10% to 49.52%) do not know to which extent the functions of the audit committee are fulfilled. The fact that relevant Romanian accounting regulations are rather recent may be an explanation for the answers „no” and „I don't know” in this respect. However, the situation is totally inadequate.

A relatively high percentage of 32.38% of the respondents are not informed that the statutory auditor reported to the audit committee the essential aspects that result from the financial audit and the deficiencies of the internal control in connection with financial reporting. This answer („no”) shows the need for improving auditor's communication with the audit committee. This need for improvement is also pointed out by a global survey commissioned by IFAC among the participants in the financial reporting supply chain (IFAC 2007, pp.26). It is suggested that the auditor's opinion could also provide more insight in the communication that has taken place in the audit committee and between the committee and auditors.

5. CONCLUSIONS

The results presented in this paper refer strictly to the functioning of the audit committee and its relationship with the financial auditor in Romanian public interest entities. They are part of a wider research project. The future research step would be to develop a national training program that involves partnerships between different professional bodies and institutions (e.g. the Bucharest Stock Exchange). The program would increase the knowledge and competence of those charged with governance and would contribute to creating a corporate governance culture that also promotes the qualitative communication between the audit committee and the auditor.

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