

## THE CONCEPT AND THE APPEARANCE OF INTERNAL AUDIT COMMITTEES

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### ABSTRACT

The Audit Committee is a concept of Corporate Governance, whose main concerns are focused on organizing and ensuring the proper functioning of internal control, internal audit and its relationship with external audit.

Audit committees have emerged from the need to send recommendations to the general management or board, in order to understand them and provide needed assistance for their implementation.

For these reasons, the boards of directors thoroughly oversee the qualifications of committee members, their autonomy towards managers, the information they receive from auditors and what they report.

**Keywords:** *internal audit committees, internal control, internal audit*

### 1. INTRODUCTION

Members of the audit committee may be non-executive board members, non-executive directors and highly experienced individuals in the academic and research fields. In practice, the members of the audit committee should not be confused with internal auditors. Internal audit and the membership of the audit committee as part of the entity's management perform two totally different activities. The quality of internal auditor is an authorized profession which is exercised in accordance with professional and ethical standards and being a member in an audit committee confers rights and obligations of the chosen person. The internal auditor is a professional who has mutual respect and mutual recognition for the members of the audit committee and provides professional support and assistance when needed.

In Romania, there are currently Audit Committees within the entities in the banking system that work for the Ministry of Public Finance in order to monitor the implementation of the internal audit function in the public system (Public Internal Audit Committee). The recognized international practice recommends the implementation of audit committees in Romania. A guide that is systematically updated and which provides guidance for board members to perform better their own responsibilities was developed in 1993 by the US Institute of Internal Auditors. One of the management's expectations is the clear understanding of when the Audit Committee's objectives are finished and those of the board of directors begin. The strength and success of the audit committee are determined by the transparency of its work and the style of maintaining the relationship between internal auditors and

management. The way of setting up the audit committee component is the key to its success. For these reasons great attention is given to the process of selection of members, autonomy requirements, committee dimensions and duration of service. The conduct of the audit committee's work is based on the committee's charter, which should include the current practice and new rules, the frequency of meetings and their duration, the style of receiving and analyzing the materials, their self-evaluation method and the reporting system to the board of directors.

The activity and organization of the audit committee remains a constant preoccupation for the management, in order to adapt to emerging events and their way of evolution. Frequently, the audit committee takes on additional supervisory responsibilities, including responsibilities concerning risk management and control, starting from the exhaustive basis of the entity and through special inquiries. Management often transfers responsibility for monitoring some of their activities, and therefore, the audit committee must be careful not to be overworked and to not sacrifice their own goals.

Considering that the activities of the audit committee are quite comprehensive, it is very important that any transfer of attributions has to be thoroughly analyzed. It is up to the Audit Committee to decide to take over the additional duties that the Board of Directors wishes to delegate. However, an audit committee that fully understands its key responsibilities as a management delegate, it is able to respond effectively to all the issues faced by the entity.

### 2. THE AUDIT COMMITTEE'S RELATIONSHIP WITH MANAGERS AND AUDITORS

The honesty of the relationship between the members of the audit committee with managers and auditors is a key

factor in helping them to fulfill their responsibilities effectively. Audit committee members should have the most important interactions with the management. Normally, management takes the initiative to present to the audit committee subjects for analysis, estimates on reports,

internal control assessments, etc. Management also participates through its representatives at committee meetings.

The permanent and meaningful dialogue of the management with the audit committee contributes to the understanding of the entity's activity and the problems it faces and it also ensures the supervision of the entity. The working meetings of the members of the audit committee are also necessary for open and sincere discussions on the efficiency of managerial activity. The Audit Committee analyzes the activities of Internal Audit Components, which are characterized as "the Audit Committee's eyes and ears" in fulfilling its role of surveillance of the entity.

For these reasons, the management decision to organize the internal audit function in an entity needs to be reviewed by the audit committee. One of the most important responsibilities of internal audit is the evaluation of the functionality of internal control and risk management, which provides valuable information to the management and to the audit committee. The internal audit function allows management to conduct special investigations, including for potential fraud or irregularities. In the monitoring activity, the audit committee plays a key role in ensuring the efficient functioning of the audit, while keeping an open line with the internal audit department, but also with the management. From the evaluations it performs, the audit committee must be satisfied with the degree of independence and objectivity of the internal audit department manager, as well as with his skills and ability to organize his activities.

The permanent dialogue between the audit committee and the management of the internal audit department contributes to the establishment of a strong relationship and allows the committee to be quickly informed about the potential problems or restrictions that might affect its work. Furthermore, the audit committee should be involved in approving a decision to hire or replace a manager of the internal audit department. The audit committee should monitor the development and also the implementation of the plan by the internal audit departments. A major objective is to verify how the internal audit compartments comply with the IIA standards or their equivalent.

### **3. ACCESS OF INTERNAL AUDITORS TO THE AUDIT COMMITTEE**

Internal audit and external audit are the fundamental resources available to the audit committee to carry out its activities and responsibilities.

In order to maximize their efficiency, both categories of auditors need to have direct and unrestricted access to the audit committee. In order to achieve this access, efforts are needed from everyone, and the auditors must be willing to talk honestly with the committee, and the committee must provide its full availability for approaching these problems.

Audit committee meetings must be promoted and held regularly even if the head of the internal audit department does not consider that there are special issues that should be discussed. During the audit committee meetings, discussions include specialized issues but also staff quality issues, committee leader concerns, external audit relationship, and issues that members of the committee want to clarify.

### **4. COMPONENTS AND DURATION OF THE AUDIT COMMITTEE FUNCTIONING**

The key to ensure that the committee's responsibilities are properly met is to bring the most appropriate executives to their leadership, respectively, those who have a proper knowledge luggage, an adequate, independent, and appropriate way of judging problems. In our opinion, the members of the audit committee should be named by the board of directors or a specially created committee made up of independent members of the board. Considering that the main function of the audit committee is the supervision of the management, it is specified that the involvement of the general management in the naming the members of the committee or in changing some members could compromise the independence of the committee.

We consider that members of the audit committee may be represented by non-active system directors, experienced academics and specialists in certain areas adjacent to the entity. The board of directors or the special committee created for the naming of the members, or new members of the audit committee, must ensure that there are sufficient experienced executives to effectively guide the other members of the committee. If they want to be members of the audit committee, directors must be willing to sacrifice a lot of time and energy, get familiar with the entity, prepare for meetings and participate in any other necessary way in this process. In addition, members must devote themselves to a process of continuous training, maintenance and development of individual and collective efficiency, taking into account the entity specificity.

The members of the audit committee also have other tasks, such as:

- acquiring the specific financial knowledge of the field
- ensuring professional independence
- an extremely high degree of integrity
- an adequate understanding of the Committee's important role
- a good knowledge of the entity-specific risks
- Information capacity and independent judgment ability to provide insights and constructive suggestions
- Ability to promote effective working relationships between committee members, management and auditors

The duration of the activities of the audit committee members within the mandate must balance the advantages of entrusting the task of carrying out this complex activity to experienced members, or the risk that, after exercising their function for a long period of time, some audit committee members may become incapable of working efficiently and lose their power of being efficient in their work.

## 5. THE CHARTER

In order to successfully discharge its attributions, the audit committee must understand exactly its responsibilities and in this regard it must avoid misunderstandings and gaps in the overall view of the entity's activity and how to achieve its objectives. Also, in order to be in the top performance, the audit committee must monitor its own effectiveness and identify its improvement needs and opportunities. In the Romanian public system there is the Public Audit Committee (Comitetul de Audit Public) – CAPI- consultative committee, besides The Central Unit for Harmonizing the Internal Public Audit (UCAAPI), within the Romanian Public Finance Ministry (MFP). This has the following public attributions:

- debates the strategic development plans in the field of public internal audit and issues a pillar on its development directions
- discusses and issues an opinion on the normative act elaborated by UCAAPI in the field of public internal audit
- discusses and endorses the annual report on the public internal audit activity and presents it to the government
- endorses the plan of national public internal audit missions with multisectoral implications
- debates and issues an opinion on public internal audit reports with multisectoral implications
- analyze the importance of recommendations made by internal auditors in the event of divergences of opinions between the public entity's manager and internal auditors, giving an opinion on the consequences of non-implementation of the recommendations made by them.
- analyzes the cooperation agreements between the internal and external audit regarding the definition of concepts and the use of standards in the field, the exchange of results from the audit activity as well as the joint professional training of the auditors

- endorses the appointment and dismissal of the UCAAPI General Manager.

An internal audit charter clearly defines the purpose and responsibilities of the audit committee by addressing the following issues:

- purpose and mission
- component: size and characteristics of members, such as independence and financial literacy
- Frequency and schedule of sessions
- roles and responsibilities
- Relations with management, internal auditors and external auditors
- reporting responsibilities
- the authority to organize special investigations.

The Charter will be revised, approved and reviewed by the Board of Directors, which will not restrict the activities of the Audit Committee, because the Audit Committee has to demonstrate great flexibility to ensure an efficient functioning. One of the basic responsibility of the audit committee is to supervise the general management and to issue recommendations to the board of directors. The audit committee charter is a living document that is permanently adaptable to the reality of the entity.

## 6. EVALUATION OF THE AUDIT COMMITTEE

To assess the performance of its activities, the audit committee may consider the following:

- comparing the activities of the audit committee with the charter
- comparing audit committee activities with official guidelines and regulations
- comparing the audit committee's activities with best practices recognized in the field.

In practice, there are several ways to carry out the evaluation of the audit committee's work, but the most commonly used is requesting external consultants who can issue opinions on best practices in the field. The audit committee will periodically evaluate its performance to ensure that it continues to meet the expectations of its members, the board of directors and other stakeholders interested in the entity's activities.

## 7. REPORTING THE ACTIVITY OF THE AUDIT COMMITTEE

Since the board of director's delegate's responsibilities to the audit committee, it will normally inform the board of directors about how it has solved the tasks set out in the charter. The reporting takes place in writing and it is a subject of analysis for the board of directors, which may make suggestions to the audit committee or request an extension of the analysis. In private firms, the audit committee also reports to the shareholders in order for them to better understand its role in supervising financial reporting. Also, depending on the jurisdiction, the committee may also report to other categories of institutions, for example to the parliament, when their report concern some areas of national interest. After determining its responsibilities and the way it will discharge the tasks, the audit committee will have to include these decisions in a written charter. In the future, internal audit committees will have to be set up in Romania also, especially at the level of the main credit officers, who through their activities will contribute to support and strengthen the internal audit function within them as entities, through monitoring according to internationally recognized practice in the field.

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