ORGANISATIONS OVERSEEING THROUGH THE AUDIT COMMITTEE

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Abstract: *Financial oversight of the financial reporting process is one of the major responsibilities of audit committee members. Besides the concerns of knowledge and understanding of financial reporting in accordance with national regulations, the audit committee must ensure a high quality and the availability of financial reporting, transparency embodied in financial statements, consistent and comparable from one period to another, but also amongst organizations. In these circumstances, the audit report for the financial reporting process oversight of the Board of the organizations must have a certain structure, as shown in Appendix - Audit Committee Report. Another important responsibility of the audit committee is the audit oversight function within the organization, which includes internal audit activity and external audit of the organization. In this regard, the audit committee assesses the internal audit function on the following elements: independence, objectivity, compliance audit methodology, findings and quality and the implementation of audit recommendations. The audit committee pays a particular attention to assessing the experience of auditors, required resources and relationship with the management of the organization. Regarding external audit, the audit committee assess the selection of financial audits, the level and quality of services provided and their reporting system. Also, the audit committee evaluates the relationship between the external audit and the internal audit within the organization and its relationship with the board, based on the analysis of the latest external audit report received by the organization. The article deals with the position of the Audit Committee, which is in a unique situation of assessing the audit function with the financial reporting system of general management of the organization, and analysis of any non-audit services required by the organization.*
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1. THE SUPERVISION OF THE FINANCIAL REPORTING PROCESS

The supervision activity of the financial reporting process is one of the most important - and difficult - responsibilities of the audit committee members.

In this sense, the members of the audit committee must gain an understanding of issues regarding the financial reportings affecting the company and the audit committee must ensure that there is a process of financial reporting of high quality and that financial statements are transparent, consistent and comparable .

The management board, the auditors and the audit committees should have distinct roles and responsibilities in the financial reporting process. However, they share a common goal, namely ensuring financial reporting of the highest quality.

Regarding this, the audit committee should be informed by the management on the significant problems of the financial reporting, to check the company's financial statements and, together with management, to discuss these matters with the internal and external auditors.

The solid business and risks knowledge the company may face, allows the members of the audit committee to ask correct and concrete questions on financial statements and other supplementary declaration.

Therefore, *the audit committee must acquire an understanding of the significant financial reporting issues that concern:*

• *the financial results compared to the established results;*

• *the consistency of the facts presented in the financial statements by comparison with the non-financial statements;*

• *the major changes in the company's balance sheet or changes in trends or in the financial reporting;*

• *the accounting principles, including the changes taking place, and the rules and practices in the field in which the company operates;*

• *the significant matters that may reflect the credibility of the intermediate accounting and of the reporting practices;*

• *the significant transactions with third parties;*

• *significant topics in accounting or audit area that may affect the company or influence the quality of earnings on the overall quality of financial reporting, such as:*

- *declaring overstated restructuring tasks that have periodic results in the company's revenue;*

- *excessive burdens in research and development areas, as well as recognition of the liabilities for future operating costs in combination of acquisitions;*

- *the use of unrealistic assumptions in estimating debts in order to increase revenues, for example, sales ratability, loan losses or on guarantees costs);*

- *using intended practices to incorrect records or uncorrected errors;*

- *Incorrect recognition of the revenue, before completing the sale, the products delivery to customers, before completing the transactions.*

For these reasons, the audit committee, regarding the evaluation of the quality of income, should consider any warning - "red flag" - that could indicate poor management. In practice the Committee should pay particular attention to the issues of the revenue recognition, the complexity of the arrangements with customers, the acquisition of intangible assets, the restructuring tasks of the company or the reduction of the burdens etc.

With the occasion of the management financial statements verification, the audit committee can ask managers or auditors questions, like the ones from the Ernst & Young list and from the Audit Committee Mechanism document, structured on fields, which contains questions like:

• *Financial instruments*
- does the company want to invest in some unusual types of financial instruments?
- what is the nature and extent of their use?

• *Customer accounts / loans*
- was the budget for doubtful customer rated?
- are there reserves for loans that cannot be reimbursed?
- is there a higher concentration of risk on loans in certain areas?

• *Inventory*
- What procedures were taken to ensure that the inventory does not contain obsolete or excess inventories and its decrease was appropriate?
- was there any undertaken evaluation to determine if the inventory is properly registered at the lowest market price?

• *Investments in affiliates*
- How the company does takes into account investments in partnerships, collaborations or other affiliates?

• *Long-term liabilities*
- are there unforeseen commitments or liabilities that were not included in the financial statements?
- does the company complies with its commitments on loans and repayment of debt?

• *Income and expenses*
- How the company policy to generate income compares with the other companies in the same field?
- Are there included in the financial statement unusual or extraordinary income or expense items?
- what did the management and auditors do to consider the existence of some problems regarding revenue recognition and how should they be considered?

• *Third Parties*
- are there any recordings of unusual transactions with third parties?
- What was done to ensure that they are properly recorded and disclosed, accordingly, the financial statements?

• *Special Transactions*
- Which is the purpose of the special transactions?
- These special transactions are understood and explained by management?
- The special recording transactions include critical information on investor understanding of the business purpose and economic nature of the transaction?

The Audit Committee, as a result of the financial reporting process supervision, on behalf of the Board, writes a report, as shown in the example found in the Annex. 1 - The report of the audit committee.

2. SUPERVISING THE AUDIT FUNCTION

Another major responsibility of the audit committee is the proper understanding of the audit function, which includes both internal and external audit function.
The Audit Committee verifies internal auditing procedures and recommendations provided by the management and also examine the planned activities, the resources requirements and the costs for assessing the external auditor's independence.

The members of the audit committee should have an understanding of the planning and conducting the audit work. The internal and external auditors should meet with the audit committee to provide information on the processes of audit. Periodically, the new members of the committee should be informed of the developments in the organization's auditing processes.

The audit committee should evaluate both the quality and experience of internal auditors and the objectives which they proposed, and also the corresponding amount of resources that should be used for the internal audit function. In this regard, the audit committee may encourage the management to increase the resources available for the internal audit function, if such a step is necessary.

Also, the audit committee takes into consideration the adequacy and rewarding of its staff, while maintaining the quality of work and ensuring staff continuity. *Periodically, the audit committee examines the effect of outsourcing the internal audit function.* Similarly, the audit committee verifies annually the external audit team members' qualifications and performances, including the external auditor answer to the expectations of the audit committee.

The audit committee must be directly involved in the appointment, replacement, dismissal and reappointment of the director of internal audit and, similarly, the audit committee must be responsible for recommending to the board of directors external auditors selected by the company and eventually for determining the correctness for giving up their services.

Considering that the management is working directly with the external auditors, it is always in a better position than the Board of Directors regarding the assessment of the level and quality of services provided by the external auditors. In these circumstances, the management usually makes proposal for the appointment of external auditors to the audit committee. The Audit Committee shall examine the proposal and recommends the selected audit firm to the board of directors that appoints external auditors with the approval of the Board.

After the selection of the external auditors, the board of directors defines their responsibilities in a letter that represents a commitment on the types of services that will offer the company and the expenditure estimates.

The audit committee should analyze the results of the latest audit provided by the external auditor, as well as any complaints or disciplinary action related to them, if there were any, applied by the professional bodies in the field. Meanwhile, if the internal audit function is assessed periodically, the audit committee may also investigate the results of the function assessment.

The members of the Audit Committee should focus on systematically orient the management and the work of the internal auditors and examine the performance of the internal audit activity. To achieve these objectives internal audit committee members must be concerned with the following aspects:

a) the head of the internal audit compartment skills and to whom he reports to;
b) the reporting manner of the internal audit department head;
c) when was last revised the Internal Audit Charter?
d) the development of the internal audit plan;
e) how efficient does the management team implements actions over which they agreed during the audit activity?
f) is the internal audit activity carried out in accordance with IIA Standards and with the Code of Ethics?
g) is the position of internal auditing in the entity at a sufficiently high level and detached from functional areas to ensure independence?
h)does the internal auditors manage to avoid activities that would undermine their objectivity?
i) the fulfillment of the internal audit plan;
j) does the internal audit have a quality assurance and improvement program?
k) does the program contain an external quality assessment every five years as required in standards?
l) does the internal audit has sufficient resources to provide an objective assurance about risks and controls?
m) how does the chief of the audit compartment respond to the examination made by the Audit Committee?

The external auditor's / audit firm assessment for its selection made by the audit committee can be done using a questionnaire containing the following questions:

NC	QUESTIONS	YES	NO	Comment
1.	Which are the audit processes and on what areas will they focus on?			
2.	Is the company independent in relation to the audited company?			
3.	What is the control policies quality of the company?			
4.	What is the company's expertise in auditing?			
5.	Which is the international extensions o the company?			
6.	Which will be the team of internal auditors appointed to audit the company?			
7.	What is the expertise and qualifications of the designated audit team members?			
8.	To what extent and how will the partner participate in the work of external audit?			
9.	Does the responsible partner for this commitment has leadership skills and experience to bring all the necessary resources to the company?			

10.	Does the responsible executive director for this engagement demonstrates a high degree of integrity in matters concerning the audit committee?			
11.	What other professional services will be provided by the audit firm or by another firm?			
12.	What are the estimated fees, which is the basis for determining them and how their differences will be arranged between the estimates and the actual charges?			
13.	How will it be communicated the significant deficiencies or other comments regarding the internal control?			
14.	As does he shares his knowledge and expertise within?			
15.	How will the company use the IT technology during the auditing mission?			
16.	Must the audit committees be capable of assessing the performance of the external auditors and make them accountable in case of failure in their professional duties?			

The audit committee must verify the objectives the internal and external auditors planned, their work, any changes in the planning activity, assessing the functionality and performance of the internal control and also the degree of coordination and correspondence of their activities.

In overseeing the internal audit function, the audit committee is responsible for the coverage provided both by internal and external auditors.

Since the audit committee assists in providing direction and the aim of the internal audit function, it is in a unique position to question the degree of coordination between internal and external audit.

The audit committee has also the responsibility to verify the information related to the external auditors' fees and the total cost of an audit (internal audit and independent audit). In this regard, the audit committee must ensure that the management has not restricted, inadvertently, the audit purposes in order to reduce costs.

The responsibility of negotiating the fees with the external auditors remains the responsibility of the management, but the audit committee approves the fees for the external audit and examine whether the degree of reward for external auditors is appropriate in order to ensure a well-trained staff, able to undertake the necessary procedures for a high quality audit.

The organization may require external audit some non-audit services or services unrelated to the audit, such as taxes, IT consulting and other services. *The PANEL report* included a recommendation - the approval by the audit committee of the non-audit services that did not passed a certain level of cost. However, the report stated that this level should not be so low that the audit committee would assume a management function.

In the USA, the Commission of Financial Instruments and Transferable Securities (SEC) determined the banning of certain non-audit services, clearly established that those services were and issued rules in this regard. Initially SEC banned advisory IT services, a position supported in that time, by Ernst & Young and another firm from the five largest audit firms and consultants, but subsequently did not issue rules in this regard. Meanwhile, the SEC considered necessary to prohibit the outsourcing of the internal audit regarding the financial problems, but finally allowed the auditors to provide up to 40% of the services regarding clients' financial problems.

In 2000, the SEC indicated a range of permitted non-audit services that will not damage the independence of the auditor:

• audit-related services;
• taxes related services ;
• the assessment, design and implementation of the internal accounting and risk management controls, for example checking the information from the control systems;
• the insurance evaluation for other post-employment benefits, pension or similar obligations;
• tasks related to advising on insurance for companies and other customers;
• assessments for business tax and intangible issues;
• advisory services on investments;
• corporate finance services.

Despite the SEC submission of a range of non-audit services that auditors were allowed to take for their clients, there were still expected imposed restrictions on the IT consulting and on the internal audit outsourcing.

In the auditors practice, the regulations on the prohibition of other non-audit services, was not supported because there are many so-called non-audit services that were performed traditionally by auditors, including a wide range of services relating to taxes that can only be undertaken by auditors. In addition, the accounting firms provided a range of advisory services that assist clients in managing risks more effectively and in an effective implementation of the control activities.

There should not be any concerns about the possible effect on affecting the objectivity of auditors in the audit process, when there are fees for non-audit services, because by their nature these services do not generate conflict with the audit process.

The standards, codes of ethics and professional regulations for auditors, together with the consequences of violating them, ensure an effective protection in order to maintain objectivity.

In this sense, Ernst & Young has set understandable measures to protect the quality control that is applicable to each audit. In addition, the audit committees are able to assess the nature of the services provided by the non-audit fees charged and determine the objectivity and professionalism of the audit firm. At the same time, we must bear in mind that due to their professionalism, auditors are dedicated to initiating sincere dialogues with the audit committees in the case of occurrence of such circumstances.

References

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2. * bill amending and supplementing Law no. 672/2002 on public internal audit

Annex

The audit committee report

The Audit Committee oversees the financial reporting process on behalf of the Company's board of directors. The management has a great responsibility for the financial statements and the reporting process, including the internal control system. While fulfilling the surveillance responsibilities, the Committee examined the annual financial statements together with the management, including a discussion on quality, not just the acceptability of the accounting principles; the reasonableness of significant judgments; and the clarity of the information in the financial statements.

The Audit Committee has checked together with the independent auditors who are responsible for expressing opinions on the compliance of the audited financial statements with the generally accepted accounting principles, their judgment on the quality, not just the acceptability of the accounting principles of the company and also other topics to be discussed under the generally accepted auditing standards.

In addition, the committee discussed with the auditors the issue of their independence from the management and the company, including matters required to be discussed by the Auditing Standards Board on independence and consider the compatibility of the non-audit services with the auditor independence.

The Audit Committee has discussed with the company's internal and external auditors on the main goal and on the plans for such audits activities. In this regard, the Audit Committee meets with the internal and external auditors, with or without the presence of the management, to discuss the results of the examinations, their evaluation on the internal control of the company and the quality of the financial reporting, that the committee has had four meetings during the fiscal year audited.

Based on the verifications and discussions mentioned above, the committee recommended the board of directors who approved the audited financial statements to be included in the Annual Report and in the 10-K Form for the year ended at 31st of December of the audited year in order to respect the SEC provisions. The committee and the board of directors recommended also, after it will be the subject to shareholder approval, the selection of independent auditors of the company.

1st of March , 20XX

Chairman of the audit committee,
Member of the audit committee,
Member of the audit committee,