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The role of the audit committee in corporate governance – case study for a sample of companies listed on BSE and the London Stock Exchange - FTSE 100

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Abstract

This article proposes a deductive approach - from general aspects to particular aspects - that combines quantitative and qualitative studies. Theoretical knowledge is used for a better understanding of a phenomenon and not for making assumptions (Siti-Nabiha, 2009). Thus, in order to achieve our study, we selected 21 companies listed on Bucharest Stock Exchange (11 companies) and London Stock Exchange (10 companies). Please note that all the companies belong to the main index of these Stock Exchanges (Category 1 – Bucharest Stock Exchange - and FTSE 100 – London Stock Exchange). We mention that all these companies where chosen completely randomly, not using in their selection criteria as stock exchange capitalization, but still taking into account the availability of information. In this study, we tested a lot of statements using “true” or “false”. To obtain the information, we accessed website of each company and annual reports for 2011 and Corporate Governance Regulations of companies in question. Following this study, we concluded that the role of the audit committee is crucial, although some aspects are more or less unevaluated by the companies from the sample on which the study was conducted. As a general conclusion, we can see that the companies listed on Bucharest Stock Exchange are not aware of the significant role of the audit committee in corporate governance, unlike foreign companies, which understand the significant role of this structure.

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Keywords: audit committee; corporate governance; BSE; London Stock Exchange;

1. Introduction

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A group of researchers suggests that the audit committee play a large role in consolidation of tfinancial control within a company (Collier, 1993; Vinten & Lee, 1993). A number of studies have found that inside of companies with an audit committee, particularly when the committee is active and independent, there is less chance for the occurrence of fraud (Beasley et al., 2000; Abbott et al., 2000, McMullen, 1996) and other irregularities reporting (McMullen, 1996).

It also suggests that audit committees are effective in reducing the appearance of errors in earnings management, which may lead to inaccurate financial statements (Defond & Jiambalvo, 1991; Peasnell at al., 2000).

The role of the audit committee as a key corporate governance system is a considerable interest in recent years. Corporate governance committees and regulatory authorities around the world approached the need for an effective audit committee and, moreover, require listed companies to establish an audit committee.
Recognizing that the existence of an audit committee does not guarantee his effectiveness, attention shifted to the organization and activities of audit committees. Recommendations focused on the independence and competence of the audit committee members and the frequency of audit committees sittings (Report Smith, 2003; ASX, 2003, NACD, 1999). Researches indicate that there is a significant difference in recommended structure and the role of audit committees. The establishment of an audit committee within a company is a core component of corporate governance.

Nationally, OECD recommendations were taken in the CCG (Code of Corporate Governance) prepared and published by Bucharest Stock Exchange. Thus, the audit committee is permanent, independent, reporting directly to the Board, having an advisory function. The audit committee consists of at least two non-executive members of the Board or the Supervisory Board, as appropriate, or of other representatives appointed by the Annual General Meeting, one of whom shall be chairman.

Also, the Government Emergency Ordinance no. 90/2008 states that „each public-interest company must have an audit committee. Regulators of public-interest companies determine whether the audit committee must be composed of non-executive members of the Board and/or members of Supervisory Board of the audited company and/or the members who are appointed by the Annual General Meeting, complying the law. At least one member of the audit committee shall be independent and shall have expertise in accounting and/or auditing.

The audit committee, among others, the following responsibilities: monitoring the financial reporting process, monitoring the effectiveness of internal control or internal audit, as appropriate, and risk management of the company, monitoring the statutory audit of annual financial statements and the consolidated annual financial statements, monitoring the independence of the statutory auditor of the company and, primarily, the provision of additional services to the audited company.

The audit committee represents a key element in the corporate governance process. The fight for the integrity of information in the financial statements and confidence in them depends on a balance to be achieved between management pressures, regulator, investors and the public interest.
In conclusion, the audit committee plays a large role in the decision making within a company and, at the same time, it helps the Board of Directors, management, internal audit and external audit.

2. Methodological issues regarding to the case study

To achieve the case study on analyzing the role of the audit committee in corporate governance, we chose a sample of 21 companies listed on Bucharest Stock Exchange (11 companies) and London Stock Exchange (10 companies). Please note that the companies listed on BSE belong to the main index of this stock exchange (Category I). Also, the companies listed on LSE belong to the main index of this stock exchange, namely FTSE 100.

To achieve the objectives, we went through following steps: analysis of the implementation guide corporate governance code, selecting the companies, selecting relevant information, defining the method of analysis, the proper analysis and interpretation of the results.

Also, please note that these companies were chosen completely randomly, not using in their selection criteria such as market capitalization, but still taking into account the availability of information. In this study,