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The Relationship between Audit Committee and Corporate Governance in Companies

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Abstract: The audit commitee and the corporate governance are two important structures that continously develop and related with each other. This study talks over the principles and goals of audit, independant audit, internal audit, internal control, corporate governance. The relationship between the audit commmite and the corporate governance activities is described via examining the the relationship between audit committe, independance audit, internal audit and executive board.

Keywords: Audit Committee, Corporate Governance, Internal Audit
JEL Classification: M42

1. Introduction

Although managers and capital owners are not the same people in today's enterprises, the provision of effective information at the point of decision-making is done through the reporting function. Correct decision making by business managers is possible with accurate information that can be accessed on time (Durmuş & Arat, 2000: 120-121). Accuracy of financial reporting is of great importance in a successful corporate governance. In order to prepare quality financial reporting, an effective audit committee should be present in the enterprises. Audit committees in enterprises play an effective role in the preparation of exact financial reports and in the controls related to independent audit and internal audit activities of enterprises. When the audit committee works effectively, the expected benefits of corporate governance will be achieved. The importance of the audit committee being increased in the regulations on corporate governance has been seen. Ensuring corporate transparency is linked to the work of the audit committee within the enterprise. Business management is responsible to both the board of directors and shareholders. Audit committees should be established in enterprises for effective corporate governance. The existence of audit committees in corporate governance is important for the effective functioning of risk management, internal control and financial reporting. Audit committees ensure the accuracy of financial information through their examinations in enterprises. Audit committees continue their activities by taking part in the organizational structures of enterprises in many countries. The importance given to audit committees to strengthen the financial structures of enterprises is increasing day by day.

2. Audit Committee

Shareholders would usually want to obtain accurate, timely and relevant information about the financial status of the enterprises and the risks threatening the enterprise. A number of committees are formed to fulfill these demands of shareholders and to improve business operations (Uyar, 2004: 4). Audit committees can be described as an administrative structure elected by the board of directors of the enterprises and responsible for the control activities within the enterprise and the follow-up of the financial reporting stages (Uzay, 2003: 72). Audit committees are a structure that emerged as a result of inadequate auditing and ineffective management in enterprises, decreased confidence in financial statements and frauds occurring within the enterprise. The audit committee also undertakes tasks such as ensuring the relationship between the internal auditor and the independent auditor, evaluating the activities of independent auditors, and monitoring the reporting stages with the aim of increasing the effectiveness of the audit (Çatıkkaş & Yurtsever, 2007: 80). The duties of audit committees can be grouped under four main sections: Oversight of Financial Reporting, oversight of external audit, oversight of internal control and oversight of internal audit. In general, the duties of the audit committee can be summarized as follows (Dağlı, 2000: 30-31):

a) Oversight of Financial Reporting

- Provides assistance to the board of directors in monitoring financial reporting and ensures the reporting to third parties, in particular annual financial reporting. It's balanced, fair and in accordance with the accounting rules,
- To ensure reconciliation between management and the independent auditor on behalf of the board of directors of the entity,

b) Oversight of External Audit

- To supervise whether the independent auditors have fully performed the work under their responsibility and to report the work to the board of directors,
- Provide assurance to the board of directors that the independent audit is adequate in terms of its size and depth and that it is properly performed,

- To advise the board of directors on the reappointment or dismissal of the independent auditors,
- To advise the board of directors on the remuneration of the independent auditors,

c) Oversight of Internal Control

- To oversee, on behalf of the board of directors, the adequacy of the systematic control of both operational and periodic financial reporting reviews of the arrangements made by the enterprises regarding internal control and the weak points of the internal control system,
- To endure the management letter prepared by the independent auditors as a result of their work,
- To make assignments to carry out special researches within the scope of specific issues related to internal control,
- To obtain information from the head of the internal audit unit about audit findings that the management identifies as a risk due to their cost or other characteristics,

d) Oversight of Internal Audit

- Considering the procedures implemented by the internal control unit, ensuring that these procedures have sufficient content and making recommendations in the establishment of procedures,
- Approving the appointment and termination of the term of office of the head of the internal audit unit,
- To peruse the appropriateness of the internal audit plan and to make controls,
- To inform the board of directors on whether the internal audit unit has the appropriate and sufficient amount of resources it will need in its work, from the responsible person working in the internal audit unit regarding internal audit activities,
    - The planned progress of internal audit activities and the reasons for the change in planning, if any,
    - Providing activity reports on the deficiencies identified during the audit work, which, although important, but wasn't seen sufficient by the management.

The audit committees of the enterprises continue their activities by being in constant communication with both the management staff of the enterprise, and with those working in the internal audit system and the independent auditors who provide independent audit services to the enterprise. In this context, audit committees are responsible for the internal audit unit, the board of directors and independent auditors (Keinath & Walo, 2004: 3). Independent audit is explained as the process of collecting evidence to determine whether economic activities and transactions are carried out in accordance with predetermined rules, whether the information to be disclosed with the criteria previously determined, and the process of objectively evaluating the collected evidence and reporting the results to those concerned (Toroslu, 2016: 23). The audit committee takes an active role in controlling the work of independent audits, which are one of the important factors of financial reporting stages. The duties and responsibilities of audit committees within the scope of independent audits can be stated as follows (TÜSİAD, 2012: 17).

- Audit committees should review the plans for and the results of the independent audit and discuss significant business risks with the independent auditors
- In response to conflicts of interest that may arise within the entity, audit committees should be prevented by ensuring that the independent auditors share the results obtained at the end of the independent audit work with the audit committee.
- Selecting the independent auditors to perform independent audit work, checking their performance in their work and to see if they act independently
- Resolving disputes between independent auditors and management
- Consideration of the effectiveness of the accounting treatment practices selected by the independent auditors
- Audit committees should not seek advice from independent auditors on tax matters,
- Recognizing the signs that are deeper and broader for the audits which will be necessary

Audit committees play an important role as an intermediary in the health execution of the relations between the internal audit system and the board of directors (Öksüz, 2005: 14). Internal audit is an independent evaluation system established within an enterprise for the purpose of achieving the objectives of the enterprise (Akgül, 2000: 9). The existence of an internal audit system in enterprises not only contributes to reducing the cost of audit work, but also increases the efficiency of auditors in working time and access to resources in independent audit work and increases the confidence of auditors in the enterprise (Kiracı, 2004: 111-112). The internal audit system includes examining the quality of the activities offered by the enterprises, examining whether the internal control activities are effective and efficient and evaluating these activities (Özeren, 2000: 1-2). Audit committees have many responsibilities regarding internal audit activities within the enterprise. Their main responsibilities are to ensure the effective functioning of the internal audit system and to ensure that it can continue its activities effectively. At this point, audit committees should effectively perform the following practices within the scope of their responsibility to monitor internal audit activities (Uzay, 2003: 72).

- Review the audit plans for the year and the schedules for internal auditors.
- Assess whether the activities of the internal auditors are adequate and should review the reports prepared by the internal auditors as a result of their activities.
- Examine whether those who are responsible for internal audit work are acting in accordance with their duties.
- Review the responses to internal audit reports by management.
- Examine whether internal auditors have problems in reaching the management of the business.

The board of directors, which has comprehensive information on all areas of activity related to the business, is the first place audit committees should head to for information. Boards of directors should contribute to the training of audit committees and provide the necessary financial needs for audit committees to carry out their responsibilities effectively and completely. In return, audit committees should guide the management by providing them with objective and reliable information to support their decisions on issues of importance in financial reporting and business activities. In addition, the relationship between the board of directors and the audit committees established to ensure the effectiveness of businesses should not cause the audit committees to lose their skeptical approach in their work (TÜSİAD, 2012: 65). The fact that audit committees fully dominate the business culture will also ensure efficiency in terms of audit work in the business. The audit committee is obliged to make recommendations for the improvement of these issues when it detects behaviors of the senior management that are not in line with the policies and strategies of the company (TÜSİAD, 2012: 67).

3. Corporate Governance

Corporate governance is defined as all the rules applied in the enterprise to ensure the integrity between the shareholders, stakeholders and managers of the enterprise (Hacıhasanoğlu & Babayiğit, 2020: 219). Corporate governance is the protection of the rights of business investors and the application of an equidistant approach to business partners (Kaderli & Köroğlu, 2014: 23). The importance of corporate governance for businesses and countries is given below (Yasaman, 2005: 17):

- Ensuring that capital is invested domestically and preventing its outflow abroad
- Increase in foreign investors
- Overcoming possible crises without incurring losses
- Correct allocation and use of resources
- Ensuring market conditions with high reliability, efficiency and competitiveness

We can summarize the factors that have an impact on the spread of corporate governance, which has become a mandatory management approach in enterprises today, as follows (Doğan, 2007: 43):

- Emphasis on corporate governance in order to concentrate more investments within their own structure and to gain the trust of institutions that have a say in capital markets around the world,
- The rapid development of information technologies between countries, the desire of those who want to invest to benefit from these rapidly advancing technological developments, and the easier provision of information flow and communication,
- Investors, both institutional and individual capital holders, want to increase their shares in stocks and shareholder formations are more open,
- As a result of fraudulent transactions occurring in businesses, audit work and oversight of business activities gain value day by day,
- Providing confidence for investors in places where they will invest but which may not be easily accessible,
- Easier procurement of financial requirements of enterprises and access to more affordable prices have been effective in the spread of corporate governance.

Corporate governance aims to share the financial information of enterprises in a complete and transparent manner for investors and the public (Başkan & Çopur Vardar, 2018: 584). Another purpose of corporate governance is to give confidence to investors for long-term investments. Businesses that provide this confidence provide easier financing than other businesses (Onbulak, 2017: 107). We can list the objectives of corporate governance in enterprises as follows (Küçüksözen & Küçükkocaoğlu, 2005: 83):

- Protecting the rights of shareholders
- Ensuring transparency in periodic financial reporting by identifying and improving practices related to financial transactions
- Ensuring that the board of directors can act independently in its activities

- Carrying out activities for competition in order to prevent unfair gains
- Increasing the penalties to be imposed on those who do not comply with the rules within the framework of the rules determined by the enterprise

Corporate governance has certain rules for businesses. In developing countries, effective implementation of corporate governance by businesses increases business success and market value (Mohan Bursalı, 2018: 511). The principles of transparency, responsibility, accountability and fairness applied in enterprises within the scope of corporate governance provide great support to the parties related to the enterprise in obtaining information about the enterprise (Aras, 2007: 23). The principle of transparency ensures that information is provided to the shareholders of the enterprises under uncertain conditions that may occur in the markets and that cannot be foreseen by the enterprises. It ensures the enlightenment of the society by applying the rules previously determined in the enterprises (Özsoy, 2011: 74). The principle of transparency emphasizes the necessity of informing the participants about the developments that they expect to occur in the capital markets, and is effective in ensuring the continuity of the markets in periods when the capital markets are uncertain (Dinç & Abdioğlu, 2009: 160). The principle of accountability refers to the clear and understandable reporting of all assignments and responsibilities involving management in enterprises, and the observation of the management of the enterprise and the rights of stakeholders by the board of directors of the enterprise in harmony with each other (Ege & Yılmaz, 2005: 84). With the widespread application of the principle of accountability in businesses, it will be ensured that the behaviors of the business management, such as making unexpected decisions that develop suddenly, will be prevented. In addition, the confidence of the shareholders in the decisions to be taken by the management will continue (Tuzcu, 2004: 2). The principle of fairness has enabled foreign and minority shareholders to be protected against the majority and to have a say in decision-making. The implementation of the principle of fairness together with the fulfillment of responsibilities regarding the shareholding structure and effective public disclosure ensures the protection and exercise of shareholders' rights (Sertoğlu, 2014: 312). The principle of responsibility refers to the fulfillment of the compliance of the practices in the enterprise with social values, laws and regulations related to business processes that the enterprise will take into account while carrying out its activities. Ensuring these conformities is among the objectives of the principle of responsibility (Abdioğlu, 2007: 23). Nowadays, businesses have become structures that have certain responsibilities towards the society, rather than being a structure that only makes profit by engaging in economic activities. The principle of responsibility enables businesses to contribute to the welfare of the society by directing them to social activities as well as economic activities. In this framework, the understanding of responsibility requires businesses to support education, be sensitive to human rights and promote environmentally friendly practices (Düzer, 2020: 152).

4. Relationship between Audit Committee and Corporate Governance

Audit studies are one of the many important studies in enterprises within corporate governance studies. Audit studies have a great impact on the implementation of corporate governance principles in enterprises and ensuring the reputation and trust of the enterprise (Aysan, 2007: 37). Corporate governance in enterprises enables the management to always make the right practices in terms of moving the performance of the enterprise forward by controlling those in management, preventing arbitrary decisions that will adversely affect the stakeholders. In order to be able to talk about corporate governance in an enterprise, first of all, stakeholders should be able to control the decisions taken by those in management, examine their activities and have a say. The ability of stakeholders to provide this control and make examinations can be ensured by both laws and various practices. At this point, one of the practices carried out in order to protect the rights of the stakeholders in the enterprises and which is made compulsory by laws in some countries is the establishment of audit committees (Tuzcu, 2004: 16-17).

Audit committees established within the scope of corporate governance are effective in the implementation of internal audit and independent audit in a clear and understandable manner to meet the needs of the entity. Internal auditors have the responsibility to submit their reports to audit committees. Audit committees should have the full support of the business, be supported by the management, and be provided with all the data that audit committees need to perform their duties and responsibilities effectively (TÜSİAD, 2002: 25). Audit committees show the extent to which an enterprise implements the principles of transparency and accountability among the principles of corporate governance. Audit committees reflect the importance that an enterprise attaches to corporate governance and the extent of its attitude in this regard. At this point, the extent of the relationship between corporate governance and the audit committee is determined by the level of implementation of the principles within the enterprise (Yılancı, 2003: 30). When we consider the regulations on corporate governance principles in other countries of the world and in our country and the new developments to be experienced, we can say that there are important duties and responsibilities in the corporate governance, internal audit systems and audit committees of enterprises. Boards of directors are related to the audit committee in their responsibilities related to the audit of the enterprise, and audit committees are responsible for overseeing whether the internal audit system is effective in its work (Uzun, 2005: 17).

5. Conclusion

The loss of confidence in financial reporting as a result of negative events in enterprises poses a major problem. With the understanding of corporate governance, it is aimed to achieve the goals related to the activities of enterprises. Corporate governance practices guide business management. Corporate governance is a set of rules that ensure effective management and control within the scope of the responsibilities of enterprises towards investors and other stakeholders. Audit committees have gained importance in enterprises with corporate governance practices. Audit committees are committees that audit business activities on behalf of shareholders, represent shareholders and assist the board of directors. Audit committees assist the board of directors in the compliance of financial reporting, internal audit and internal control activities with the rules within the scope of oversight responsibility. The audit committee contributes to transparency in financial reporting by preventing the management from making mistakes. It reduces the risk of fraud in financial reporting. It ensures the proper functioning of the internal control system. Audit committees create trust in capital markets and increase the effectiveness of audit work. When audit committees fulfill their duties and responsibilities, they will contribute to the reliability of financial reporting and protect business assets. The success of audit committees in enterprises is possible by ensuring their independence. This is ensured by a business management that gives due importance to corporate governance. One of the most important committees of business management is the audit committee. The audit committee first benefits the shareholders and then benefits all concerned.

The existence of audit committees ensures a healthy communication between the management, internal audit unit, independent audit and the board of directors. The audit committee carries out the evaluation process for the selection of the independent auditor by the board of directors of the entity with its effectiveness, competence and contributions to the entity in the implementation of independent audit studies (Uzun, 2010: 48). The audit committee provides assurance in ensuring independence in internal audit activities. In order to be able to talk about effective corporate governance, internal control, internal audit and audit committee, one would have to be present within the enterprise. Corporate governance will become stronger with an effective internal audit and audit committee. The audit committee has an important role in overseeing the internal audit system. After the audit committee is established, internal audit will be more effective. The existence of the audit committee will protect the assets of the enterprises, provide accurate and reliable information and will be effective in the efficient use of resources.

The full implementation of corporate governance practices in enterprises will also prevent possible conflicts of interest. By preventing the business management from making and implementing arbitrary decisions, the business staff will be strengthened and the work will be carried forward. In addition to the inclusion of successful employees in the enterprise, the establishment of an effective audit system will increase the reputation and development of the enterprise (Arslantaş, 2012: 5). With the formation of the management of enterprises within the framework of corporate governance, enterprises will be more transparent, fair, accountable and responsible. Audit committees is one of the most basic formations of corporate governance, ensuring the implementation of corporate governance principles in enterprises, the protection of shareholders' rights, the preparation of reliable financial reports and the provision of accurate information. The audit committee is the biggest assistant of corporate governance. Audit committees are the most important indicators of the implementation of corporate governance in enterprises.

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