Audit Committees in Polish Supervisory Boards: Common Practice and New Challenges

Izabela Koładkiewicz

Abstract The objective behind this chapter is an assessment of the functioning of audit committees in the supervisory boards of companies listed on the Warsaw Stock Exchange in Poland. It is made up of three parts. The first encompasses the history of the origins of the audit committee in Polish supervisory boards and presents its basic characteristics – i.e. size, composition, and scope of activities. The second part presents the opinions and views of 34 interviewed board members with respect to their experiences in connection with the functioning of audit committees. The third part of the chapter is a presentation of the results of an analysis of recommendations relating to the functioning of audit committees as found in the post–crisis versions of corporate governance best practice in Western Europe.

The conducted analysis indicates that under Polish conditions the audit committee continues to be a young institution. Among key benefits tied with its activities is its role as an institution bringing order and improving the efficiency of the supervisory board, which is especially important in the case of large boards.

In spite of the observed benefits provided by the presence of an audit committee, the rate of the process of its spreading among Polish boards is slow.

As to the challenges that must be faced by audit committees in Poland, among them is the need to pass into a higher level of maturity expressed in the character and complexity of performed tasks.

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1 Introduction

Most present day assessments on the usefulness of an audit committee in the life of the supervisory board (improvement in the quality of its work) and of the company itself (improvement in financial reporting and increased trust on the part of investors) are dominated by positive opinions. Confirmation may mainly be found in the experience of the audit committees of Anglo–Saxon countries such as the United States. However, American observations clearly demonstrate that the key impulse in transforming an audit committee into an effective body was the introduction of "hard law" regulating its operations. The Sarbanes–Oxley Act (SOX) passed by the United States Congress in 2002 incorporated the soft recommendations developed in 1999 by the Blue Ribbon Committee (BRC), an organization made up of representatives of the NYSE and NASD, which were intended to increase the effectiveness of audit committees (Myers and Ziegenfuss 2006, pp. 48–49). It should also be stressed that the United States is not alone in such moves. Recent times have seen major world capital markets taking action to incorporate "soft" best practice defining the framework and operations of audit committees into legal regulations with increasing frequency. An analysis of the character of regulations defining the tasks and principles of the functioning of audit committees in the boards of companies listed on the stock exchanges of 40 of the world's largest capital markets indicates that its presence in those boards has become obligatory in 31 countries. This was achieved through code/legislative solutions or stock market regulations governing the given market. In the case of the European Union, the passage in 2006 of Directive 2006/43/EC on the Statutory Audit of Annual Accounts and Consolidated Accounts was of particular significance in this process. Most member states of the European Union have applied this Directive (Fichtner 2010, p. 233).[1]

The audit committee, like the board of directors/supervisory board, is a rather difficult object to examine. It is often compared to a "black box." What goes in and what the final outcome of its work should be is known. However, relatively little is known about the processes going on within it (Spira 1998, p. 30). To a great extent this is the result of the fact that access is problematic. The main barrier is the sensitivity of information. Among the main reasons for reluctance on the part of board members in sharing knowledge relating to their work is the fear that such information might have a negative impact on their relations with investors or with other board members. A significant role is also played by fear of increased risk of legal action by shareholders as a result of the divulging the inner workings of board operations. Apprehension against being sued by the other board members also

[1] At the time when J. R. Fichtner was conducting his research, the presence of an audit committee was obligatory in the supervisory boards of companies in Spain (introduced in 2002), Austria (2006), Portugal (2006), Finland (2008), France (2008), the Netherlands (2008), Romania (2008), Great Britain (2008), Belgium (2009), the Czech Republic (2009), Denmark (2009), Germany (2009), Greece (2009), and Poland (2009) (Fichtner 2010, p. 234).

limits any tendency to share information with researchers about what goes on during board meetings (Payne et al. 2009, p. 705).

In spite of these limitations and difficulties, each successive year sees an increase in the number of studies devoted to audit committees and with them growth in knowledge about them. To a great extent, the results received indicate its usefulness to boards. These observations have been confirmed by the results of studies carried out by Bédard and Gendron (2010) who conducted an analysis of 113 articles on the effectiveness of audit committees published over the years 1994–2008 in 18 scientific journals. Their analysis showed that the results of research mostly indicated the usefulness of such committees as compared with results showing an absence of influence or a negative impact on processes within the sphere of committee responsibility (Bédard and Gendron 2010, p. 199).

Research results also indicate that the audit committee has recently undergone significant changes. These modifications should be assessed positively. It is thanks to them that the process of transformation of some committees from mere ornaments of the board into institutions conducting active monitoring of critical spheres of company activity has been observed. A key change shown by the results of the research is without any doubt an increase in specialized expertise in the realms of finance and accounting as held by members of the audit committee. In its turn, this expertise serves as a basis for the primary activity of the audit committee, which is the directing of questions to collaborating actors – the managerial staff, external auditors, internal auditors, and the internal control staff. This questioning as well as the committees' ability to verify received results is mainly intended to guarantee the reliability and quality of company financial results (Cohen et al. 2010, p. 752, p. 754). However, not all audit committees are going down the above road. A certain group has no intention of changing and continues to remain an adornment serving as an adjunct to the board without bringing with it any added value.

In light of the fact that topical literature is dominated by the results of analyses of the experiences of audit committees that are primarily found in economically developed countries, an interesting challenge is a look at experience in the area of the development and activities of such institutions in developing countries. Thus, it is the audit committees that are active in Polish supervisory boards that are at the focus of this chapter.

The aim of this chapter is to assess the functioning of audit committees in supervisory boards listed on the Warsaw Stock Exchange (WSE). This investigation encompasses two components:

- An assessment of the current practice of audit committees in the supervisory boards of companies listed on the WSE, including the identification of factors determining their effectiveness as well as an indication of challenges facing them, and
- An assessment of the scope to which Polish audit committees are keeping pace with European reforms contained in post–crisis versions of corporate governance best practice as well as whether the practice of Polish committees is similar to challenges faced in economically developed countries, where the

baggage of experience in the realm of corporate governance is decidedly greater than in Poland.

Data from primary as well as secondary sources have been used in preparing this chapter. Empirical materials for analysis were received through interviews that were conducted with 34 respondents, members of the supervisory boards of 27 companies listed on the WSE. The interviews were conducted between April and June of 2011. The average duration of each interview was 1 h.

The basic secondary information source consisted of reports on studies conducted by professional companies as well as the results of the work of Polish researchers.

This chapter is made up of three parts. The first encompasses the history of the origins of the audit committee in Polish supervisory boards and presents its basic characteristics – i.e. size, composition, and scope of activities.

The second part presents the opinions and views of 34 interviewed board members with respect to their experiences in connection with the functioning of audit committees. The weight of these experiences is linked to the fact that the companies on whose boards the respondents sit are major listed companies in terms of capitalization (the top 40). This translates into the level of complexity of the functioning of those companies as well as just how complicated the challenges faced by their boards, including its committees, actually are.

At the center of attention of interviewed board members are matters relating to the functioning of audit committees in those boards:

- An assessment of the usefulness of the audit committee, including benefits stemming from its establishing in the board, and
- Factors prerequisite to effective action on the part of the audit committee.

The third part of the chapter is a presentation of the results of an analysis of recommendations relating to the functioning of audit committees as found in the post–crisis versions of corporate governance best practice in Western Europe. They form the starting point for comparisons of Polish experience in audit committees and the expectations articulated with respect to audit committees on mature capital markets.

The chapter ends with a summary of current audit committee experience subject to Polish conditions and an indication of successive challenges facing them.

2 The Audit Committee in Poland

2.1 Audit Committees in Poland: Legal Regulations

The watershed year in the process of implementing the audit committee in Polish supervisory boards was 2009. The determining factor was the passage of the Act of May 7 2009 on Certified Public Accountants and Their Professional Associations, Entities Empowered to Audit Financial Reports, and Public Oversight (Act on Auditors). In line with its provisions, entities of public interest, such as listed companies, must have an audit committee established as a part of their supervisory board; it is to be composed of members of that board (Article 86.1.). The basic determinant of its creation is the size of the board, where the threshold is set at five members. In cases in which the board is made up of five members, the tasks of the audit committee may be entrusted to the board itself (Article 86.3.). Prior to the introduction of the above Act, only writers of corporate governance best practice saw the need for the establishing of audit committees in Polish boards. That need was first articulated in the recommendations of 2005 (the second version of Polish best practice). The authors advocated the establishing of at least two committees in the board – i.e. an audit committee and a remuneration committee – whose tasks should be detailed in the bylaws of the supervisory board (CGF 2004, p. 7). They also recommended that “at least two independent members and at least one member holding qualifications and experience in accounting and finance” (Principle #28) be on the audit committee (CGF 2004, p. 8).

As time passed, recommendations suggesting the creation of committees in the board were “relaxed” with respect to the number of committees and the number of independent members forming them. January 2008 marked the approval of a third version of corporate governance best practice under the title of “Best Practice for Companies Listed on the WSE.” This time, the authors only recommended that in establishing audit committees in boards, their composition “should include at least one member independent of the company and other entities with significant links to the company and hold competencies in the area of accounting and finance. In companies where the supervisory board is made up of the minimal number of members required by law (5), the tasks of the committee may be performed by the supervisory board” (Principle #III.7.) (WSE 2007, p. 10). At the same time, as a source of information on guidelines relating to the tasks and functioning of audit committees, the above version of best practice made reference to a document entitled “Commission Recommendation of 15 February 2005 on the role of non–executive or supervisory directors of listed companies and on the committees of the (supervisory) board” in its Attachment No. I (Principle #III.8.) (WSE 2007, p. 10).

Currently, matters related to the manner of appointing members to the committee as well as the scope of audit committee tasks is regulated by Chap. 8 of the Act. In line with its provisions, the basic tasks of the audit committee include (Article 86.7.):

- Monitoring of the financial reporting process;
- Monitoring of the effectiveness of the internal control system, internal auditing, and risk management;
- Monitoring of financial audits;
- Monitoring the independence of the external auditor and entities empowered to audit financial reports.

The legislator was also precise in indicating the scope of jurisdiction of the audit committee, recommending that the supervisory board have a body empowered to audit financial reports as well as for conducting financial audits of the entity, where decisions should be taken by the board as a whole, however (Article 86.8.).

Lawmakers also specified the size of the audit committee, recommending that it be composed of at least three members, including at least one meeting the condition of independence and holding qualification in the field of accounting or financial auditing (Article 86.4.). As to the independent board member, the legislator provided the following criteria defining independence (Article 86.5. and Article 56, Clause 3, Subclauses 1, 3, and 5):

- Holds no shares, stock, or other ownership titles in the entity where that member performs financial audit functions or in any other related entity,
- Has not been a party to bookkeeping or drafting financial reports for the entity where the member performed any financial audit over the past 3 years, and
- Has no spouse, relative, or direct kin to the second degree who is a member of any supervisory, management, or administrative body of the entity.

At the same time, it is worth adding that the above criteria defining the independence of an audit committee member are the same as in the case of auditor/certified public accountant.

In analyzing the functioning of audit committees in Polish supervisory boards, it should also be remembered that the Commercial Company Code, which contains the basic legal regulations defining company operations, lacks any provisions regulating the activities of audit committees. The placement of the audit committee in the board is derived from the Act on Auditors as well as company charters or board bylaws (Domański and Jagielska 2011, p. 20).

In summarizing the characteristics of the legal regulations governing the creation and the scope of activities of audit committees subject to Polish conditions, it should be stated that regulations give it the role of a permanent working group of the board, which in no way restricts the board's freedom in decision–making, where the committee has no powers to act in the name of the company or represent the board with respect to other bodies and entities (Domański and Jagielska 2011, p. 20). The tasks performed by the audit committee are analytic, preparatory, and opinion–generating in nature, where the final decision is taken by the board (Domański and Jagielska 2011, p. 20; Czerniawski and Rapacka 2007, p. 141). Stability and continuity of composition are seen as important factors fostering the work of the committee. This guarantees a steady level of knowledge about the company (Czerniawski and Rapacka 2007, p. 147). It should be stressed that the presence of the committee in the board in no way changes the scope of responsibility of board members, regardless of whether the given member is a member of the audit committee or not.

2.2 Audit Committee Practice in Poland: Basic Characteristics

The year 2012 marked 3 years as of the introduction in 2009 of the Act on Auditors. To a great extent, this fact determined the volume and character of experiences stemming from the activities of audit committees in Polish supervisory boards. There can be no doubt that the introduction of this Act forced an increase in the activeness of the boards of listed companies in establishing audit committees.[2] An analysis looking at the presence of audit committees in all boards of WSE listed companies conducted at the end of 2012 showed their presence in only 41 % of the boards. More detailed analysis, taking into account company size as expressed by listing on a stock market index, showed that audit committees were present in all the boards of the largest companies in terms of capitalization listed on the WIG20 (95 %), with the exception of a single WIG20 company board that failed to establish a committee. Research results also demonstrate that as company size diminishes, interest on the part of boards in creating audit committees decidedly drops. Thus, 72 % of WIG40 company boards established audit committees, the figure for WIG80 company boards was only 52 %, while a mere 37 % of companies not listed on any of these indexes decided to take such a step (Szułdrzyński et al. 2013, p. 23).

At this point it is worth adding that the conducted research analyzing the presence of audit committees in listed company boards after the elapse of a year (2010) and 2 years (2011) as of the introduction of the Act shows that levels of committee presence are just slightly lower. Committee presence was observed in almost 40 % of the boards of these companies (Szułdrzyński and Spiechowicz 2012, p. 7 and p. 38). A comparison of the data – 41 % of boards in 2012 and just under 40 % in 2010 and 2011 with audit committees – indicates low dynamics of change. One explanation for this phenomenon might be the fact that the boards of companies listed on the WSE are not particularly populous. Studies conducted by Bohdanowicz (2011, p. 79) show that the average number of members of a supervisory board of a non–financial company listed on the WSE over the years

[2] Research results show that successive versions of corporate governance best practice recommendations for establishing audit committees in boards in 2005 and 2008 did not engender any increased interest on the part of listed company boards. Studies of declarations regarding the application of best practice as submitted in 2005 by 250 companies listed on the WSE showed that Principle #28, which speaks of the establishing of an audit committee and a remuneration committee in the supervisory board, was among the least applied. A total of 165 from among 250 then listed companies declared that they do not apply the principle (Campbell et al. 2006, p. 367). In its turn, an analysis of the application of principles conducted in December 2008, 1 year after the introduction of the modified version of best practice, showed that Principle #III.7. is among the most frequently non–applied principles of "Best Practice for Companies Listed on the WSE" by listed companies. Among the main reasons for failure to apply was primarily difficulties in meeting all conditions –i.e. the presence of an independent member holding expertise in the area of finance and accounting (Gontarek 2008).

2005–2008 was 5.79. This means that five–member boards dominate in such companies. They took the functions and tasks of the audit committee on themselves when the Act on Auditors came into effect.

As to the size of the committees created, the practice of listed company boards in Poland demonstrates that they most often consist of three members, which is in agreement with the minimum recommendations found in the Act of Auditors (Szułdrzyński and Spiechowicz 2012, p. 8). Usually, committee members are people who professionally fill posts on the management boards of other companies or provide independent advisory services (28 %). Members of the scientific community and individual investors are also appointed to audit committees at times (17 %, each). A cause for concern might be the fact that only one out of four members is professionally involved in finance (Szułdrzyński and Spiechowicz 2010, p. 10). There is probably no need to convince anyone of the importance of experience in finance and accounting brought in by members of the audit committee and that it is in fact a key to its effectiveness. Among primary key competencies that should be held by members of audit committees are:

- Proficiency in reading and interpreting financial results;
- Familiarity with financial engineering basics;
- Expertise relating to financial markets;
- Skill in drawing proper conclusions (Dobija et al. 2011, p. 70).

In 2010 the frequency of meetings of the audit committees in boards of listed companies was five. The year 2011 saw a minimal increase to 5.5 meetings (Szułdrzyński and Spiechowicz 2012, p. 18).

To a great extent, it is the scope of activity that determines the maturity of an audit committee. That audit committees in the boards of companies listed on the WSE continue to be young institutions is seen in their concentration on traditional areas – i.e. analysis of financial reports and the reports of auditors/certified public accountants. Monitoring the effectiveness of internal control systems, risk management, internal audits, and financial management in its broad sense continue to be challenges for most (Szułdrzyńki and Spiechowicz 2012, p. 22).

Among areas that continue to require a change in the alignment of powers between the audit committee and the company management is the matter of the commissioning of an external auditor, monitoring that auditor’s work, and defining the level of the auditor’s remuneration. It is still the management that deals the cards “in this game.” However, worth adding is the fact that certain changes are beginning to make their appearance in this area. Among them is the growing tendency to hold regular meetings of the audit committee with the external auditor (Dobija et al. 2011, p. 72).

It may be assumed that the rate at which domestic audit committees mature is, to a great extent, determined by their composition. This primarily concerns the presence of people with expertise and experience that is adequate to meet needs. The results of research conducted in 2011 pointed to positive changes that took place in the make up of Polish audit committees starting with 2010. These certainly include an increase in participation by auditors/certified public accountants and professional board members (Szułdrzyński and Spiechowicz 2012, p. 9). Thus, it may be assumed that the improvement in the professionalism of audit committees in Poland is going in a desirable direction.

There is a cause for concern in the context of performance of audit committee tasks, however. The Act on Auditors does not guarantee, by way of legislative obligation, the presence on the board of members qualified in the fields of accounting and financial audits in cases when that board decides not to establish an audit committee and, instead, assigns its tasks to the board as a whole. That requirement only appears with respect to the audit committee (Szułdrzyński and Spiechowicz 2010, p. 5). This makes it possible for a situation to exist whereby a board performing the duties of an audit committee has no member with expertise and experience in the above areas (Szułdrzyński et al. 2013, p. 24). This is a significant problem, as 59 % of the boards of companies listed on the WSE in 2012 had not established any audit committee. This means that the entire five–member board of these companies fills the function of an audit committee. At this point it should be added that failure to establish an audit committee in the supervisory board is beginning to be seen by capital market participants, including by the supervisory boards themselves, as a significant risk factor (Deloitte et al. 2012, p. 12).

The list of problems that Polish audit committees must tackle as seen by members of listed company boards includes a lack of time on the part of committee members to perform their tasks (62 % of indications in 2010 and over 70 % in 2011) and a dearth of specialists with the relevant competencies and experience in the area of accounting, internal audits, and risk management (40 % of those interviewed in 2010) (Szułdrzyński and Spiechowicz 2010, pp. 26–27; Szułdrzyński and Spiechowicz 2012, p. 5 and p. 33). The reason identified behind the difficulties in attracting suitable specialists to fill positions as audit committee members is unsuitable remuneration for compensating a dual–function board member. At this point it should be added that most chairmen and members of audit committees in Poland are not compensated for their work on the audit committee (Szułdrzyński and Spiechowicz 2012, p. 5 and p. 33).

As to the requirements of the Act on Auditors relating to the independence of an audit committee member, only approximately 20 % of respondents in 2010 and 2011 saw this as a factor restricting the development of audit committees in Poland (Szułdrzyński and Spiechowicz 2010, p. 26; Szułdrzyński and Spiechowicz 2012, p. 33). In analyzing the question of the independence of a board member it is necessary to bear in mind that independence formally meeting legislative criteria may be insufficient for the member of the board and committee to be truly independent. Decidedly more desirable is independence understood as a "state of the mind," including being guided by one's own views or even intuition. It is primarily the interests of the company that should be at the center of attention of the independent member. Action undertaken by such a member should chiefly be targeted at the good of the company (Dobija et al. 2011, p. 70).

3 Audit Committee Practice Assessment

3.1 Audit Committee Usefulness and Its Key Role

Interesting observations on the operations of audit committees in the supervisory boards of the largest companies listed on the WSE in terms of capitalization (top 40) have been provided thanks to interviews conducted in 2011 with 34 of their members. In practice, all of the examined board members had contact with the committee, either through collaboration, as board members where such a committee existed in the board, or directly as committee members. An analysis of their opinions indicates that in spite of the fact that the audit committee is still a relatively young institution under Polish conditions, their experience with respect to it is decidedly positive. A prevailing opinion among interviewed board members is the conviction that the audit committee is useful for improving the quality of work of the board. This was particularly stressed in the case of major listed companies. The tying of committee presence with company size is explained by the view of respondents of its role as something of a "safety valve" for the board. This safety aspect stems from the structuring of board work, which finds expression in the assigning of defined tasks to members of the audit committee. These assigned tasks also foster a more in–depth and detailed "getting into" the given subject matter by its members. This also leads to growth in the level of transparency in terms of member responsibilities. Interviewed board members see a significant benefit derived from the creation of a several–member audit committee in the board in the form of facilitated mutual communication and a safeguard against undue talk during meetings.

The experience of the respondents shows that, in practice, being active on the audit committee most often means that its members "get their teeth" into such spheres of company operations as financial reporting, internal audits, internal control, risk management, and collaboration with external auditors. In their activities, members of this committee go beyond simple collaboration with the management. Sources of their information also include lower level staff members who work on the above areas directly. This expanded scope of collaboration also finds expression in greater information flow that translates into increased knowledge on the part of audit committee members on what is happening inside the company. This provides a basis for the audit committee to develop solutions that are adequate with respect to company needs. Subsequently, such solutions are presented to the entire board, which should take a look at them in its entirety. Benefits flowing from the subdivision of work in the board as introduced by the committee that are seen by some of the interviewed board members is the achieving of a better level of information for the board as well as better prepared materials for its meetings. One of the persons interviewed summed up the usefulness of the audit committee as follows: "[. . .] in general, those boards in which committees function actively do better than those where they do not." However, it should be remembered that each board is different. Their needs are different. It is dependent on the board just how the practice of their operations unfolds. This also applies to the audit committee.

The respondents simultaneously stressed that the audit committee can only serve as a body providing support for the board. Its activities should take on the form of recommendations for solutions developed by its members, where decisions should be taken by the board. It is also the board that remains responsible for those decisions.

3.2 Quality Determinants in Audit Committee Operations

The audit committee, like other committees in the board, creates the potential for delving deeper into company matters. Certain conditions must be met in order for the audit committee to benefit from this potential, however. The experience of interviewed board members shows that a key to this potential is the presence on the committee of people with professional competencies that are up to the tasks as well as sufficient time resources. The character of competencies determines the spheres of activity that should be encompassed in the operations of the audit committee (i.e. financial reporting, internal audits, internal control, risk management, and collaboration with external auditors). In practice, this means a need for the composition of the committee to include people with the relevant expertise and experience in the realms of finance and accounting. One respondent underscored the need for selecting audit committee members while keeping in mind their propensity to “work with numbers.”

Making sure the committee has people who like and understand numbers, which means people who have skills and experience in the area of finance and accounting, is an important factor defining the quality of committee work. However, this is not the only factor. In the view of many interviewed board members, the basis for success on the part of the committee in performing its tasks is guaranteeing access to a broad spectrum of information to its members, including financial information, information on key risks facing the company, and information on the existing system of risk management and internal control. An important component of the stream of information flowing to the audit committee also includes information on internal audit activity. Such information is vital with respect to spheres monitored by the committee that are a part of its operations.

A successive important factor determining the quality of the work of the audit committee is the availability of time on the part of its members. The question of work outlay required of members pops up often in the views of respondents. Their statements indicate that being a member of an audit committee is tied with a significantly greater workload. This in and of itself signifies a need on the part of its members for more time to devote to it, which stems from not only a need for a greater number of meetings as compared with the number of meetings of the entire board, but primarily of the necessity to review larger volumes of materials relating to diverse spheres of audit committee activities. Moreover, audit committee meetings are not brief. Analysis of the opinions of respondents makes it possible to put forward the conclusion that appropriate reserves of time on the part of members must be treated as one of the major factors prerequisite for efficient operation.

Statements made by interviewed board members indicate that the list of determinants behind effective action on the part of audit committees is not complete when it restricts itself to only the above–mentioned factors. According to them, a factor that without any doubt should find its way onto such a list is the will of committee members to become involved in their work. In its absence, the usefulness of resources such as experience and expertise as brought in by them remains small.

According to the interviewed board members, an important factor fostering the involvement of committee members in committee work is shareholder awareness that they put in greater amounts of work as compared to "single–function" board members. In their view, a basic indication of the understanding of this fact should be the offering of higher compensation for serving two functions. Unfortunately, under Polish conditions, additional remuneration for membership in a board committee is not very common. Interviewed board members decidedly postulate the necessity of implementing changes in this sphere. It might be worth adding that, in their view, the absence of financial compensation for additional work outlay as incurred by audit committee members may be one of the reasons behind the development of audit committees in Polish boards being inadequate in terms of needs.

In identifying other factors limiting the development of audit committees under Polish conditions, the respondents indicated insufficient numbers of board members with the relevant expertise and experience in the realm of finance and accounting.

In concluding this presentation of the opinions and views of the 34 interviewed board members on the functioning of audit committees, worth showing are the limitations and weaknesses that they noted stemming from a committee presence in the board. The possibility of a conflict of interest among members representing various groups of shareholders was also deemed as a primary and significant threat to the results of the work of an audit committee. Moreover, nobody needs convincing that the appearance of a constellation of conflicting interests in this body can significantly upset the effectiveness of its operations. In its turn, this cannot remain without an impact on the quality of work of the board as a whole. Moreover, the list of potential weaknesses of an audit committee as forwarded by respondents included the committee's acceptance of an orientation targeting day–to–day action and the passivity of its members. Ultimately, this can lead to the undertaking by the committee of mock activity. Thus, the board will not feel expected benefits from its presence.

An interesting aspect as seen by the interviewed board members is the "danger" that may be ushered in through the presence of an audit committee in the form of the potential threat of "languor" within the supervisory board. A symptom of this may be the "automatic" acceptance of committee recommendations without any desire on the part of the remaining board members to get involved in the details of the solutions proposed by that committee. The absence of discussions on audit committee recommendations by the board as a whole can significantly lower the effectiveness of committee operations (Fig. 1).

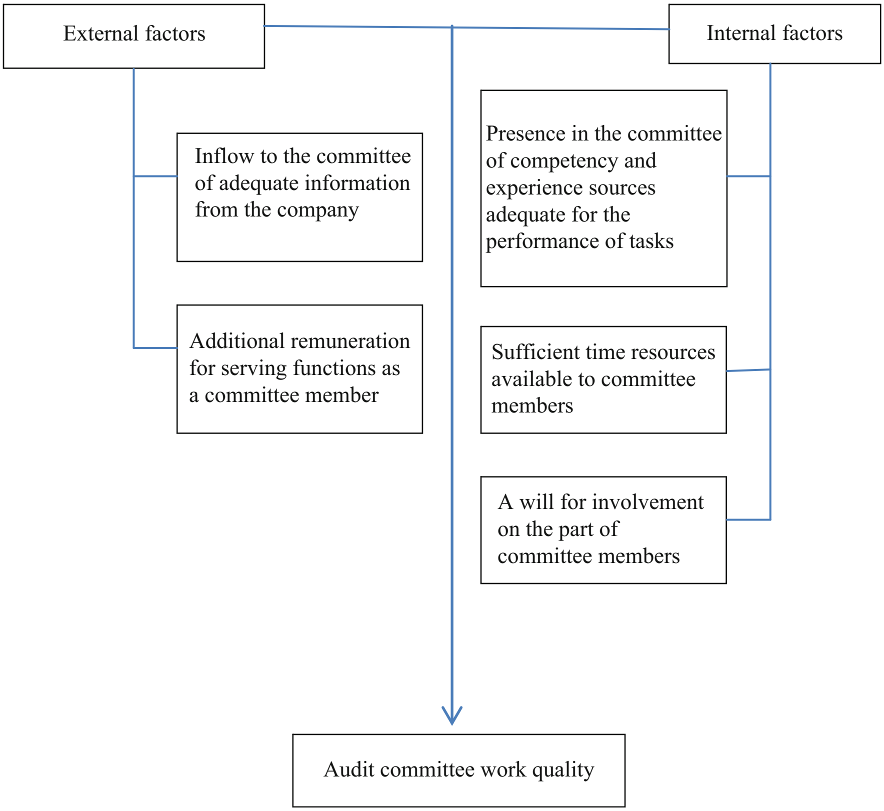

Fig. 1 Factors determining the quality of audit committee activity (Source: Own research)

4 Corporate Governance Best Practice Recommendations in Western European and Polish Practice

An analysis of post–crisis sets of best practice in Western Europe indicates that, in practice, they all include recommendations pointing to a need to create audit committees in boards of directors/supervisory boards.[3] At the same time, some of

[3] The selection criterion for choosing best practice for analysis was its year of appearance on the capital market. Documents that were developed in 2008 and over the successive three post–crisis years were subject to analysis. A successive selection criterion was place of origin. The starting point in choosing countries from Western Europe was their having been encompassed by research by Heidrick and Struggles in 2009. A preliminary analysis of available documents in line with the year of appearance criterion narrowed the sample down to 12 best practice sets. The analyzed pool of documents included recommendations from such countries as Austria, Belgium, Denmark, Finland, France, the Netherlands, Germany, Portugal, Sweden, Switzerland, Italy, and Great Britain.

them allowed for the possibility of their function being served by the whole board. Depending on perceived needs on the given capital market, the authors of the analyzed documents formulated recommendations that ranged from the relatively general to significant levels of detail. The establishing of an audit committee (as well as other committees) in the board is tied with the hope that the committee's presence will have a positive impact on the effectiveness as well as the quality of the work of the board (e.g. AWGfCG 2009, p. 26; KfgS 2011, p. 15; SMA 2010, p. 13; GConGCGC 2010, p. 10; CCG 2011, p. 21). This stems from the fact that the audit committee – a permanent working group in the board – will be specialized in overseeing such sensitive spheres of company activities as finance and accounting, external audits, internal audits, internal control, and risk management. Among key factors determining the meeting of hopes accompanying the committee, there is no doubt that composition is one. It should guarantee independence of action as well as efficient movement among company activities within its jurisdiction. It is agreed that a basic determinant for the latter is not only specialized expertise in the area of finance and accounting, external audits, and internal audits, but also embracing internal control systems and audit management systems. Also strongly accented is the need for members of this committee to have practical experience, which can also be linked to management experience.

As to the size of an audit committee, the most frequently met proposal is that it be made up of at least three members (e.g. BCGC 2009, p. 19; KfgS 2011, p. 15; SMA 2010, p. 14; SCGB 2010, p. 20; CCG 2011, p. 20; FRC 2010, p. 19). Among these there should be at least one independent board member or independent members should make up its majority (this second suggestion is among the most often recommended solutions) (e.g. AWGfCG 2009, p. 26; BCGC 2009, p. 30; KfgS 2011, p. 15; SCGB 2010, p. 20; Economiesuisse 2008, p. 16). As to a member holding specialized expertise and experience, the dominant position was for the composition of the audit committee to have at least one member meeting this competency criterion. It should be stressed that in the case of a board of directors, committee members should be selected out of the group of non–executive board members (e.g. BCGC 2009, p. 30; Economiesuisse 2008, p. 16).

An important aspect of the operations of an audit committee, as seen by the designers of the corporate governance recommendations, is its positioning in the role of an "advisor" formulating proposals and recommendations within its field of tasks on the basis of conducted in–depth analyses. Thus, the committee should propose and consult specific solutions, but the final decision remains with the board. The committee's presence cannot upset the collegiate activities of the board and it also cannot take over the board's responsibility for decisions (albeit, certain best practice authors allow for certain decision–making powers on the part of a committee, Austria and Sweden, for example) (e.g. AWGfCG 2009, p. 26; SCGB 2010, p. 10).

The authors of the analyzed sets of recommendations see the board as responsible for the development and writing down of guidelines for committee operations, including its role and objective, the defining of tasks, and principles of operations as well as the specifying of forms of reporting to the board as a factor facilitating the functioning of the audit committee. These guidelines can take on various forms (such as audit committee charters, board resolutions, committee bylaws, and terms of reference) (e.g. BCGC 2009, p. 19; KfgS 2011, p. 15; SMA 2010, p. 15). However, of particular significance is availability to other members of the capital market. Stockholders and other actors should be equally informed of the composition of the audit committee as well as the results of its activities, including meetings held. A basic tool for communication with the market on the activities and effectiveness of the work of the audit committee is the company annual report, its webpages, and declarations of the application of corporate governance best practice, also referred to as the report on corporate governance (e.g. KfgS 2011, p. 15; AFG 2011, p. 18; CMVM 2010, p. 9; FRC 2010, p. 20; CCG 2011, p. 20).

In summarizing the above presented observations relating to the expectations of mature markets with respect to audit committees as expressed by the authors of corporate governance best practice, it should be stated that the basic factor determining the quality of its activities is considered to be committee composition. Its members should guarantee independence of action as well as hold specialized expertise and practical experience adequate to meet the needs of committee tasks. In juxtapositioning the above expectations with the practice of audit committee operations in Poland, it may be stated that current Polish legal regulations strive in the same direction as Western European recommendations. In line with the Act on Auditors, independence of action by the committee is guaranteed by the presence of at least one independent member holding qualifications in the area of accounting or financial audits. The weight postulated by the designers of best practice for independent committee members has also been noted under Polish conditions. However, greater stress is placed on the independence of views and assessments rather than on the mere meeting of defined criteria for the independence of a member as contained in the Act or found in best practice principles.

The authors of Polish regulations as well as the authors of corporate governance best practice documents were also in agreement that three members is the minimum size of a committee. Their alignment of views is also visible in assigning the audit committee the role of an advisory group recommending solutions, where decision–making is left with the board itself.

Observation of the practice of Polish audit committee operations indicates that the greatest challenge 3 years after the introduction of the Act on Auditors continues to be the guaranteeing of an audit committee composition that is appropriate in terms of competencies. A significant restriction in this respect is the limited resources of board members holding competencies and experience in the area of finance and accounting. Yet another barrier under Polish conditions is that not providing remuneration for serving as a member of the committee remains commonplace.

5 At What Point of Development Are Polish Audit Committees?

In summarizing the above–presented collection of Polish experiences in the area of audit committee activities in the Polish supervisory boards of listed companies, it is necessary to stress that subject to Polish conditions the audit committee continues to be a young institution. Perceiving it in this way is, to a great extent, determined by the concentration of audit committees on traditional areas such as analysis of financial and auditor's reports. Overseeing the effectiveness of systems for internal control and risk management, internal audits, and broadly understood financial management continue to challenge most Polish audit committees. In spite of the fact that in today's Poland the audit committee is still in its developmental phase, board members who have had contact with such committees, both directly and indirectly, see its usefulness in most cases. However, it must be stressed that there are certain dangers stemming from its presence. Among these the taking on of a role of a ceremonial body and the unthinking acceptance of committee proposals by the remaining members of the board were identified.

Some key benefits tied with the activities of audit committees are its role as an institution bringing order and improving the efficiency of the supervisory board, which is especially important in the case of large boards. The ability of an audit committee to delve into the details of activities that form a central sphere of the company, including the preparing of financial reports, external and internal audits, internal control systems, and risk management systems, increases the sense of safety of the board. This is determined by the ability of committee members to take a more in–depth look at the above spheres, the greater effectiveness of its operations, including easier communication, and usually a greater number of meetings as compared with the board as a whole. However, it should not be forgotten that in addition to the above structural factors, the main determinants of the effectiveness of committee work is for its members to hold competencies and experience in accounting and finance. Another key is the amount of time that they can devote to work on the committee as well as their real desire to get involved in the performance of its tasks. Faced with a lack of desire to act, competencies and time are not enough. Decidedly less weight is applied to the meeting of the criterion of independence of the committee member in line with the definition contained in the Act. Much more importance is placed on a member's independence of views and assessments.

In spite of the observed benefits provided by the presence of an audit committee, the rate of the process of its spreading among Polish boards is slow. Among basic factors retarding it is the limited participation in boards of people holding competencies in the area of finance and accounting. A second important factor limiting the potential for committee development in Polish boards is remuneration, which is presently inadequate with respect to work outlay by its members. Moreover, it should not be forgotten that the multiplicity and complexity of audit committee tasks makes it necessary for its members to have sufficient time resources. Their absence may be an important reason for refusing an invitation to sit on it.

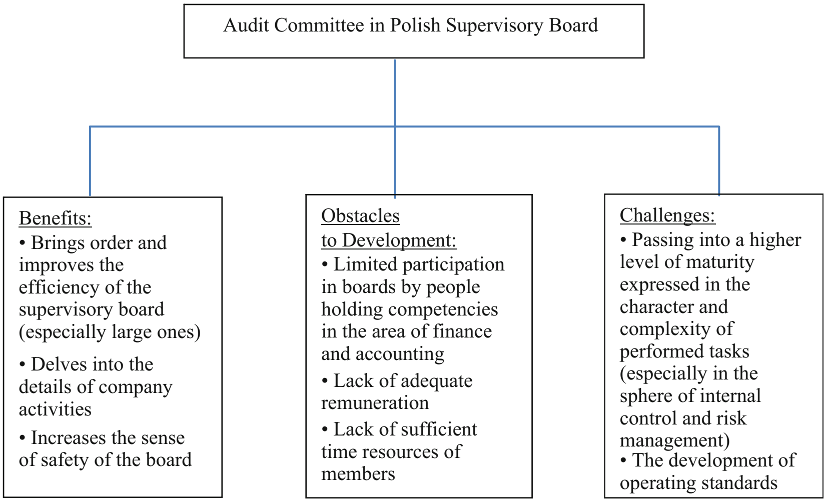

Fig. 2 Audit committee in Poland – benefits, obstacles for development, and future challenges (Source: Own research)

As to the challenges that must be faced by audit committees in Poland, among them is the need to pass into a higher level of maturity expressed in the character and complexity of performed tasks. Among areas that are particularly desirable and where there should be an increase in Polish audit committee activity is the sphere of internal control and risk management. Another important challenge facing Polish audit committees is the need for the development of operating standards that are adequate with respect to needs. (Fig. 2)

6 Conclusion

In summarizing, it is necessary to stress that in the case of Polish supervisory boards made up of more than five members that operate in large and complex companies, the audit committee is seen as an important board working group. Experience to date in the functioning of the audit committee indicates that its usefulness in such boards is appreciated. Its presence makes it possible to introduce a subdivision of labor in the boards as well as make clear assignments of tasks and responsibilities to individual board members. However, an important challenge remaining is the awareness that it is the supervisory board that makes the decisions, while the audit committee only makes recommendations.

It should also be remembered that in the population of companies listed on the WSE in Warsaw there are companies that have not established audit committees. They assign audit committee tasks to the supervisory board as a whole when that board consists of five members (pursuant to the Act on Auditors). It may be assumed that these are smaller companies in which the supervisory function does not have to be expanded in the form of supervisory board committees. A cause for concern is the fact that the Act on Auditors fails to regulate the matter of the guaranteeing of qualifications in the area of accounting and financial auditing when such a solution is used. Thus, an important challenge facing shareholders is undoubtedly the guaranteeing of an appropriate level of competencies and independence on such board making possible the autonomous execution of tasks assigned to audit committees.

There can be no doubt that the audit committee under Polish conditions continues to be an interesting object of study. However, research undertaken should already move beyond better–understood matters, such as descriptions of its characteristics – i.e. committee size, composition, and tasks. Spheres that remain practically unexplored include the dynamics of committee behavior, its relationship with the board and other stakeholders, including the external and internal auditor.

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