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EMPIRICAL EVIDENCE ABOUT THE RELATIONSHIP BETWEEN EXTERNAL AUDITING AND THE SUPERVISORY BOARD IN THE REPUBLIC OF CROATIA

Analyzing the impact of the audit committee on efficiency of external auditing and the supervisory board is the main focus of this paper. Based on the conducted empirical research, by way of surveying, the developed hypothesis, which states that the audit committee, as a subcommittee of the supervisory board, has a direct impact on higher efficiency of both external auditing, and the supervisory board, is being tested. Additionally, basic roles of the supervisory board and the audit committee, and theoretically relevant and methodological aspects of external auditing will also be analyzed.

Key words: supervisory board, audit committee, corporate governance, external auditing

1. Introduction

External auditing work quality and also the supervisory board work quality are essential for the good corporate governance[1] practice. A relationship between

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[1] Corporate governance represents a set of relations between managers, the management board members, shareholders and other stakeholders (OECD, 2004.). Corporate governance, also, represents a system that governs and supervises the corporations (Cadbury Report, 1992.). There are

external auditing and the supervisory board increasingly depends on the audit committee, a subcommittee of the supervisory board in charge of improving the financial reporting process and improving the communication with external auditors. Additionally, as a consequence of the public interest for disclosure of real and objective information about company's financial position and company's business success, the role of audit committees becomes more significant with the wider scope of responsibilities.

In the context of legal or regulatory requirements for the establishment of the audit committees' as opposed to a voluntary establishment of those same audit committees, it should be pointed out that the practice varies among countries. In certain countries the audit committees are mandatory for business entities which stocks are listed, while in other countries the audit committees are established and work as an economic necessity and a need for delegation of the proper supervisory functions. Depending on the local culture and particular circumstances of every company, the audit committees might have different responsibilities. Anyway, well structured and with clear competencies, the audit committees provide huge benefits to the management, shareholders, stakeholders as well as the external and internal auditors.

This research analyses the impact of the audit committee on external auditing and the supervisory board efficiency. Based on the conducted research, by way of surveying, the developed hypothesis, which states that the audit committee, as a subcommittee of the supervisory board, has a direct impact on higher efficiency of both external auditing, and the supervisory board, is being tested. Before the analysis of the audit committee impact on efficiency of external auditing and the supervisory board, analysis and synthesis methods, as well as induction and deduction methods are used in order to examine the supervisory board role and the role of the audit committee in the corporate governance process. Additionally, theoretically relevant and methodological aspects of external auditing are also being analyzed.

2. Basic roles of the supervisory board in corporate governance

The supervisory board is company's body in charge of controlling, monitoring and tracing of the business operations. The supervisory board controls com-

two types of the corporate governance systems: Anglo-Saxon or one-tier and Continental or two-tier. The supervision of company's business operations, in the one-tier corporate governance system, is performed by non-executive directors and business operations are managed by executive directors. Both non-executive and executive directors compose the unitary board of directors. In the two-tier corporate governance system the supervision of company's business operations is performed by the members of the supervisory board and business operations are managed by the management board members.

pany's business operations and ascertains if the operations are in accordance with the legislation and company's statute. The supervisory board is company's mandatory body which could not be eliminated or replaced with any other body not even with the statutory rules nor with the decision made by shareholders assembly (Ćesić, 2007.). This body is empowered to represent the company with respect to the management board members. Besides that, the supervisory board monitors the whole company's business operations. Monitoring of the business operations is not only concerned with detecting and sanctioning of possible problems but is also charged with trying to prevent them (Čolaković, 2007.).

The supervisory board is an internal mechanism of corporate governance characteristic for the two-tier corporate governance system. Because of the specific position between the shareholders assembly and the management board, the supervisory board undertakes a control, strategic and connecting role. The control role refers to the selection of the management board members, supervision and monitoring as well as assessment of the management board performance. The strategic role refers to the authorization of the proposed strategic decisions, assessment of the previous strategic decisions, and an active involvement when formulating and implementing company's business strategy. The connecting role includes maintaining of formal and non-formal relations with all stakeholders. Furthermore, the supervisory board helps the company to connect with all relevant factors and segments of the business environment (Tipurić, 2006.).

In the Republic of Croatia, the highest and the lowest number of the supervisory board members is defined by the Croatian Company Law. Thus, the Croatian Company Law limits the company's autonomy when determining the size of the supervisory board by company's statute. Intention of the Company Law is to restrict the shareholders assembly impact and to achieve a selection of such supervisory boards which would, with respect of the company's size and the number of the supervisory board members, ensure reasonable performance of the defined tasks. When the Law sets limits on the number of supervisory board members, that applies to the whole supervisory board regardless weather the members are chosen among candidates or appointed (Barbić, 2005.). According to the Company Law, the lowest number of the supervisory board members is three, and the number of supervisory board members has to be odd.

Majority of the supervisory board members should be independent members not related to the company in any form (business relations, family, etc.).[2]

[2] A member of the supervisory board could be a person who is completely capable for fulfilling its responsibilities, and the company's statute could be used in order to determine conditions that have to be satisfied in order to become the supervisory board member. The member of the supervisory board could not be: the management board member, the member of the supervisory board in ten companies, the management board member of the company's subsidiary (Gorenc, et al., 2004.).

Members of the supervisory board are appointed at four year periods, and at the end of that period they could be appointed again. Members of the supervisory board are appointed by the shareholders assembly, usually with the majority of votes. After the supervisory board is established, members elect chairmen, and vice chairmen (Gorenc, et al., 2004.).

Supervision of the way management runs a company's business operations is the main task of the supervisory board. The supervision could be divided into two categories: an ongoing and a preventive supervision. The ongoing supervision refers to completed business operations as well as current business operations. When performing ongoing supervision, business records along with documentation and company assets are examined. Preventive supervision refers to supervision of the decision making process in the company's business governance. The supervisory board has to submit written reports to the shareholder assembly about the supervision of the decision making process (Gorenc, et al., 2004.).

Except in regard to ongoing and preventive supervision of the company's business operations, the supervisory board should also:

- appoint and recall management board members,
- nominate a new external auditor to the shareholder assembly,
- create rules for its own procedures, and rules for management board procedures,
- make decisions that restrict management in running business operations,
- represent the company in front of the management board members,
- convene the shareholder assembly when needed,
- approve contracts concluded by management board members, etc.

The supervisory board is not entitled to run the company's business operations, to interfere with management board work, or to affect the management board in any matter. At the same time, it is possible to introduce a law which would allow, via statute, or supervisory board decision, for the management board to ask approval from the supervisory board when performing certain operations. This approval from the supervisory board is usually needed when it comes to the company's strategic decision making. However, approval for certain management activities does not mean that the supervisory board is entitled to undertake those business activities. The supervisory board members could suggest to the management board what they think is useful for the company, and the management board should consider that suggestion and decide whether that suggestion would be accepted or not (Tipurić, 2006).

The supervisory board is entitled to establish subcommittees in order to perform its activities more efficiently. Continuous growth of supervisory board subcommittees is a characteristic of present day corporate governance in all of Europe. By focusing on certain issues and by providing solutions for said issues, members of the subcommittee help the supervisory board in the decision making process. The supervisory board could establish subcommittees in order to prepare or implement its own decisions. Subcommittees are not entitled to make decisions on issues which are in the supervisory board jurisdiction, and subcommittees should inform the supervisory board about its work (Gorenc, et al., 2004.). Subcommittees should be composed out of, at least, three members, while companies with the lower number of the supervisory board members could compose the subcommittee with two members (Hanfa & Zagrebačka burza d.d., 2007.). The supervisory board should prescribe a mandate and competencies of the subcommittees in detail.[3]

3. The role and responsibilities of the audit committee

The audit committee is a subcommittee of the board of directors (in the one-tier corporate governance system) or the supervisory board (in the two-tier corporate governance system). The audit committee is responsible for monitoring the reporting process directed to outside users of financial statements, for monitoring the risk and control procedures as well as monitoring of the external and internal auditing process. The audit committee acts as an independent management check and a representative of outside users when ensuring that financial statements truly represent the economic activities of the company (Ritenberg & Schwieger, 2000.).

As a consequence of corporate scandals all over the world (Enron, WorldCom, Parmalat, etc.), the relevant framework and rules of the capital market have changed. Furthermore, the traditional role of the audit committee has also been redefined. The conventional role of the audit committee referred to the supervision, monitoring and consulting of management and the external auditor when performing the auditing process. This traditional role also included monitoring the drawing up of financial statements.

According to the European Commission's Green Paper the audit committees became an essential part of every supervisory board. The audit committee is originally an Anglo-Saxon mechanism of corporate governance that emerged in Europe at the beginning of 1990. The audit committee is expected to play a key role in ensuring high standards of financial reporting (Collier & Zaman, 2005).

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[3] The supervisory board is entitled to establish following subcommittees: an audit committee, a nomination committee and a compensation committee. Ethics and social responsibility committees are being established in United Kingdom. Those committees still have no higher significance because they are present in only 4% of the corporations in other European corporations (Albert-Roulhac & Breen, 2005.).

In the Anglo-Saxon corporate governance system, within *The Public Company Accounting Reform and Investor Protection Act* also known as the *Sarbanes-Oxley Act,* new roles and new tasks of the audit committee have been defined. According to the Act, the audit committee, as a specialized subcommittee of the board of directors, is responsible for appointing the external auditor and contracting the fee that should be paid for auditing services. The audit committee is also responsible for monitoring and reviewing the external auditor's independence, objectivity, and effectiveness. That includes a more active participation of the audit committee in solving possible issues and misunderstandings between the management board and the external auditor regarding the financial reporting process. The act also dictates that the external auditor should directly inform the audit committee. Furthermore, the Sarbanes-Oxley Act demands that all auditing and non-auditing services provided to the client have to be approved by the audit committee in advance. Moreover, in cases when the external auditor provides non-auditing services to the client, i.e. consulting services, the auditor is prohibited in providing auditing services to the client in the same business year.

According to the Croatian Auditing Law, the audit committee, as a mechanism of corporate governance in the Republic of Croatia, is mandatory in all public interest companies. Public interest companies, according to the Croatian Auditing Law, are (Narodne novine, 2005):

- companies whose securities are listed on the stock exchange,
- banks and other financial institutions, such as insurance companies, investment funds, pension funds as well as other companies according to special regulations,
- companies of special government interest whose equity exceeds 300.000.000,00 kuna (The Kuna is Croatia's national currency) according to government stipulation.

The audit committee should analyze the company's financial statements and support the accounting department in the company. The audit committee should also establish an efficient internal control in the company. The audit committee is composed of the supervisory board members or the members appointed by the supervisory board (Narodne novine, 2005). If you would literally interpret this legislation act you would think that all members of the supervisory board are at the same time members of the audit committee. It would be better if the act was written like this: "the audit committee is composed of members chosen among supervisory board members and the members appointed by the supervisory board". However, despite the undefined legislation act, the audit committee could be composed of all supervisory board members and also of the members appointed by the supervisory board. The number of audit committee members should be adjusted to company's needs. Therefore, the audit committee should include at least three members but it should not include more than five members (Tušek, 2006). It is expected that all members of the audit committee have certain knowledge of finance and that they are able to read and understand financial statements. According to the Croatian Auditing Law at least one member of the audit committee should have significant, recent and relevant knowledge in the accounting and auditing field. A membership in the audit committees is usually limited to four (4) years (Hanfa & Zagrebačka burza, 2007).

The main role and responsibilities of the audit committee, according to the Croatian Auditing Law, should be (Narodne novine, 2005):

- to monitor integrity of the financial statements of the company and to oversee financial reporting procedures,
- to review the company's internal financial control system,
- to monitor and review the effectiveness of the company's internal audit function as well as risk assessment systems,
- to monitor and review the external auditor's independence, objectivity, and effectiveness as well as other auditor services provided to the company,
- to monitor the auditing process of annual financial statements and consolidated financial statements,
- to make recommendations to the supervisory board in relation to the appointment of the external auditor and to approve the remuneration and terms of engagement of the external auditor following appointment by the shareholders in general meeting,
- to review and assess the annual internal audit work plan.

The roles and responsibilities mentioned here regarding the audit committees are almost identical to those of audit committees around the world.

In the context of monitoring financial reporting procedures, the audit committee should ensure that the company draws up all assigned financial statements and that the financial statements are drawn up in accordance with the company's adopted accounting policies, accounting principles, and the International Financial Reporting Standards and legislation acts. The audit committee fulfills this particular responsibility by assessing financial statements, as well as all other relevant documents and decisions made by the company's governing structures. When fulfilling this responsibility, the audit committee intensely communicates with the company's accounting department and especially with members of the management board who are most responsible for drawing up and presenting financial statements.

An important task of the audit committee is linked with reviewing the efficiency of a company's internal control system, internal auditing, and the risk assessment system. When performing this task, the audit committee examines the internal auditing reports and findings regarding the internal control activities in certain areas of the company's business procedures. The audit committee also discusses management board reports on activities of the company's body undertaken in order to increase the quality of internal control systems and the quality of risk assessment systems in the company.

The audit committee should monitor the process of reviewing the financial statements and consolidated financial statements. By doing that, the audit committee expresses its interest for cooperation with the appointed auditor in order to receive all information regarding the auditing process in time (e.g. possible issues with the management board).

The audit committee should examine the external auditor's independence as well as special contracts that auditor signs with the company when providing extra services.[4] The examination of auditor's independence and the examination of the possible special contracts, the audit committee conducts by collecting proper management board statements and also the statements coming from the auditor.

According to the Croatian Auditing Law, one of the audit committee tasks relates to proposals for external auditor nominations. The audit committee should propose the nomination of an external auditor to the shareholders assembly. Furthermore, the audit committee should discuss annual plans and reports of internal auditing as well as look at important issues in the field. In certain companies (e.g. financial institutions) this particular task is also performed by the supervisory board.

The auditor should inform the audit committee on a regular basis about key issues coming out of the auditing process and especially about significant weaknesses of the internal control system concerning the financial reporting process. The audit committee should inform the supervisory board about its work and the committee should communicate with both the management and supervisory board. For all its activities the audit committee is responsible to the supervisory board (Hanfa & Zagrebačka burza, 2007).

4. Theoretically relevant and methodological aspects of external auditing

The etymology of the term "auditing" comes from the Latin word „*revidere*", and stands for review, looking backward, or afterward examination of certain

[4] The auditor should not provide auditing services to the client if: the auditor provides financial and accounting services, evaluates company's assets and liabilities and provides judicial expertise to the client in the same year. The prohibition of providing auditing services refers to all clients' subsidiaries and subsidiaries of the auditing company (Narodne novine, 2005.).

facts, etc. Auditing also originates from the Latin word „*audire*“, which stands for listening and hearing, and describes a way auditors used to perform the auditing process by listening to a client's oral report. Particularly, at the beginning of auditing development, accounting statements were presented orally and the auditor performed the auditing process by listening to a client's oral report (Meigs W. B., 1988.).

During the historical emergence of external auditing, many theoreticians and professional associations and organizations were occupied with issues in determining the definition of external auditing. Therefore, there is variety of external auditing definitions in auditing literature.

External auditing represents the act of examination and verification of financial statements and consolidated financial statements along with the methods and data used in creation of the financial statements, which is a base for expressing an expert and independent opinion about authenticity and objectivity of company's financial situation, financial result and cash flows. Auditing covers many tasks defined by the Croatian Company Law and other special acts (Narodne novine, 2005). Auditing characteristics are:

- afterwards examination of the financial statements or financial information in the situation when examination is required by law or when legal entity initiates examination,

- the auditing process wants to affirm if the financial statements present real and objective financial state and financial result of the company, which implicates criteria selection for objectivity and reality assessment. Criteria for objectivity and reality assessment of the financial statements are composed of accounting principles, accounting standards and legislation acts,

- the auditing process is conducted by independent experts outside the company according to the rules contained in the International Auditing Standards, with the respect of auditor's professional ethics code,

- an auditor's report is based on objective evidence and the report is delivered to intended users.

A fundamental goal of the auditing process is protection of the capital owner's interest, and the creation of an informational base for rational decision making and managing. The auditing process should be seen as an assumption of quality and reliable information. Consequently, auditing becomes one of the key instruments in corporate governance and a base for mutual communication and trust among all stakeholders. An auditor's opinion on the validity and objectivity of the financial statements, in all significant aspects, is the main goal of the auditing process. However, it should be mentioned that the auditor's opinion can not guarantee a company's business success in the future because only the management board is responsible for a company's success. The management board is responsible for modeling the proper accounting and internal control system, and drawing up and presenting the financial statements. The auditor's responsibility, based on the collected auditing evidence contained in working documentation and tailored in accordance with the auditing standards and the professional ethics code, is to express the opinion on the reality and objectivity of client's financial statements.

Except in the context of the capital owner's interest protection, auditing is usually considered as an instrumental variable of managerial economy which generates a need for an insight in the theoretical auditing framework, as a set of knowledge about basic assumptions, categories and definitions which constitute ontological determination of the auditing process. In fact, every scientific discipline with the certain degree of development can be divided in two basic parts: an ontological and operational. The theoretical auditing framework contains the ontological part of auditing with the description of key definitions, categories, assumptions, characteristics, etc. The other relevant source of science is auditing practice and practice needs. The result is an auditing operational part. Accordingly, ontological and operational parts are closely related, i.e. these two parts are in the reversible interaction. Anyway, during the early stages of auditing development, the theoretical auditing framework was not considered significant since auditing links to the accounting which is based on the implementation of the adequate theoretical accounting framework. That way of thinking changed very soon because it became clear that the successful practical performance of the auditor relies on adequate theoretical bases. A significant contribution, in modeling of the theoretical auditing framework and in proving thesis which states that the practical auditing performance can only be accidentally successful without the adequate theoretical base, was given by R. K. Mautz and H. A. Sharaf, prominent scientists in this field, in the book *The Philosophy of Auditing* published in 1961.

The most significant part of the theoretical auditing framework (Tušek B., 2000.) are auditing principles and auditing standards. Auditing principles are basic rules of the behavior which should be respected in the auditing process. Auditing principles represent a starting point for shaping of the auditing standards while the auditing standards represent a core framework of the auditing process. Auditing standards contain a methodological framework of the auditing process, along with the global auditing approach which should be elaborated in detail in form of the specific auditing methodology.

The auditing process includes a set of complex activities which result in auditor's opinion. Every phase of the auditing process, depending on its needs, is divided on more or less sub phases. Quality of the activity in one phase depends on the quality of the activity in the previous phase and in that matter contributes to the quality of the whole auditing process. An auditor will decide, based on the professional judgment and the ability of underwriting the risk and the responsibility for the presented opinion, which phase of the auditing process would have higher importance.

The auditing process of financial statements is composed of the following phases (Messier W.F., 1998.): preliminary engagement activities, planning activities, performing an internal control evaluation and tests of control, obtaining audit evidence tests, finishing of the auditing process and expressing an auditor's opinion. The auditing process starts with the preliminary engagement activities which are performed before planning activities. The preliminary engagement activities include procedures regarding the continuance of client relationship and acceptance of the new client as well as procedures regarding audit letter acceptance. Afterwards, the procedures regarding client's internal auditor work evaluation and the procedures about the selection of quality auditing staff should also be considered. The auditor has to get to know and understand client's business procedures in order to successfully plan and perform the auditing process.

Parallel with getting to know client's business procedures the planning of the auditing process is done. Auditing planning encompasses the whole auditing process which includes planning the timing of the audit along with the scope and type of the audit tests that ought to be performed and the number and competencies of the personnel included in the auditing process.

Analytical procedures, which are being used in all auditing phases, have a significant meaning for the whole auditing process. In the countries with the developed market economy and developed auditing profession implementation of the analytical procedures is gaining more importance every day. Analytical procedures include variety of procedures, but the most important part of them is concerned with the financial statements analysis. Depending on assessment of the significance and the auditing risk, the auditor makes a decision on the type, the scope and the timing schedule of auditing procedures, with the reference to quantity and quality of the audit evidence as a base for expressing an opinion on reality and objectivity of the financial statements.

The insight and the evaluation of the internal control system is an integral part of the financial statements auditing process. Well organized and efficient internal control system increases the possibility that the information on company's financial position, business success and changes of the business position are really and objectively presented in the financial statements. Consequently, that makes the auditing process shorter and easier to perform. After the insight and the understanding of the internal control system, tests of control are being performed. Tests of control examine the efficiency of the internal control system in preventing and detecting significant mistakes. There are three types of control tests that are usually being performed: tests of account balances, analytical procedures, and independent tests of business transactions.

Modeling and completing of the auditors' working papers, which has to contain sufficient amount of auditing evidence in order to express opinion on reality and objectivity of the financial statements, is very important for all auditing phases.

Final phases of the auditing process are finishing and composing of the auditor's report on financial statements. Just before the auditor's report composition, in the finishing phase, the auditor has to consider certain issues that can be significantly material and can affect the financial statements and the intended users of financial statements. Those issues are potential liabilities, business events after the balance sheet date (post balance sheet events) and final procedures of the audit evidence assessment. The auditor's report is the main product of the auditing process which expresses an opinion on reality and objectivity of the financial statements and their compliance with the defined framework of financial reporting (accounting principles, standards, policies and legislation acts). The auditor can express: an unqualified opinion, a qualified opinion, a disclaimer of opinion and an adverse opinion.

An unqualified opinion should be expressed if the financial statements present real and objective information about company's financial position while the *qualified opinion* should be expressed if the auditor cannot be sure that information contained in the financial statements are real and objective. An *adverse opinion* should be expressed when the financial statements are not real and objective and the *disclaimer of opinion* should usually be expressed if there is a lack of the audit evidence. If the expressed opinion is different than the unqualified one, the auditor should point out and explain reasons which led to that kind of opinion.

After the auditing process is done, the financial statements represent significant informational potential for different stakeholders which rely on the financial statements when making business decisions. In fact, financial reporting is directed to internal (the management board) and external (owners, creditors, investors, buyers, suppliers, government, general public) users whose needs and demands are different. Financial statements have to present real and objective information regardless of the type of users and the type of business decisions. Therefore, auditing is considered to be an essential assumption of the financial statements quality.

5. Empirical research about the impact of the audit committee on external auditing and the supervisory board efficiency

5.1. Goals and methodology of the empirical research

Starting with an explanation of basic supervisory board roles in corporate governance and with pointing out the roles and responsibilities of the audit committee, and also with theoretically relevant and methodological aspects of external auditing, the empirical research about the impact of the audit committee on higher efficiency of external auditing and the supervisory board in the Republic of Croatia was modeled and conducted using a surveying method. For the purpose of the empirical research, two surveys were conducted. The first survey is based on the perceptions of certified auditors and the second on the perceptions of the supervisory and management board members. Members of the management board were included in the survey because in Croatian publicly traded companies, without the established audit committee, external auditors usually communicate with members of the management board. The empirical research conducted began in May 2007 and lasted till January 2008. The survey included data from 50 publicly traded companies (feedback quota 58%) and 50 auditing companies (feedback quota 46%). Of the total 100 participants, 42%[5] were certified auditors, 30% were members of the management board and the other 28% were members of the supervisory board.[6]

Ascertaining the intensity of the audit committee impact on external auditing and the supervisory board efficiency in Croatian publicly traded companies was the main goal of the conducted empirical research. The research is based on an application of the following statistical methods: descriptive statistics (arithmetic mean, standard deviation), and the t-test for independent samples.

5.2. Hypothesis regarding the impact of the audit committee on increased efficiency of both external auditing and the supervisory board

Empirical research starts with the testing of a developed hypothesis: "the audit committee, as a subcommittee of the supervisory board, has a direct impact on higher efficiency of both external auditing, and the supervisory board."

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[5] Certified auditors which participated in the conducted survey work in the following auditing companies: Auditor d.o.o. Kaštel Sućurac, Bašrevizor d.o.o. Split, Concordia Audit d.o.o. Zagreb, Data-revizija d.o.o. Zagreb, Deloitte d.o.o. Zagreb, Dodig revizor d.o.o. Split, Fimar d.o.o. Split, Iris nova d.o.o. Rijeka, Istina d.o.o. Kaštel Stari, Kalibović i partneri d.o.o. Split, Kopun revizije d.o.o. Zagreb, List d.o.o. Split, Nivo revizija d.o.o. Dubrovnik, PricewaterhouseCoopers d.o.o. Zagreb, Refinal d.o.o. Dubrovnik, Remira d.o.o. Zagreb, Revicon d.o.o. Zadar, Revizija bat d.o.o. Dugi Rat, Revizija uzor d.o.o. Zagreb, Revizija Zagreb d.o.o. Zagreb, SD Nika d.o.o. Split, Šibenski revicon d.o.o. Šibenik, Veritas d.o.o. Split.

[6] Members of the management and the supervisory boards which participated in the conducted survey work in the following publicly traded companies: Agrokor d.d. Zagreb, Badel 1862 d.d. Zagreb, Borik d.d. Zadar, Brodomerkur d.d. Split, Credo banka d.d. Split, Croatia banka d.d. Zagreb, Dalekovod d.d. Zagreb, Dalmacijacement d.d. Kaštel Sućurac, Dioki d.d. Zagreb, Dom holding d.d. Zagreb, Elektroprojekt d.d. Zagreb, HEP d.d. Zagreb, Hrvatska pošta d.d. Zagreb, Jadran d.d. Rijeka, Karlovačka banka d.d. Karlovac, Kaštelanska rivijera d.d. Kaštel Stari, Konstruktor d.d. Split, Lantea d.d. Zagreb, Lola Ribar d.d. Karlovac, Lošinjska plovidba-holding d.d. Mali Lošinj, Piramida d.d. Rijeka, Pismorad d.d. Zagreb, Podravka d.d. Koprivnica, Prehrana d.d. Stobreč, Privredna banka Zagreb d.d. Zagreb, Sas-vektor d.d. Zadar, Slobodna Dalmacija d.d. Split, Tekstilpromet d.d. Zagreb, Tep d.d. Zagreb, TUBS d.d. Donji Stupnik, Veneto banka d.d. Zagreb.

The processing of answers on given questions received from survey participants tested the hypothesis. The participant's answers represent a base for analyzing the impact of the audit committee on the increased efficiency of external auditing and the supervisory board. The efficiency is usually determined by the accomplishing of basic goals. In that context, higher efficiency of external auditing meant a quality increase of both the auditing process and the managing of the auditing process which linked to the function of accomplishing the goals of the financial statements audit. Furthermore, higher efficiency of the supervisory board implies a quality increase of supervisory board work and the underwriting of higher responsibility of board members with respect to the appropriate fulfillment of a variety of tasks assigned to the company's body which were discussed in previous parts of this paper.

5.3. Results of the empirical research

In order to test the developed hypothesis participants were asked about the existence of audit committees in publicly traded Croatian companies. A statistical description regarding the existence of audit committees in publicly traded companies is shown in table 1.

Table 1

THE EXISTENCE OF THE AUDIT COMMITTEE
IN PUBLICLY TRADED COMPANIES

The existence of the audit committee			Yes	No	Total:
Function	An auditor	Count % within function	13 31.0%	29 69.0%	42 100.0%
	A member of the management board	Count % within function	8 26.7%	22 73.3%	30 100.0%
	A member of the supervisory board	Count % within function	9 32.1%	19 67.9%	28 100.0%
Total:		Count % within function	30 30%	70 70%	100 100.0%

Out of 42 certified auditors who participated in the conducted survey, 31% provide auditing services to publicly traded companies with an established audit committee. The other 69% provide auditing services to publicly traded companies which do not have an audit committee. Out of the 30 management board members who participated in the conducted survey, 26.7% work in companies that have established an audit committee. The other 73.3% work in companies that do not have such a committee. Out of the 28 members of the supervisory board who participated in the conducted survey, 32.1% are members of the supervisory board working in companies with an established audit committee. The other 67.9% are members of the supervisory board in companies that do not have such a committee.

Table 2 presents the opinions of certified auditors about the impact of the audit committee on efficiency of external auditing. Only auditors who provided auditing services to publicly traded companies with an established audit committee answered the following question.

Table 2

THE AUDIT COMMITTEE IMPACT ON HIGHER EFFICIENCY OF EXTERNAL AUDITING

The audit committee and external auditing efficiency			Medium impact	High impact	Extremely high impact	Total:
Providing auditing services to companies with an established audit committee	Yes	Count	4	6	3	13
		% within companies with established audit committee	30.8%	46.2%	23.0%	100.0%

Out of the total number of certified auditors, 30.8% thought the audit committee has medium impact on efficiency of external auditing, while 46.2% thought the audit committee impact on efficiency of external auditing is high with 23% concluding the audit committee impact on efficiency of external auditing is extremely high. The following table (table 3.) presents the opinions of certified auditors regarding the establishment of the audit committee, in companies currently without one, and how that will have an impact on efficiency of external auditing.

Table 3

OPINIONS OF CERTIFIED AUDITORS ABOUT THE IMPACT OF ESTABLISHING THE AUDIT COMMITTEE, IN COMPANIES WITHOUT ONE, AND ITS INFLUENCE ON HIGHER EFFICIENCY OF EXTERNAL AUDITING

Impact of establishing the audit committee on external auditing efficiency			No impact	Medium impact	High impact	Extremely high impact	Total:
The audit committee	Yes	Count	0	3	5	5	13
		% within the audit committee	0.0%	23.0%	38.5%	38.5%	100.0%
	No	Count	1	12	11	5	29
		% within the audit committee	3.4%	41.4%	37.9%	17.3%	100.0%
Total:		Count	1	15	16	10	42
		% within the audit committee	2.4%	35.7%	38.1%	23.8%	100.0%

Out of 13 certified auditors who provide auditing services in companies with an established audit committee, 23% thought the impact of establishing the audit committee (in companies which do not have such a committee) on efficiency of external auditing would be medium, while 38.5% thought the impact would be very high. The rest, 38.5%, thought that the impact would be extremely high.

Out of 29 certified auditors who provide auditing services to companies which do not have an audit committee, 3.4% thought there would be no impact in establishing the audit committee on efficiency of external auditing, while 41.1% thought there would be medium impact while 37.9% thought the impact of establishing the audit committee (in companies without such a committee) on higher efficiency of external auditing would be high. The rest, 17.3%, thought the impact of establishing the audit committee on higher efficiency of external auditing would be extremely high.

Table 4 presents the mean scores (scaled from 1 to 5; with the scale defined as: 1 – no impact, 2 – low impact, 3 – medium impact, 4 – high impact, 5 – extremely high impact) of the surveyed certified auditors with regard to the impact of establishing the audit committee on higher efficiency of external auditing.

Table 4

MEAN SCORES OF CERTIFIED AUDITORS REGARDING IMPACT OF ESTABLISHING THE AUDIT COMMITTEE ON HIGHER EFFICIENCY OF EXTERNAL AUDITING

The impact of establishing the audit committee on efficiency of external auditing		N	Mean	Std. deviation	Std. error mean
The audit committee	Yes	13	4,15	,801	,222
	No	29	3,66	,897	,167

Table 5

T-TEST ON THE DIFFERENCE BETWEEN MEAN SCORES OF CHARTED AUDITORS REGARDING THE IMPACT OF ESTABLISHING THE AUDIT COMMITTEE ON HIGHER EFFICIENCY OF EXTERNAL AUDITING

The audit committee establishment	Levene's test for equality of variances		*T-test for equality of means*						
	F	Sig.	T	Df.	Sig. (2-tailed)	Mean diffe-rence	Standard error diffe-rence	95% confidence interval of the difference	
								Lower	Upper
Equal variances assumed	,210	,649	1,718	40	,093	,499	,290	-,088	1,085
Equal variances not assumed			1,796	25,815	,084	,499	,278	-,072	1,070

The mean score of the surveyed certified auditors who provide auditing services to the companies with an established audit committee was 4.15, while the mean score of certified auditors who provide auditing services to companies without an audit committee was 3.66. Table 5 presents a t-test for independent samples that helps better understand the difference between these mean scores (the difference between means was 0.49).

When equal variances are assumed, and the T value of 1.718 and 40 degrees of freedom significance equals 0.093. Therefore, we can conclude the average opinion of certified auditors is that the impact of establishing the audit committee, in companies without one, on better efficiency of external auditing would be high.

Table 6 presents the opinions of supervisory and management board members regarding the audit committee impact on efficiency of both external auditing and the supervisory board.

Table 6

OPINIONS OF SUPERVISORY AND MANAGEMENT BOARD MEMBERS REGARDING THE IMPACT OF THE AUDIT COMMITTEE ON HIGHER EFFICIENCY OF BOTH THE SUPERVISORY BOARD AND EXTERNAL AUDITING

Impact of the audit committee on the supervisory board and external auditing efficiency			Medium impact	High impact	Extremely high impact	Total:
Function	A member of the management board	Count	3	4	0	7
		% within function	42.9%	57.1%	0%	100.0%
	A member of the supervisory board	Count	0	6	4	10
		% within function	0%	60%	40%	100.0%
Total:		Count	3	10	4	17
		% within function	17.7%	58.8%	23.5%	100.0%

Only those members of the supervisory and management boards who work in publicly traded companies with an established audit committee answered this question. Out a total seven members of the management board, 42.9% thought the audit committee had medium impact on higher efficiency of both external auditing and the supervisory board, while 57.1% thought the audit committee impact on better efficiency of the supervisory board and external auditing was high. Out of the 10 members of the supervisory board, 60% thought the audit committee had a high impact on higher efficiency of the supervisory board and external auditing, while 40% thought impact of the audit committee on better efficiency of both the supervisory board and external auditing was extremely high.

Table 7 presents the opinions of both supervisory and management board members on the impact of establishing an audit committee, in those companies without the audit committee, and how this will effect higher efficiency in both the supervisory board and external auditing.

Table 7

OPINIONS OF SUPERVISORY AND MANAGEMENT BOARD MEMBERS ON THE IMPACT OF ESTABLISHING AN AUDIT COMMITTEE, IN COMPANIES WITHOUT ONE, AND THE EFFECT ON HIGHER EFFICIENCY OF THE SUPERVISORY BOARD AND EXTERNAL AUDITING

Impact of establishing the audit committee on the supervisory board and external auditing efficiency			No impact	Medium impact	High impact	Extremely high impact	Total:
Function	A member of the management board	Count	0	7	10	4	21
		% within function	0%	33.3%	47.6%	19.1%	100.0%
	A member of the supervisory board	Count	1	8	6	6	21
		% within function	4.7%	38.1%	28.6%	28.6%	100.0%
Total:		Count	1	15	16	10	42
		% within function	2.4%	35.7%	38.1%	23.8%	100.0%

Out of 21 management board members who answered this question, 33.3% thought the impact of establishing the audit committee (in companies without such a committee) on efficiency of the supervisory board and external auditing would be medium, while 47.6% thought impact would be very high. The other

19.1% thought impact would be extremely high. Out of the 21 members of the supervisory board who answered the question, 4.7% thought there would be no impact of establishing the audit committee on higher efficiency of the supervisory board and external auditing, while 38.1% thought there would be medium impact with 28.6% thinking impact would be high and extremely high.

The t-test for independent samples was used in order to test the difference between the mean scores of the supervisory and management board members regarding the impact of establishing the audit committee on higher efficiency of both the supervisory board and on external auditing. Table 8 presents the mean scores (on a scale from 1 to 5) of those supervisory and management board members participating, on the impact of establishing the audit committee (in companies without it) on higher efficiency of the supervisory board and external auditing.

Table 8

MEAN SCORES OF SUPERVISORY AND MANAGEMENT BOARD MEMBERS REGARDING IMPACT OF ESTABLISHING THE AUDIT COMMITTEE, IN COMPANIES WITHOUT ONE, AND ITS ROLE IN HIGHER EFFICIENCY OF BOTH THE SUPERVISORY BOARD AND EXTERNAL AUDITING

Impact of establishing the audit committee on the supervisory board and external auditing efficiency		N	Mean	Standard deviation	Standard error mean
Function:	A member of the management board	21	3.95	.590	.129
	A member of the supervisory board	19	3.95	.705	.162

The mean score of the management and supervisory board members was 3.95 (there is no difference between means because there are only two decimal places). Table 9 presents a t-test for independent samples in order to test the difference between the mean scores (the difference between means equals 0.005).

When equal variances are assumed, a T value of 0.024 with 38 degrees of freedom, the difference is not significant (significance is higher than 5%). Therefore, it is feasible to conclude the average opinion of both supervisory, and management board members is that the impact of establishing the audit committee, in companies without one, and its role in higher efficiency of external auditing and supervisory board is high.

Table 9

T-TEST FOR THE DIFFERENCE BETWEEN MEAN SCORES OF BOTH SUPERVISORY AND MANAGEMENT BOARD MEMBERS REGARDING THE IMPACT OF ESTABLISHING THE AUDIT COMMITTEE, IN COMPANIES, WITHOUT SUCH A COMMITTEE, AND THE ROLE ON HIGHER EFFICIENCY OF THE SUPERVISORY BOARD AND EXTERNAL AUDITING

Establishment of the audit committee	Levene's test for equality of variances		*T-test for equality of means*						
	F	Sig.	T	Df.	Sig. (2-tailed)	Mean diffe-rence	Standard error difference	95% confidence interval of the difference	
								Lower	Upper
Equal variances assumed	.065	.799	.024	38	.981	.005	.205	-.410	.420
Equal variances not assumed			.024	35.275	.981	.005	.207	-.414	.424

According to the conducted survey and presented tests, it is fair to deduce that certified auditors who provide auditing services in companies with an established audit committee think that the audit committee has an impact on higher efficiency of the external auditing service. The average opinion of all certified auditors who participated in the survey is that the impact of establishing the audit committee, in companies that do not have one, and its effect on efficiency of external auditing would be high. Members of the supervisory and management board who work in publicly traded companies with an established audit committee thought that the audit committee impacts on higher efficiency of the supervisory board and external auditing and that the impact of establishing such a committee, in companies without one, would result in an increased efficiency of both the supervisory board and external auditing. Based on the application of secondary research methods and on opinions of survey participants, we can conclude that the audit committee does have an impact on higher efficiency of external auditing and the supervisory board. Furthermore, the developed hypothesis, which states, the audit committee, as a subcommittee of the supervisory board, has a direct impact on higher efficiency of the supervisory board and external auditing, has also been verified.

6. Conclusion

Efficiency of external auditing and the supervisory board is extremely important for the good corporate governance practice. Supervision systems, both internal and external, play crucial role in increasing the quality of the company's business system and company's organizational parts. All of that reflects on higher quality of the financial statements – which are a key source of financial information and data for all participants in the corporate governance process.

The fact that there has been no significant research about the impact of the audit committee on external auditing and the supervisory board work efficiency and the fact that efficiency of external auditing and the supervisory board is extremely important for the good corporate governance practice, scientifically funded starting hypothesis was developed as an examination necessity of the audit committee impact on external auditing and the supervisory board which includes examination of the intensity of that impact as well as the audit committee impact on the increase of both external auditing and the supervisory board efficiency.

A relationship between external auditing and the supervisory board increasingly depends on the audit committee, a subcommittee of the supervisory board in charge of improving the financial reporting process and improving communication with external auditors. Since the results of the conducted survey confirmed that the auditing committee has a direct impact on higher efficiency of both external auditing and the supervisory board, it is necessary to create and maintain conditions that will allow that kind of relationship to prosper in the Croatian corporate governance system. When talking about such conditions we imply the establishment of the audit committees in publicly traded companies.

In the near future, better and more efficient communication between external auditing and the supervisory board is expected. The result of that communication will be a much higher quality of the financial reporting process and more reliable information for the sake of business decision making.

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EMPIRIJSKA EVIDENCIJA O ODNOSU UZMEĐU EKSTERNE REVIZIJE I NADZORNOG ODBORA U REPUBLICI HRVATSKOJ

Sažetak

Cilj ovog istraživanja je utvrditi i analizirati utjecaj revizijskog odbora na povećanje efikasnosti eksterne revizije i nadzornog odbora. Na osnovi empirijskog istraživanja, provedenog metodom anketiranja, testira se hipoteza prema kojoj revizijski odbor, kao pododbor nadzornog odbora, utječe na povećanje efikasnosti eksterne revizije i nadzornog odbora. Uz to, u ovom se radu analiziraju uloge nadzornog i revizijskog odbora u korporativnom upravljanju, kao i relevantni teorijski i metodološki aspekti eksterne revizije.

Ključne riječi: nadzorni odbor, revizijski odbor, korporativno upravljanje, eksterna revizija.