The role of the Auditors in Italian Listed Companies

MARIA TERESA BIANCHI
Department of Law and Economics of Productive Activities
University of Rome La Sapienza
Via del Castro Laurenziano 9, Rome
ITALY
mariateresa.bianchi@uniroma1.it

Abstract: - The paper aims at discovering the role of the auditors in the Italian listed companies, by proposing an updated conceptualization of the existing literature. In this way, the adoption of a qualitative methodology allows for the construction of a literature analysis on the role of the auditors in the Italian listed companies. As source for the analysis the databases of the Italian Stock Exchange, Consob and the Code of Conduct, as well as the governance proposals by ENI, were consulted. Moreover, the research uses secondary sources and includes documents, papers and scientific books and databases.

Key-Words: - corporate governance, auditors, audit, listed companies, Consob, Italian Stock Exchange

1 Introduction

This paper investigates the role of the auditors in Italian listed companies, proposing an update conceptualization of the existing literature.

In this context, the objective of the paper is to define the figure appointed as coordinator of the auditing activity in the corporate governance perspective [3] [12] [20] [23] in order to achieve the objective of the transparency and simplification.

The present work is the result of a research carried out on models of governance [25] adopted by the companies listed on the Italian Stock Exchange. Such observation enabled the analysis of these models, and, most importantly, of the roles taken by the different auditors. Particularly, on the base of the indications coming from the legal auditing matter laws, it was possible to detect a radical change of the auditing role. The reference set of rules is often contradictory and does not clearly reveal which controller, between the various involved, is the one appointed to synthesize the various "core" of the control activity. Therefore, as resulting from the Italian Stock Exchange data, from the new internal orders coming from the Code of Conduct and the proposals about the governance matter carried out by ENI, this work proceeded to check the state of the art and possible solutions already used from the major listed groups. All this is intended to understand which figure appointed as coordinator of the auditing activity, in order to achieve the double objective of transparency and simplification.

The research uses a qualitative method [24]. As source for the analysis the databases of the Italian Stock Exchange, Consob and the Code of Conduct, as well as the governance proposals by ENI, were consulted. Moreover, the research uses secondary sources and includes documents, papers and scientific books and databases.

The research adopts an exploratory approach and has the purpose of filling the gaps in literature declaring the role of the auditors in the Italian listed companies.

The paper is structured as follows. After the introduction, the second section presents the corporate governance models. The methodology and approach are described in the third sector. The findings are set out in the fourth section, together with the implications of the research. The fifth section contains the discussions, conclusions, limitations of the study, together with a number of suggestions for future research.
The research question to be asked is the following:

Q1: Which is the role of the auditors in the Italian listed companies?

2 The corporate governance models and their practical application

The delicate issue of corporate audits requires careful examination, during the last few months, in fact, the spreading crisis of the economy has put into question the need for control [22]. Rules such as the one of the single auditor, for the purpose of simplification, the role and the quality of the auditing activity itself.

Auditing must be an investment, rather than a cost, for the corporation, by granting:

• transparency of management;
• transparency in asset, economic and financial values;
• transparency in internal and external relationships;
• transparency towards funders;
• transparency towards current and potential investors;
• transparency towards the Public Administration.

Transparency means guarantee [27] and this demands an added value for the company [11]. The auditing activity should take place with effectual purpose. It is pointless to demand for an audit while creating the circumstances that turn it into being inappropriate. Auditing must not be only a pointless catch-phrase, it should be the achievement of an effective and efficient application. This means that the control on the one hand must not be superficial and on the other does not even have to be oversized, in fact being oversized would result in the absence of the control itself. So today, more than ever, it seems necessary to implement a cross covering auditing activity that would apply to different strategic areas, but that does not stratify to the point of being useless.

An important issue is the need to reconcile the auditing with the control. From the operating point of view, in fact, many "managers" consider auditing as a diminution of their freedom of decision, not understanding the added value of transparent management and the of the possible synergies with the auditing part. It should also be recalled that currently the scenery of the audits is diversified and changes along with the governance model, with the size of the company and the business sector to which it belongs. This often "annoys" the management, which claims to be undergoing unnecessary and often harmful costs.

On the one hand, therefore, there is a need for the culture of control, on the other hand the audits must not be too invasive or oversized [17].

The models of governance [28], [31] contemplate the listed above requirements and should be its legal configuration, as well as the appropriate governance structure, carries out an important strategic choice. Today, this choice must consider different conflicting interests. First of all, the economic entity that needs to pursue, through the management, its own aims. Then there are the investors - minority shareholders and potential investors - that aim to control and to know the corporate action. Then the creditors who need to understand company's performance and to monitor the assets on which to rely for the fulfillment of their claims. Finally there are the workers who have the right to be aware of the trend of the management and, within certain limits, to take part in the choices of the company.

There are, then, the various Authorities who need information and guarantees of transparency. In this regard, the governance model is crucial for the composition of the various stakeholders interest and, last but not least, to allow the company to compete effectively in the market.

Following such assumption, the analysis focuses on listed companies which, although not representing a significant sample from the numerical point of view [29], [30], are those on which encumber "charges for information" in the biggest amount and in which, quite often, there is a significant overlap between "controllers".

The models currently contemplated under national law are three: the traditional, the two-tier and the one-tier model.

The traditional model entrusts (following the art. 2380 Civil Code) the administration to a board of directors (or a sole director) and the auditing activity to the board of auditors. Both are an expression of the shareholders assembly.

The in-word model demands that the economic entity [7], [9] manages the business directly or by
appointing chosen persons (Is that subject able to "manage" the company directly or by exerting its influence over the appointment of managing entities of its trust). The logic is to have a governing organ that acts in order to satisfy the property interests, while there is a monitoring organ that must watch over the work of the governing organ in order to protect the company and the shareholders interests, being expression both of the economic entity and of the minority. To achieve such target, this auditor must be independent. In fact, only the independence allows to protect all stakeholders and not just the minority shareholders but also all the other subjects of the business: creditors, employees, government, etc.

The one-tier system foresees that the assembly appoints the administrators, which is responsible for the operational management of the company, the administrators themselves will have to appoint a committee of management auditing. The assembly also provides for the appointment of an external auditor who is entrusted with the accounting auditing (the use of an auditing firm is compulsory for all those companies that make use of the "market risk capital", defined, as already mentioned, in the art. 116 of Legislative Decree no. 58/1998.). The peculiarity of the model lies in the one-tier body, appointed by the assembly, who is entrusted with the tasks of management and auditing [21]. This implies that the auditing committee is the emanation of the controlled entities themselves (the board). The mixture of management and control as expression of a single body, leaves doubts about the effective operation of the governance. To weaken the effects of this risk, more stringent criteria of professionalism and independence of the board have been pursued. The risks within the model concerning the lack of impartiality are evident and can be overcome only with the explicit request of professionalism and independence.

The two-tier system contemplates that the auditor is appointed by the assembly, while the management is appointed directly by the same auditor. The assembly also provides for the appointment of an external auditor (also in this case the use of an audit firm is required in cases where the company has resorted to the "market risk capital" within the meaning given to that expression by art. 116 of Legislative Decree 58/98 and its implementing regulation).

The members of the Management Board, members or non-members, have the task of managing the company. The Supervisory Board watches over the management company and verifies the adequacy, the effective and proper functioning of the organizational and administrative-accounting systems. These functions are adapted from the similar ones of the board of auditors in the traditional model. To the Supervisory Board belong functions typical of the assembly such as the approval of the budget, the appointment, the removal and replacement of members of the management board, it is enabled to promote legal action towards the members of the management board.

The two-tier model has been designed in order to limit the interference of "ownership" in business management, but also to identify in the supervisory board the authority charged with putting together, in advance, different and, not infrequently, opposed interests in order to facilitate the management task of the Board of Management. The application of this model made by the legislature deviate from this paradigm, resulting thus poorly efficient as it determines, if not properly defined, conflict between those who manage and those who control and lack of clarity concerning roles and responsibilities.

Starting from the examination above, it is clear that the models currently present in our law system have features that are not always compatible with the actual Italian entrepreneurial situation. Not by chance the so-called alternative models of governance have found poor application in Italy; on December 31st 2011 only 10 listed companies have adopted alternative models and, specifically, 3 adopted the one-tier and 7 the two-tier (CONSOB, 2012). This leads to the conclusion that the listed companies believe is appropriate to trust in the traditional model. Therefore, the analysis focused, as already noted, on that model.

3 Research Approach

The method used for research is qualitative, with an exploratory approach, proposing to the academic community and to policy makers, an updated conceptualization of the auditors' role in the Italian listed companies.

Analysis of this topic integrates and updates existing literature, allowing for the definition of key aspects of the auditors role in the corporate governance system.
The research uses a qualitative method [24]. As source for the analysis the databases of the Italian Stock Exchange, Consob and the Code of Conduct, as well as the governance proposals by ENI, were consulted. Moreover, the research uses secondary sources and includes documents, papers and scientific books and databases.

The research adopts an exploratory approach and has the purpose of filling the gaps in literature declaring the role of the auditors in the Italian listed companies.

4 Internal audits in listed companies

The modern concept of the internal audits gravitates around the notion of business risks, around their identification, assessment and monitoring, it is also for this reason that the legislation and the Code of Conduct refers to the system of internal audit and risk management as a unit system where the risk is the common thread.

It is necessary not to forget that the company must manage its business risks, after having mapped them. From here will descend the procedures and, by consequence, the audits. A control system to be effective, must be "integrated": this implies that its components are mutually connected and interdependent and that the system as a whole, is itself integrated into the general organizational, administrative and accounting structure of the corporation.

Is up to the board of directors (Italian Stock Exchange, 2011), being the strategic supervising body, to absolve the task of defining the guidelines for the auditing system, consistent with the risk profile of the company as determined by the board of directors [4], [16]. The Board is also responsible, in accordance with law previsions, for the assessment of the adequacy of the audits. This assessment is carried out periodically, but, in case of unexpected events occurring within the corporate life, may be required extraordinary insights, aimed at testing the effectiveness of audits relating to particular situations. Performing these tasks, as well as for the examination of periodic financial reports, the Board requires an adequate inquest activity. This activity, in listed companies, is typically carried out by a committee of directors, "control and risk committee" [6], [14] [26].

In the perspective of streamlining the governance structures, the Board of Directors may decide to carry out the mentioned inquests directly, i.e. without the setting-up of a special committee, where such a choice is consistent with the characteristics of the company.

There are several main functions involved in the governance of the auditing system. Crucial importance is detained by the internal auditing function (or internal review), invested of the "third level" auditing activity. The internal audit function is strongly characterized from independence, which explicates both through the attribution of autonomous powers concerning the initiative in the predisposition of the auditing plan and activation of single interventions, either through the procedures previously established for the appointment, dismissal and remuneration of its responsible.

The powers proper of the Board of directors concerning the auditing activity denote the existence of a real hierarchical relationship with the head of the internal audit function. In any case, it is necessary that decisions regarding the matters above mentioned are taken with the approval of the control and risk committee (or, as alternative, of the remuneration committee, limitedly only to the proposals relating to the remuneration) and having consulted the board. Particular attention must be paid to the information flows generated by the internal audit function: the results of the audits should be transmitted, at the same time, to the chairmen of the board of directors, of auditors, of the control and risk committee and to the administrator accountable for the system of internal audits and of risk management, underlining that this accountable cannot receive any anticipated communication regarding the job done.

Are placed on a different level the corporate functions holding the so-called "second-level" auditing tasks, those aimed to monitor and manage business-related risks, such as operational risk, financial risk, market risk, the risk of (non) conformity, etc. Excluding the figure of the manager in charge for compiling accounting documents, which is by law responsible to predispose adequate administrative and accounting procedures for the composition of the financial informative documents, there are not general provisions applicable to all companies regardless of sector, in terms of risk management. Conversely, certain sectoral regulations provide for the establishment of specific structures or corporate roles appointed to manage risk, such as the chief risk officer, the compliance...
function, a risk committee, made up of managers and put in charge in order to assist in the in the risk assessment process the social parts. In the scope of a rationalization of the auditing system, the companies consider the opportunity to assign the auditors the functions of Supervisory Body of the Legislative Decree. No. 231/2001.

The board of Auditors recovers a central role on the supervision system of a company. The board of Auditors has the duty ensures in advance and not only ex post, this for controlling the processes of which result has to be known by the administrator. In order to adopt any necessary corrective actions. All this it’s important also for controlling reputational risks, which are under observation especially by banks and financial companies. [1], [2] [5], [10] [18], [19].

The resulting coordination with the organs of management, including delegates, is intended to be compatible with the role of monitoring the compliance (to the rules, to the statute, to the internal procedures), typically entrusted to the Board of Auditors, which distinguishing it clearly from the Board of directors and the audit committee and risks, all of which play the role of evaluation (also about the merit) upon the adequacy of the structures and the trend of the management.

Within the Board of Auditors stands out the role of the president, which is responsible of coordinating the works of this organ and of the connection with other corporate organs involved in the governance of the auditing systems. The fact that the chairman of the board of auditors role is reserved to a member elected by the minority shareholders introduces a further element of impartiality that can increase the guarantees of independence, but should not be intended as an element of estrangement from the corporate organization: the board of auditors is an organ that operates from the inside of the company and in coordination with the management organs, in order to achieve its primary goal of creating value for shareholders in the medium-long term perspective.

A constant exchange of information is essential between the auditors and the organs and functions within the company that absolve tasks concerning internal auditing.

The need for an action by the auditing board observant to the decisions of the top management, as well as a coordinating role of the auditing functions, starting from the most operating within the company. Coordination contemplates meetings of the board involving the functions of internal audit, compliance, coordinator of the Supervisory Board (ex Decree 231/2001), if there is risk manager, in addition to the external auditors. Attention of the board must be directed to the procedures, whose control and update must be highlighted in the plans of auditing and during the monitoring of their effective execution. To tell the truth, most of the provided colleges follow the practice above indicated.

5 Discussion, Conclusions and future research

From the outcome of the analysis led and of the Italian Stock exchange and CONSOB data is clear that an efficient governance is the one that best meets the needs of the company organization. So, the model has to be customized for the specific company. If the activity is restricted there can be also a monocratic authority, or even there can not be auditing authority, because, de facto, the audit is exercised by the economic subject that makes the internal audit for technical-operational and legal purposes, but when the dimension and, so, the stakeholders increase in number the behaviour changes and the internal and legal audit can no be longer exercised by a single authority, it is necessary to separate the two functions. These both have to be exercised with strictness, transparency and professionalism. The collegiality is a necessary element, of course it is not enough, but it is necessary to ensure such characteristics.

The audit system represents one of the crucial feature of the company governance, as it is clear by the reading of the Conduct Code of Italian stock exchange. Its components are very diversified and they are represented by “first levels auditing”, so-called, made by operating managers, to, so-called, management auditing, concerning the planning and the corporate business audit, until internal audit, meaning the activity of general control on structure and functionality of internal audit. It is clear that the company dimension supposes different models of coordination between management and audit. The choice of government model has to be made considering the features of the company, of the property, of the leadership type, of the direction type, as well as, obviously, of the model internal feature.

The audit in the micro company is, normally, an audit not formalized, exercised by the same
This entrepreneur does not want to give information about its own activity and its own choices. The moment and the way to inform about his own work results in the balance sheet (if drafted up) and in the tax return. These documents are shown, mostly, at the revenue authority and at the banks.

In cases, such as those described, it is clear that the need of the audit is exercised from within and there isn’t a borderline between governance and management. It is sufficient, however, that the size of the company increases also a bit and so the need of audit is amplified. The audit becomes an organizational need and it is imposed by the chosen model of management. The audit, so, is exercised at the level: of management audit, of the internal auditing, of the technical-administrative procedures, of the balance sheet, of the correct application of the procedures, of the principle and of the rules.

It’s evident in the operation, but perhaps that isn’t very explicit in the governance principles, and namely that the board of auditors is the centre of the audit activity with the tasks of coordination and support structure. To achieve this hypothesis is necessary have unique rules that make this activity clear, while now it is only sketched. So the elements to be monitored in order to have an effective audit are:

- A) risk analysis;
- B) establishment of procedures;
- C) allocations of tasks to the corporate bodies and functions;
- D) coordination and integration of the audits in the hands of the committee in charge for this (the board of auditors in the traditional model).

The auditing without a right coordination turns out to be inefficient. In fact, there is the necessity to have a coordinator, that, having experience and skills, make the audit an embedded system and, so, in synergism with the usefulness for senior managers.

In this way, the multiple regulatory actions are interpreted in the matter of audit having changed, de facto, the board of auditors in the coordinator of the audit and of the controllers. The role of the auditor lost its original function statutory auditor to take on more and more the one of controller of the administration, seen as especially as monitoring the adequacy of the organizational, administrative and accounting structure of the company.

It is significant the extension of the duty of the board of auditors, in addition to s.r.l. with capital equal to € 120,000, to the s.r.l. that exceed the quantitative limits of the 2435-bis and that monitor a public interest company (listed company) or a company subject to a mandatory auditor or obliged to the consolidated. The presence of an authority of audit in the more complicated business background ensures the protection of the transparency and fairness of the management.

The legislation about the board of auditors identified, so, an authority more engaged in the firm to coordinate the controllers, with features of professionalism, independence and integrity clearly identified [8].

Nowadays the coordination of the audit appears more than ever the actual item on which is based the match of audit effectiveness and efficiency.

In this way, it’s right to read the proposals made by important Italian listed group that change the own model of corporate governance according to the business needs and enhancing the role of audit authority. In particular the ENI worded proposals and made some of them, about the governance system, public analyzing the foreign best practices.

The proposals about board of directors, its strategic role, its configuration, its requirements for its members and the principles of conduct that regulate its task.

Between the main pursued objectives: the strengthening of the strategic role of the board of directors and the introduction of the managerial experience as a central requirement of the administrators professionalism and of the staggered board, in order to promote the stability and the continuity of management. It is clear that these proposals assume business scale in that the authorities is exercised by a professional managers.

Another set of observations concerns the composition and duties of the various Committees of the board of directors, always in order to an its more strategic role and in order to a enhancement of audit tasks of the board of auditors. Among the proposals: the strengthening of the role of the Committee for the internal audit in the matter of risk management, the establishment of a committee for the Corporate Governance (authority present in different models adopted by national listed company), the periodic renewal of the Committees and the rationalization of the functions of the
Committee for the internal audit and of the board of auditors in order to avoid them overlap.

A last group of proposals concerns the assembly and aims to involve more the shareholders in the company life and to improve them information. In particular for the Assembly are hoped, among other, rules that simplify the procedures and that allow the Assembly to focus about the issues of real interest for all shareholders and initiatives that promote the transparency of the voting policies of the institutional investors.

The proposals above mentioned appear to be indicative of an evident dissatisfaction for the current order. One side, in fact, there is the requirement of saving and combining of tasks [15], the other an increasingly need of transparency and of professionalism in all company bodies.

A unique common denominator: the traditional model.

From the latter is necessary restart to make it compatible with the firm that, from time to time, must “dress up”.

The main limit of research derives from the absence of empirical evidence.

In this direction, future research is aimed at provide empirical study of the role of the auditors starting from the italian listed companies, by finding implications for listed companies in the international scenario.

References


