MEANING OF CORPORATE GOVERNANCE

Introduction

The government's proposed reforms for auditing/financial reporting are contained CLERP 9, which is based upon business adopting acceptable corporate governance practices. Senator Ian Campbell, who developed CLERP 9, has stated that it is based upon a co-regulatory approach (Abernathy, 2002, p. 35). As previous editions of *Current Affairs in Auditing* have noted, the Australian Stock Exchange (ASX) is due to publish its best practice guidelines for corporate governance at the end of March 2003. Also imminent is the presentation of the Royal Commission's findings into the collapse of HIH Insurance, due on 4 April 2003. These three documents concentrate, or will concentrate, upon corporate governance, leading to many articles on corporate governance being published in the media. For example, *The Australian Financial Review* on 20 March 2003 published a special report containing many articles on corporate governance. Consequently, this edition of *Current Affairs in Auditing* will be devoted to the issue of corporate governance.

Meaning of corporate governance

The term corporate governance has two meanings and you should be careful that you understand the context in which the term is used. Firstly, the term is used to describe 'the various organizational mechanisms which exist externally and internally to monitor and control the corporate entity and its management' (Lee, 1993, p. 30). Examples include 'internal audit and external audit, the use of audit committees, the appointment and role of non-executive (or outside directors), voting rights, including proxy voting and institutional investor involvement in corporate affairs' (Lee, 1993, p.30). Secondly, the term describes the internal means by which the company is controlled. It is the second meaning of the term that the majority of this month's edition of *Current Affairs in Audit* will discuss. Examples of corporate governance practices adopted within a company include:

- a different person to be chairperson and managing director of company. It is argued that one person who fulfils both these positions would have too much power and may abuse that power by committing corporate excesses.
- the majority of the board being independent
- establishing an audit committee to oversee the audit of financial statements. Such a committee should consist exclusively of, or have a majority of, non-executive directors.
- risk committees whose task is to assess all major risks confronting the company and devise strategies to manage those risks
- a recent call for directors to limit themselves to one position as a chairperson. Directors would have too high a workload if they were the chairperson of more than one board.

Corporate governance became popular after the corporate collapses of the late 1980s and was seen as a means to control the excesses of the dominant chief executive officer. The popularisation of corporate governance systems may be likened to the period between 1920 and 1960 when the size and complexity of businesses increased, accompanied by an increase in the number of transactions processed. The responsibility for collecting and processing accounting data and other information was delegated to employees. Companies reacted to these changes by installing internal control systems, and the auditors, rather than check all transactions, checked the operation of internal controls (Porter, 1997, p. 34). The popularisation of corporate governance may have a similar profound impact on auditing.

Corporate governance envisages that non-executive directors will control the excesses of executive directors and management. The non-executive directors are those directors who are not employed full time in the company and attend the periodic directors meetings. These directors may be retired successful business people who can use their wealth of business knowledge to counter the excesses of executive management. In early December 2002, *The Australian Financial Review* ran a series of articles about directors in Australia and the following comment shows how directors and boards have dominated corporate thinking: ‘In the ’80s we loved the buccaneers. In the ’90s we lauded the CEOs. From 2000 forward, it will be boards’ (Ryan and Shand, 2002, p. 60).

References

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