RELATIONSHIP OF CORPORATE GOVERNANCE TO AUDITING

Corporate governance may be seen to have two effects on auditing. The first is that corporate governance through audit committees should ensure the independence of auditors; and secondly, directors through corporate governance mechanisms assume greater responsibility for the reliability of financial statements.

Ensuring independence of auditors

Corporate governance through the audit committee should ensure that the auditors are independent. The committee can do this by:

- advising on resolutions put before the annual general meeting relating to the appointment, dismissal and setting of audit fees. Executive management will thus not handle these matters, removing considerable power that could be held by executive management. This power could cause independence problems.
- discussing with auditors any problems the auditors experienced during the course of the audit. To allow free discussions, executive management would not be present when these discussions occur.
- implementing and reviewing processes to ensure the auditor is independent
- adopting policies and performing reviews to ensure the provision of non-audit services does not affect auditor independence.

Tate (2001) even suggests that members of the audit committee could be legally responsible if the auditor is not independent (p. 14).

Directors assuming greater responsibility for reliable financial statements

Society through debates on corporate governance is demanding directors assume greater responsibility for the reliability of financial statements and it would then follow that the law would impose greater legal responsibilities on directors for the proper preparation of reliable financial statements. This shared responsibility between auditors and directors for the preparation of reliable financial statements may result in auditor's role in this area being diminished, with directors filling the vacuum left by auditors. Tate (2001) provides an interesting article detailing how members of the audit committee might minimise their risk of being sued resulting from what he calls the avoidance of its tough new liabilities (p. 11). You should read this article for details.

Tate (2001) also suggests that the board of directors may place greater responsibility on audit committee members for ensuring financial statement reliability. This greater reliance may be accompanied by greater legal responsibilities, with a greater probability of paying damages if the financial statements prove unreliable. Main (2003) adds that the indemnity insurance premiums of the position of chair of the audit committee may rise sharply and the number of directors volunteering for membership of the audit committees may diminish.

References

Main, A 2003, 'Rewriting the boardroom rule book', *The Australian Financial Review: Special Report*, 20 March, p. 10.

Tate, D 2001, 'Risk management in the audit committee', *Corporate Board*, March/April, pp. 11–16.