

## WHY THE EMPHASIS ON CORPORATE GOVERNANCE?

There are several reasons why corporate governance is the most popular suggestion to improve financial reporting. They are:

- Minimal cost to government. The main cost involved in corporate governance systems would be directors' fees paid to non-executive directors, which the company would bear. The main cost borne by government will be the costs of maintaining courts, where disputes about governance could be heard. Gary Banks, Chairman of the Productivity Commission, is critical of government implementing regulation that requires high compliance costs to be borne by business. He argues government 'departments and agencies appear not to have sufficient internal expertise to adequately perform an assessment' of compliance costs (Fabro, 2003, p. 3). Whether the costs borne by business in implementing and operating corporate governance systems is greater than benefits received is a question that could be further researched.
- Corporate governance is a market-based approach. The former leader of the Liberal Party, John Hewsen (2002) argues you cannot legislate for good governance and that the market must be the final regulator. He states the market has done its job by identifying failed companies. He sees regulations should be directed at:
  - criminal penalties for corporate malpractice
  - ensuring companies self regulate by adopting good corporate governance practices, such as by having boards of directors that are predominately independent (p. 82).

Corporate governance acts as a market-based control by allowing investors to read company's corporate governance practices and using this information in any investment decision. In this manner, there would be incentives for companies to improve their corporate governance practices. This is facilitated by the ASX requirement that companies must report on the degree to which their corporate governance practices deviate from best practice. If they do deviate from best practice, the companies must explain why.

- Corporate governance systems adopt a principle-based approach that is preferred by government and business to black-letter law. Senator Campbell states that black-letter rules add 'layers of rigidity, cost and administration to a largely law-abiding, ethical and principle-based marketplace (as quoted in Pheasant, 2002, p. 68).
- Similar to auditors, corporate governance is a real-time control. That is, the control operates while transactions occur and financial reports are being prepared. Hopefully, the control has preventive as well as detection aspects.
- There are major criticisms relating to auditor performance, leading to the question of whether auditors are fulfilling their role of adding credibility to financial statements. The auditing profession have claimed that these criticisms relate to auditors' liability for fraud detection and failure to warn of companies not being a going concern. The auditing profession would claim these are expectation gap issues. Whatever the validity of this claim, the criticisms shows society wants issues such as fraud detection and warning of companies not being a going concern to be addressed. Mautz comments in relation to the roles professional groups play in society becoming highly relevant. He states that:

society either accepts or rejects the role that a professional group assumes for itself; in time the group either finds a role acceptable to society or the group disappears. As conditions and apparent needs change, society may reject roles formerly considered acceptable so professional groups must continually be alert to the desirability of role modification and revision (as quoted in Flint, 1988 p.16).

It would follow that if a professional group does not fulfil or adapt its role to those demanded by society, another body of professionals might have to fulfil or help in fulfilling the desired role. In this case, it could be that non-executive directors, acting through various corporate governance mechanisms, are asked to help ensure that financial statements are reliable.

#### *References*

- Fabro, A 2003, 'Re-think urged on regulation', *The Australian Financial Review*, 24 March, p. 3.  
Flint, D 1988, *Philosophy and Principles of Auditing: An Introduction*, McMillan, London.  
Hewson, J 2002, 'Market the key regulator', *The Australian Financial Review*, 19 July, p. 82.  
Pheasant, B 2002, 'Business resists governance by black-letter law', *The Australian Financial Review*, 15 August, p. 68.