

Addis Ababa
University
(Since 1950)



ADDIS ABABA UNIVERSITY SCHOOL OF GRADUATE STUDIES SCHOOL OF LAW

**Ensuring Good Corporate Governance through Auditors: Appraisal of the Ethiopian
Legal Regime Governing their Roles and Responsibilities**

By: Dureti Abate

May, 2016

**ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES
SCHOOL OF LAW**

**Ensuring Good Corporate Governance through Auditors: Appraisal of the Ethiopian
Legal Regime Governing their Roles and Responsibilities**

**A Thesis Submitted In Partial Fulfilment of the
Requirement for Degree of Master of Laws (LL.M) In Business Law**

By: Dureti Abate

Advisor: Zekarias Keneaa (Associate Professor)

May, 2016

**ADDIS ABABA UNIVERSITY
SCHOOL OF GRADUATE STUDIES
SCHOOL OF LAW**

(Approval Sheet)

**Ensuring Good Corporate Governance through Auditors: Appraisal of the Ethiopian
Legal Regime Governing their Roles and Responsibilities**

**A Thesis Submitted In Partial Fulfilment of the
Requirement for Degree of Master of Laws (LL.M) In Business Law**

By: Dureti Abate

**Approved by
Board of Examiners**

1. **Zekarias Keneaa (Associate Professor)**

Advisor's Name

Signature

2. **Fekadu Petros (Assistant Professor)**

Examiner's/ Reader's Name

Signature

3. **Tewodros Meheret (Assistant Professor)**

Examiner's/ Reader's Name

Signature

Declaration

I, the undersigned, declare that this thesis is my original work, has not been presented for a degree in any other university and that all materials used have been duly acknowledged.

Declared by:

Name: Dureti Abate

Signature: _____

Date: _____

Name of Advisor: Zekarias Keneaa (Associate Professor)

Signature: _____

Date: _____

Acknowledgement

First of all I would like to praise the Lord, Jesus.

I am deeply grateful to my advisor Zekarias Keneaa (Associate Professor) for his professional guidance, invaluable comments and unreserved support. This thesis would not have been completed without his support and guidance.

I would also like to thank Mr. Demelash Debele and Mr. Yohannes Nigatu from the Accounting and Auditing Board of Ethiopia for their cooperation in explaining questions related to the Board and providing materials.

I am also thankful Teklework Ayalew, Roza Bargicho, Zelalem Fekadu and Nahom Shewangizaw for assisting me in gathering materials for the study and all my friends for their encouragement.

I am thankful to my employer, Dilla University, for sponsoring me during the entire study period.

Last, but not least, I would like to extend my special gratitude to my family for their support.

TABLE OF CONTENTS

Abstract	i
Acronyms	ii
CHAPTER ONE.....	1
INTRODUCTION	1
1.1 Background Of The Study	1
1.2 Statement Of The Problem And Research Questions	4
1.3 Objectives Of The Study	8
1.3.1 General Objective	8
1.3.2 Specific Objectives	8
1.4 Significance Of The Study.....	8
1.5 Scope Of The Study	8
1.6 Methodology Of The Study	9
1.7 Limitations Of The Study.....	9
CHAPTER TWO.....	10
THE NOTIONS OF CORPORATE GOVERNANCE AND AUDITING.....	10
2.1 The Notion of Corporate Governance	10
2.2 Why Corporate Governance Matters.....	12
2.3 Significance of Good Corporate Governance.....	13
2.4 Corporate Governance Frameworks.....	14
2.5 The Notion of Audit and Auditor.....	15
2.5.1 Types of Audits	16
2.5.2 The Notion of Auditor	17
2.5.3 Types of Auditors	18
2.6 The Need for Audit of Financial Statements by an External Auditor.....	19
2.7 The Link between Audit and Corporate Governance.....	20
CHAPTER THREE.....	21
ENSURING GOOD CORPORATE GOVERNANCE THROUGH AUDITORS	21
3.1 The Role of Auditors in Ensuring Good Corporate Governance.....	21
3.2 Mechanisms of Ensuring Good Corporate Governance through Auditors	22
3.2.1 Reduction of Conflict of Interest.....	22

3.2.2	Limits on Multiple Roles and Services by Auditors.....	23
3.2.2.1	Approaches to Limiting Non Audit Services	25
3.2.3	Disclosure of Non Audit Services by Auditors.....	26
3.2.4	Setting Audit Tenure and Restricting Personnel Flow	26
3.2.5	Audit Committees	27
3.2.5.1	Role of audit committees	28
3.2.5.2	Audit Committee Membership, Size and Expertise	30
3.2.5.3	Enhancing Effectiveness of Audit Committees.....	31
3.2.6	Determining the Body to Hire and Compensate Auditors	33
3.2.7	Oversight of Auditors.....	34
3.2.7.1	Oversight of Qualification.....	36
3.2.8	Non Financial Statement Audit	36
3.2.9	Accountability and Reporting Mechanism	37
CHAPTER FOUR		39
APPRAISAL OF THE ETHIOPIAN LEGAL REGIME GOVERNING THE ROLES AND RESPONSIBILITIES OF AUDITORS		39
4.1	Overview of the Ethiopian Legal Framework on Corporate Governance and Auditors.....	39
4.2	The Roles and Responsibilities of Auditors under the 1960 Commercial Code	39
4.3	Assessment of the Commercial Code Provisions Governing the Roles and Responsibilities of Auditors in Light of the OECD Principles of Corporate Governance.....	41
4.4	Appraisal of Provisions Governing Auditors under the Commercial Code.....	43
4.4.1	Appointment of Auditors	44
4.4.2	Personnel Flow	44
4.4.3	Non Audit Services.....	45
4.4.3.1	Auditors as Interim Managers.....	47
4.4.4	Setting Audit Tenure and Auditor’s Rotation	47
4.4.5	Excluding Individuals Affiliated to the Audit Client from the Role of Auditing	48
4.5	Audit Committee.....	50
4.5.1	Audit Committee Composition and Membership.....	50
4.6	Auditors in the Financial Sector	52
4.6.1	Appointment of Auditors	52
4.6.2	Persons Incompetent to Be Auditors of Companies in the Financial Sector	53
4.7	Auditors of Private Limited Companies.....	54

4.7 The Role of Auditors in the Protection of Minority Shareholders.....	56
4.9 Oversight of Auditors.....	58
4.9.1 Overview of the Roles of the Accounting and Auditing Board of Ethiopia (AABE)	58
4.10 Auditors' Responsibilities	60
4.11 Auditing Standards.....	61
4.12 Concluding Remarks and Recommendations	62
4.12.1 Conclusion.....	62
4.12.2 Recommendations.....	66
Bibliography.....	69

Abstract

Business organizations of the company form are the preferred mode of running business in modern society and they are considered one of the ingenious creations. The limited liability attribute of such organizations and the opportunity they provide for the public to pool resources together are the main traits that make them appealing. Inasmuch as companies offer the privilege of limited liability to their members and enable individuals to pool their resources, they also pose threat to creditors and members are usually forced to entrust management of their resources in the hands of few individuals. The special threats of companies and their significance in the economy compel putting in place legal framework that promotes good corporate governance.

The problems of separation of ownership and control and threats to creditors are rectified by a check and balance mechanism of audit. Auditors are regarded as watchdogs of a company and they provide checks on the affairs of management, safeguarding shareholders and other stakeholders both from fraud and genuine mistakes. The conduct of audit enhances reliability of financial statements and can bring problems within the company to the attention of concerned bodies before crisis occurs.

However, for auditors to discharge their duties as watchdogs of the company there needs to be a legal regime that effectively governs their roles and responsibilities. In the absence of effective laws that enhance the role of auditors in ensuring good corporate governance, they can be put in a difficult place where they can not discharge their responsibilities but rather further the interest of managers or their own personal interest. History has witnessed the collapse of companies around the world and in the wake, there have been various legal reforms focusing on how to best enable auditors discharge their duties and foster the good corporate governance of the companies.

How to best ensure good corporate governance through auditors in various laws and corporate governance codes are dealt through mechanisms of ensuring their objectivity and effectiveness since checking the work of management is based on independence from management. The exclusion of individuals affiliated to members of a company from involving in audit of the company, prohibition of auditors from rendering certain types of services to their audit client, rules on appointment procedures and the forming of independent audit committees are measures taken in different countries in order to ensure good corporate governance through auditors.

This work studies how to ensure good corporate governance of companies through external auditors and assesses the existing Ethiopian legal regime governing their roles and responsibilities to this end. It examines whether the legal frameworks foster the external auditors' role in promoting good corporate governance of Ethiopian companies. The study was conducted based on legislative and comparative analysis. The findings of the study show that there are different possible ways to enhance the role of auditors in ensuring good corporate governance. It also shows that the current legal regime governing companies acknowledges external auditors have a very significant role in bringing about the good corporate governance of companies and there also exist some ongoing reforms. Finally, this work provides some recommendations which the writer considers appropriate.

Acronyms

AABE	Accounting and Auditing Board of Ethiopia
CPA	Certified Public Accountant
IOSCO	International Organization of Securities Commissions
NBE	National Bank of Ethiopia
OECD	Organization for Economic Cooperation and Development
OFAG	Office of the Federal Auditor General
PLCs	Private Limited Companies
SOX	Sarbanes Oxley Act
UK	United Kingdom
US	United States

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Corporate governance is an eclectic subject and the relevant literature is found in several disciplines, including accounting, business management, economics, finance, law, psychology, political science and sociology.¹ There is accordingly no single definition of corporate governance that can be applied to all situations and jurisdictions. The various definitions that exist today largely depend on the institution, author, country and legal tradition.²

The International Financial Corporation defines corporate governance as the structures and processes for the direction and control of companies.³

The United Kingdom's Code of corporate governance defines it as the system by which companies are directed and controlled.⁴ Corporate governance is also defined as the system by which a business corporation is directed and controlled at its senior level in order to achieve its objectives, performance and financial management, accountability and integrity.⁵

A somewhat broader definition would be to define corporate governance as a set of mechanisms through which firms operate when ownership is separated from management.⁶

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders and provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.⁷

Corporate governance refers to all issues related to ownership and control of corporate property, the rights of shareholders and management, powers and responsibilities of the board of directors, disclosure and transparency of corporate information, the protection of interests of stakeholders that are not shareholders and enforcement of rights.⁸ Corporate governance is not limited to rules

¹ Minga Negash, "Corporate Governance and Ownership Structure: The case of Ethiopia", Ethiopian E-Journal for Research and Innovation Foresight, vol.5, no.1 (2013), p. 33.

² The International Finance Corporation Corporate Governance Manual, (2nd ed. 2010), BACSON, Hanoi, P.6

³ Ibid

⁴ The UK corporate governance code(2014) p.1

⁵ T.Karagiorgos, G.Drogalas , E. Gotzamanis and I. Tampakoudis , "Internal Auditing as an Effective Tool for Corporate Governance " , Journal of Business Management , vol.2, no.1 (2010), p.18

⁶ Stijn Claessens, Corporate Governance and Development (2003), IBRD , Washington DC, p.5

⁷ Organization for Economic Cooperation and Development (OECD)Principles of Corporate Governance (2004), p.11

⁸ Hussein Ahmed, "Overview of Corporate Governance In Ethiopia: The Role, Composition and Remuneration of Boards of Directors in Share Companies", Mizan Law Review , vol. 6, no.1 (2012) , p.48

prescribing how boards of directors operate but extends to the control mechanisms used to reconcile company managers' interests and shareholders' interests which in other words means it deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.⁹

When companies fail as a result of poor corporate governance, losses through their failures are felt not only by shareholders. Since employees lose their jobs, their families lose their livelihood, the consumers lose choice of products, the suppliers lose customers, and the whole economy of a country may possibly suffer as a consequence.¹⁰ Every corporation saved from failure preserves precious jobs and sustains the economy.¹¹ Corporate governance is a key element in improving economic efficiency and growth as well as enhancing investor confidence.¹² The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy and attract more investors whose support can help to finance further growth.¹³ The Organization for Economic Cooperation and Development (OECD) principles of corporate governance hereinafter (OECD principles), also state that corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence.¹⁴ The role of auditors in ensuring that international standards of accounting and reporting are adhered to by corporations is a fundamental element of this principle.¹⁵ The board of directors, the audit committee, the external auditor, and the internal audit process constitute major factors of corporate governance.¹⁶ Corporate auditing is one of the mechanisms of proving assurance to the investors and other stakeholders. The principal characteristics of ensuring effective corporate governance such as transparency, accountability and integrity are enhanced with conduct of audit into the affairs of a corporation.¹⁷ In fact accountability, integrity and transparency are provided in the different definitions of corporate governance as its basic component. Framework of effective accountability that does not impede boards to drive their companies forward is the essence of any system of good corporate governance.¹⁸

⁹ Jean Paul, Corporate governance and Value Creation (2005), The Research Foundation of CFA Institute, USA, p.1

¹⁰ Commonwealth Association for Corporate Governance Guidelines (CACG) Principles For Corporate Governance In The Commonwealth (1999), p.15

¹¹ Ibid

¹² Using the OECD Principles of Corporate Governance: A Boardroom Perspective, (2008), P. 103

¹³ Ibid

¹⁴ OECD principles, Supra note7

¹⁵ CACG Guidelines, Supra note 10, p.15

¹⁶ Karagiorgos et al., Supra note 5, p. 15

¹⁷ James O. Alabede, "The Role, Compromise and Problems of the External Auditor in Corporate Governance", Research Journal of Finance and Accounting, Vol. 3, no. 9 (2012), p. 115

¹⁸ The Cadbury Committee Report on the Financial Aspects of Corporate Governance, (1992), p.10

Audit can be defined as the process by which a competent independent person objectively obtains and evaluates evidence regarding assertions about economic activity or event for the purpose of forming an opinion about and reporting on the degree to which the assertion conforms to an identical set of standards.¹⁹ It is a reassurance to all who have a financial interest in companies, quite apart from their value to boards of directors. The most direct method of ensuring that companies are accountable for their actions is through open disclosure by boards and through audits carried out against strict accounting standards.²⁰ The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders²¹ and the financial audit remains an important aspect of corporate governance that makes management accountable to shareholders for its stewardship of a company.²²

Audit is one of the cornerstones of corporate governance.²³ Given the separation of ownership from management, the directors are required to report on their stewardship by means of the annual report and financial statements sent to the shareholders.²⁴ The audit provides an external and objective check on the way in which the financial statements have been prepared and presented, and it is an essential part of the checks and balances required.²⁵ Auditors, persons who conduct audit professionally, have been seen as playing an important role in ensuring corporate integrity.²⁶ The external auditor's responsibilities and the audit committee's role in corporate governance are therefore fundamental in helping to achieve the desired aims of corporate governance.²⁷

The corporate climate in Ethiopia is changing with the emergence of newer companies with several thousand shareholders who have no control over the company giving rise to the "ownership of wealth without appreciable control and control of wealth without appreciable ownership".²⁸ This, in other words, means the corporate climate has opened up to the age old agency problem whereby owners have an interest in maximizing the value of their shares whereas managers tend to be more interested in the private consumption of company's resources. The aforementioned need for external checks and balances by auditors is therefore an important factor that has to be considered in corporate governance of Ethiopian companies.

¹⁹ A. C. Fernando, *Corporate Governance: Principles, Policies and Practices*, (2006), Pearson Education, India, p. 226.

²⁰ The Cadbury Committee Report, *Supra* note 18, p.41

²¹ *Ibid*, p.47

²² Ojo Marianne, *The Role of External Auditors in Corporate Governance: Agency Problems and the Management of Risk*, (2009), p. 5, available at: <http://mpira.ub.uni-muenchen.de/15989/>

²³ The Cadbury Committee Report, *supra* note 18, p.35

²⁴ *Ibid*

²⁵ *Ibid*

²⁶ Roman Tomasic, *The failure of corporate governance and the limits of law : British Banks and the Global Financial Crisis in Corporate Governance and the Global Financial Crisis : International Perspectives*, (2011), p. 52

²⁷ Marianne, *Supra* note 22 p. 7

²⁸ Fekadu Petros, "Emerging Separation of Ownership and Control in Ethiopian Share Companies: Legal and Policy Implications", *Mizan Law Review*, vol.4 no.1(2010), p.27

Developments in corporate governance thinking and practice have often been responses to company collapses, corporate corruption or the domination of companies by an individual.²⁹ The US Sarbanes-Oxley Act was a response to the collapses of Enron.³⁰ The collapse of Arthur Andersen, one of the five big international audit firms, following the Enron debacle, has swung the spotlight onto the role that external auditors play in the corporate governance.³¹ Independent external auditors now play a fundamental part in corporate governance processes.³² There is no question regarding whether there should be an audit, but what matters is how to ensure its objectivity and effectiveness.³³

The very purpose of this research is therefore to examine the role and responsibilities of auditors under Ethiopian laws and see if there are any improvements that need to be made by surveying the role of auditors in foreign jurisdiction, prominent principles of corporate governance and best practices to come up with results that will enhance the role of auditors in ensuring good corporate governance of Ethiopian companies.

1.2 Statement of the Problem and Research Questions

Auditors have been seen as playing an important role in ensuring corporate integrity. However, their failure to prevent misconduct related to conflict of interests and restrain abuses in the accounting practices have undermined their effectiveness.³⁴ While expected to be the watchdogs of the organisation, they are often bought in by managements through some profitable assignments.³⁵ This has led to the rise of the concept of corporate governance which is about promoting corporate fairness, transparency and accountability relating to various participants in an organisation.³⁶ Recent unearthing of corporate frauds in developed countries, developing and transitional economies revealed the fact that auditors had failed to do what they were assigned to do.³⁷ They involved themselves in unethical practices and failed to whistle blow when things went wrong in organizations.³⁸

The 1960 Commercial Code of Ethiopia, hereinafter the Code, has basic rules governing auditors of companies. Despite change in regime and commercial environment, the Code still remains to be the major body of law governing business organizations in general and auditors in particular.

²⁹ R. I. Tricker Twenty Practical Steps to Better Corporate Governance, (2010), p.5

³⁰ Ibid

³¹ Ibid p.16

³² Ibid

³³ The Cadbury Committee Report, supra note 18, p.35

³⁴ Tomasic, supra note 26, p. 52

³⁵ Fernando, Supra note 19, p.226

³⁶ Ibid

³⁷ Ibid

³⁸ Ibid

The Accounting and Auditing Board of Ethiopia (AABE) is the body with oversight power over auditors, auditing standards and their code of conduct. This Board, established under the financial reporting Proclamation No. 847/2009 and subsequent Regulation No.332/2014 is entrusted with the power to issue directives on a wide range of oversight issues and has taken some of the powers of the Office of the Federal General Auditor. The National Bank of Ethiopia (NBE) has also issued directive on the approval of appointment of independent auditor for companies engaged in the financial sector. A corporate governance directive for banks and insurance companies has been enacted and a similar directive for microfinance institutions is also found at a draft stage. A directive of such kind with specific focus on corporate governance is not in place for companies engaged in other sectors of the economy. The Code thus remains to be the major body of law dictating the corporate governance of such companies.

The Code provides auditors as a mandatory organ of share companies and private limited companies (PLCs) with more than twenty members. The provisions governing auditors of PLCs are not as detailed as those governing share companies. Besides, PLCs with less than twenty members are not obliged to have auditors. Although the Code was enacted over five decades ago, currently, the overwhelming majority of companies in the country are PLCs formed according to the Code which are held by family members or other closely related persons.³⁹

In an attempt to cover every possible situation whereby a share company may be left without directors in a certain financial year, the Code provides that auditors shall carry on management of the company until a general meeting is called by them for the appointment of directors.⁴⁰ Such an arrangement would technically mean there could be circumstances whereby auditors are left to audit their own activities. Resolving conflict of interest and ensuring independence in such cases would be difficult to achieve.

The main tasks of auditors in the Code are related to auditing and verifying balance sheets and reports of the board of directors⁴¹ whereas most countries require auditors of companies engaged in the financial sectors to verify not only information relating to the financial condition but also compliance of the companies operations with regulatory requirements.⁴²

Provision of non audit services by auditors of a company to the same is another concern in ensuring good corporate governance through auditors. The collapse of big companies like Enron and Arthur

³⁹ Ethiopia Commercial Law and Institutional Reform and Trade Diagnostic_ (2007), USAID, p.19

⁴⁰ Commercial code of The Empire of Ethiopia, 1960, Art .351, proc. No. 166, Neg. Gaz., year 19 , no 3

⁴¹ Ibid, Art. 374

⁴² Solomon Abay, Financial Market Development, Policy And Regulation: The International Experience And Ethiopia's Need For Further Reform. (2011), p. 99

Anderson in the west has been attributed to such provision of multiple services by auditors. Limitations on non audit services that auditors may provide to the company they audit is a key concept under prominent corporate governance codes.⁴³ The Ethiopian Commercial Code provides for list of persons who may not serve as auditors of a company and prohibits auditors from serving as directors or managers of the company they audited, its subsidiaries or holding companies within three years after termination of their services.⁴⁴ Individuals who receive periodical remuneration from directors of a company, the subsidiary or holding company, founders, contributors in kind and beneficiaries holding special interest for rendering non audit services are prohibited from becoming auditors. Other stipulations as to non audit services they may and may not provide during their terms of service or after its termination is not clearly provided for.

A study conducted by Wolderuphael Woldegiorgis in 1978 on the role of auditors under Ethiopian laws particularly focusing on public enterprises, pointed out lack of uniformity in the auditing standards, absence of laws on licensing and qualification requirements as the major problems concerning the role of auditors under Ethiopian laws.⁴⁵

However, the legal and economic conditions of the country have changed and different legislations regulating the role of auditors have been put in place especially for the financial sector. Corporate governance principles and guidelines have also developed around the world since then. Concerns revealed by the work mentioned above which was conducted during the military regime also needs to be re examined in light of the new laws that to some extent attempted to tackle few of the problems tied to auditing. In addition, the study did not assess the role of auditors from the view point of ensuring good corporate governance.

A research conducted to find out the practice of some private auditors in exercising the professional and legal responsibility of auditing in Ethiopia disclosed that private auditors have been producing misleading audited financial statements by reporting assets that do not exist, considering or not disclosing inadequate provision for doubtful debts, not disclosing misapplication of accounting principles, expressing the audit opinion based on the client's interest and others mostly for the sake of personal financial interest.⁴⁶ It also revealed that there had been instances where auditors have been sanctioned by the regulatory body for violating their professional responsibility.⁴⁷

⁴³ Sarbanes-Oxley Act of 2002 (SOX), section 201(a) and The UK corporate governance code (2014) c.3.8

⁴⁴ Commercial code, Supra note 40, Art. 370

⁴⁵ Wolderuphael Woldegiorgis, The Role of Auditors under Ethiopian Laws, (1978, unpublished, Faculty of Law, HaileSelassie I University), p.83

⁴⁶ Muluneh Beyene, Auditors Professional Responsibilities and Legal Liability with Regard to Private Auditors in Ethiopia, (2007, unpublished, Department of Accounting and Finance A.A.U), p.5

⁴⁷ Ibid

The aforementioned study on the role of auditors under Ethiopian laws revealed that auditing has remained inadequate both qualitatively and quantitatively despite its importance to shareholders, bankers, creditors, prospective investors, labour unions and the government mainly as a result of lack of uniform or accepted accounting principles and auditing standards.⁴⁸

External auditor's role in corporate governance is a fundamental complement in helping to achieve good corporate governance and safeguards are necessary to ensure that their expertise is maximised.⁴⁹ To have a check on auditor's role and to prevent them from unethical practices, governments and regulatory bodies have come out with many regulations, re establishing corporate accountability and reinforcing investor confidence.⁵⁰

The previously mentioned work on auditors' professional responsibility in Ethiopian is focused on the practice.

A study examining the role of auditors in relation to good corporate governance of Ethiopian companies has not been done so far.

The purpose of this research is therefore to appraise the different Ethiopian laws governing auditors' roles and responsibilities and examine whether good corporate governance can be achieved through them.

Hence, this study will attempt to assess the roles and responsibilities of auditors under Ethiopian laws in light of prominent good corporate governance principles, codes, and best practices.

Accordingly, the research questions are;

1. What are the roles and responsibilities of auditors under Ethiopian laws?
2. What mechanisms exist to enhance the role of auditors in ensuring good corporate governance?
3. How are auditors regulated?
4. Does the existing Ethiopian legal regime on the roles and responsibilities of auditors promote/ensure good corporate governance?
5. What should be done to ensure good corporate governance through auditors?

⁴⁸ Wolderuphael, supra note 45, p.82

⁴⁹ Marianne, Supra note 22, p.7

⁵⁰ Fernando, supra note 19, p. 226

1.3 Objectives of the Study

1.3.1 General Objective

The main objective of the study is to examine how to ensure good corporate governance through auditors and to appraise the existing Ethiopian legal regime governing their roles and responsibilities in this regard.

1.3.2 Specific Objectives

The study has the following specific objectives:

- To examine how prominent corporate governance codes address the roles and responsibilities of auditors and try to ensure good corporate governance through them.
- To explore the roles and responsibilities of auditors under Ethiopian laws
- To assess the roles and responsibilities of auditors under Ethiopian law in light of well developed corporate governance principles.
- To assess whether the roles and responsibilities of auditors under Ethiopian law promote good corporate governance

1.4 Significance of the Study

The examination of the laws and the analysis to be made under this study is hoped would serve academic purpose. It is also hoped that the study will inform policy makers and legislators and assist them in making decisions in relation to auditors in the forthcoming overhauling of Ethiopian Commercial Code. At the same time, the research will point out areas that require further research as well, adding to the academic significance. To

1.5 Scope of the Study

The study focuses on the role of external auditors (private auditors) of share companies and private limited companies. It does not examine the roles of auditors for public enterprises or other governmental institutions since corporate governance issues in such institutions take a different form, mainly related to accountability, transparency and proper utilization of budget allocated to them by the government. The study is thus limited to appraisal of the laws governing external auditors in relation to privately held companies. Neither is internal audit the focus of the thesis.

1.6 Methodology of the Study

The major methodology to be employed in conducting this research will be analysis of legal provisions of the Commercial Code and other laws in the area of study. To this end review of published and unpublished materials, journals, and books will be made. A comparative approach with prominent corporate governance systems will also be employed in the due course of the research. This qualitative approach is hoped to best address the research questions the study aims to answer.

1.7 Limitations of the Study

The researcher has faced different challenges in conducting the study. These challenges, among others, include the scarcity of materials in the area of study, shortage of time and the fact that laws below Regulations in the hierarchy of laws are not made available to the public.

The absence of an organized system to assist in distinguishing among operative and repealed laws has also posed the writer difficulty in conducting the research. The writer has also attempted to access background documents of legislation but such documents are mostly unavailable. Yet, the writer believes the work has examined and appraised the relevant existing Ethiopian legal regime in light of the issue at hand.

CHAPTER TWO

THE NOTIONS OF CORPORATE GOVERNANCE AND AUDITING

2.1 The Notion of Corporate Governance

The notion of corporate governance has been around for a long time.⁵¹ As stated in the introduction, it is an eclectic subject the relevant literature of which is found in several disciplines and the various definitions present largely depend on the institution, author, country and legal tradition.

According to the OECD principles of corporate governance, corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders and provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.⁵²

Corporate governance refers to all issues related to ownership and control of corporate property, the rights of shareholders and management, powers and responsibilities of the board of directors, disclosure and transparency of corporate information, the protection of interests of stakeholders that are not shareholders and enforcement of rights.⁵³ It is not limited to rules prescribing how boards of directors operate but extends to the control mechanisms used to reconcile company managers' interests and shareholders' interests which in other words means it deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.⁵⁴

The Cadbury report defines it as a set of mechanisms through which firms operate when ownership is separated from management and the system of direction and control of a company.⁵⁵ It focuses on a company's structure and processes to ensure fair, responsible, transparent and accountable corporate behaviour.⁵⁶

⁵¹ Bob Garratt, Why Corporate Governance Matters and How to Measure and Improve Board Performance (2006), Nicholas Brealey publishing, UK, P. 33

⁵² OECD principle, supra note 7, p.11

⁵³ Hussein, Supra note 8, p.48

⁵⁴ Paul, supra note 9, p.1

⁵⁵ The Cadbury Committee Report, supra note 18, p.24

⁵⁶ Ibid

Some define corporate governance as the appropriate board structures, processes and values to cope with the rapidly changing demands of both shareholders and stakeholders in and around their enterprises.⁵⁷

What can be concluded from the various definitions available is that there is no uniform scope or content of corporate governance.⁵⁸ Some focus on the link between shareholders and the company; some concentrate on the formal structure of the board, codes of board practice and corporate effectiveness ; yet others believe the focus should be on the social responsibilities of corporations to a wider set of stakeholders.⁵⁹

From the academic point of view corporate governance focuses on some structures and mechanisms that would ensure the proper internal structure and rules of the board of directors; creation of independent committees; rules for disclosure of information to shareholders and creditors; transparency of operations and an impeccable process of decision making; and control of management.⁶⁰ Operationally speaking, corporate governance is composed of activities of various kinds, strategic, supervision, auditing, control, and evaluation.⁶¹

Corporate governance has traditionally focused on the problem of the separation of ownership by shareholders and control by management.⁶² But with the passage of time, experiences gained from historical developments of corporate wrongs and with the impact of a growing vision of society, the framework of corporate governance has increasingly broadened.⁶³ It is now accepted that firms should respond to the expectations of more categories of stakeholders which include employees, consumers, government and the society as a whole.⁶⁴

There are ongoing debates on which among the age old shareholders approach and recent broad stakeholders approach a particular system should adopt.⁶⁵ However, from the point of view of ease for implementation, the shareholder approach, particularly, making the accountability of the company governors to the shareholders is considered easier for implementation.⁶⁶ In general, the term

⁵⁷ Garratt, Supra note 51, p.2

⁵⁸ Fernando, Supra note 19,p.52

⁵⁹ Ibid

⁶⁰ Ibid p 9

⁶¹ A. Naciri (ed.), Corporate Governance around the World, (2008), Routledge , New York, P.9

⁶² Fernando, Supra note 19, p.18

⁶³ Ibid

⁶⁴ Ibid

⁶⁵ F" Ç ' @_éS, yx!T x' !Ä yk#ENÄ HG,(2004> .M) g} 124

⁶⁶ Ibid

corporate governance is a useful umbrella term to cover the exercise of power over and within the company, for the good of all concerned.⁶⁷

From the different definitions of corporate governance it can be concluded that what lies at the heart of the notion of corporate governance is the protection of the interest of shareholders and other stakeholders as the case may be and accountability of management and the board of directors.

2.2 Why Corporate Governance Matters

Corporate governance has become a more important policy issue in many countries.⁶⁸ Organizations in modern economies were granted extraordinary privileges allowing them to participate effectively in social and economic human advances.⁶⁹ Business organizations of the company model prove to be one of the most ingenious human organizational creations and they are today shaping every facet of people's lives in a non measurable way.⁷⁰ On the other hand, recent history indicates that private organizations are also invading political grounds and they are directly impacting politics as well as development and it is only a matter of fairness, to require some minimum level of good governance from them as it is also a matter of economic growth, democracy and social justice.⁷¹

Another reason is the proliferation of scandals and crises.⁷² Recent financial audacious frauds among western corporations were surprising by both their impact and ingeniousness, drawing attention on the dramatic consequences of weak corporate governance and giving governance issues urgent priority.⁷³ Such frauds have underscored the critical importance of structural reforms in the governance of companies.⁷⁴ Although most corporate controversies occurred in the western corporations, they exist in other economies of the world as well.⁷⁵ Successive business failures and frauds in the United States, several high profile scandals in Russia and Asian crisis have brought corporate governance issues to the forefront in developing countries and transitional economies as well.⁷⁶ The scandals also show that corporate governance issues transcend national boundaries.⁷⁷ They are in fact considered as

⁶⁷ Fernando, Supra note 19, p.52

⁶⁸ Claessen, Supra note 6, p.6

⁶⁹ Naciri, Supra note 61, P. 344

⁷⁰ Ibid, p. 2

⁷¹ Ibid

⁷² Claessen, Supra note 6, P.6

⁷³ Naciri, supra note 61, P. 346

⁷⁴ Ibid

⁷⁵ Ibid

⁷⁶ Fernando, supra note 19, p 12

⁷⁷ Naciri, supra note 61, P. 346

manifestations of a number of reasons why the subject has become more important for economic development.⁷⁸

Increase in importance of private, market-based investment process underpinned by good corporate governance for most economies has also raised corporate governance issues in sectors that were previously state held.⁷⁹ Firms have gone to the public markets to seek capital and mobilization of capital is increasingly one step removed from the principal owner and the increasing size of firms in turn increases the need for good corporate governance.⁸⁰

International financial integration, increase in trade and investment flows leading to many cross-border issues in corporate governance, technological progress, liberalization and opening up of financial markets, trade liberalization, and other structural reforms make good governance more important, but also more difficult.⁸¹

2.3 Significance of Good Corporate Governance

Good corporate governance is important on a number of different levels. At the company level, well-governed companies tend to have better and cheaper access to capital and outperform their poorly governed peers over the long-term.⁸² This is mainly because the level of risk assigned to the company by investors is directly proportional to the cost of capital and by reducing risks such as investors' rights violation; companies with strong corporate governance structure and practice reduce cost of equity and debt capital.⁸³

Investors, especially creditors, have recently tended to include a company's corporate governance practices such as a transparent ownership structure and appropriate financial reporting as key criteria in their investment decision making process.⁸⁴ Therefore, corporate governance practices can determine the ease with which companies are able to access capital which in turn results in higher growth and greater employment.⁸⁵

Corporate governance improves the management and oversight of executive performance and accountability combined with effective risk management can bring potential problems to the forefront

⁷⁸ Claessen, Supra note 6, P.6

⁷⁹ Ibid

⁸⁰ Ibid, p. 7

⁸¹ Ibid

⁸² The International Finance Corporation, supra note 2, p.17

⁸³ Ibid, P.20

⁸⁴ Ibid

⁸⁵ Claessen, Supra note 6, p.14

before crisis occurs.⁸⁶ The economic and social costs of financial crisis can be prevented in such manner.

Adherence to good corporate governance standards also helps to improve the decision-making process.⁸⁷ High quality corporate governance streamlines all the company's business processes, and this leads to better performance and lower capital expenditures which in turn may contribute to the growth of the company.⁸⁸

The better the corporate governance structure and practices, the more likely that assets are being used in the interest of shareholders and not misused by managers.⁸⁹

Corporate governance in companies plays a crucial role in emerging economies, which often do not have as good a system of enforcing investors' rights as countries with developed market economies.⁹⁰

Good corporate governance practices contribute to and improve a company's reputation.⁹¹ This would mean the company, through its good will, will enjoy greater trust, valuation and ultimately profits.

Good corporate governance results in better operational performance through better allocation of resources and better management resulting in wealth.⁹²

Generally, well-governed companies are better contributors to the national economy and society.⁹³

They tend to be healthier companies that add more value to shareholders, workers, communities, and countries in contrast with poorly governed companies that may cause job and pension losses, and even undermine confidence in securities markets where one exists.⁹⁴

2.4 Corporate Governance Frameworks

Corporate governance frameworks typically comprise elements of legislation, regulation, self-regulatory arrangements, voluntary commitments and business practices that are the result of country specific circumstances, history and tradition.⁹⁵ The efficiency or otherwise of the governance system will directly depend on the framework conditions and the desirable mix between elements of the framework will vary from country to country.⁹⁶ As new experiences accrue and business circumstances

⁸⁶ The International Finance Corporation, supra note 2, P. 18

⁸⁷ Ibid

⁸⁸ Ibid

⁸⁹ Ibid, P. 19

⁹⁰ Ibid, P. 21

⁹¹ Ibid, P. 22

⁹² Claessen, Supra note 6, p. 14

⁹³ The International Finance Corporation, supra note 2, P. 17

⁹⁴ Ibid

⁹⁵ Ibid, P. 32

⁹⁶ Ibid

change, the content and structure of this framework needs to be adjusted.⁹⁷ Companies will need to carefully monitor such adjustments on a regular basis and update their governance systems accordingly.⁹⁸

Governments play a crucial role in making the legal, institutional and regulatory framework within which governance systems are kept in place.⁹⁹

In many legal systems and prominent corporate governance principles, regulations are usually found as legal requirements where no deviation is allowed, comply or explain rules where any deviation needs to be accompanied by the reason for deviation and suggestions which are recommendation that companies are at liberty not to adhere to if they wish without owing any explanation.

2.5 The Notion of Audit and Auditor

Audit is the process by which a competent independent person, an auditor, objectively obtains and evaluates evidence regarding assertions about economic activity or event for the purpose of forming an opinion about and reporting on the degree to which the assertion conforms to an identical set of standards.¹⁰⁰ Black's Law Dictionary defines audit as a formal examination of an individual's or organization's accounting records, financial situation, or compliance with some other set of standards.

Although the objectives and concepts that guide contemporary audits were almost unknown in the early years of the 20th century, audits of one type or another have been performed throughout the recorded history of commerce and government finance.¹⁰¹

The original meaning of the word auditor was "one who hears" and was appropriate to the era during which governmental accounting records were approved only after a public reading in which the accounts were read aloud.¹⁰²

During the industrial revolution, as manufacturing concerns grew in size, their owners began to use the services of hired managers.¹⁰³ With this separation of the ownership and management groups, the

⁹⁷ Ibid

⁹⁸ Ibid

⁹⁹ Fernando, Supra note 19, p. 16

¹⁰⁰ Ibid, p. 226

¹⁰¹ O.Ray Whittington and Kurt Pany, Principles of Auditing and Other Assurance Services (13th ed.2001), McGraw-Hill companies Inc., p.8

¹⁰² Ibid

¹⁰³ Ibid

absentee owners turned increasingly to auditors to protect themselves against the danger of unintentional errors as well as fraud committed by managers and employees.¹⁰⁴

Before 1900, consistent with this primary objective to detect errors and fraud, audits often included a study of all, or almost all, recorded transactions.¹⁰⁵ However, in the first half of the 20th century, in response to the increasing number of shareholder and corresponding increased size of corporate entities, the direction of audit work tended to move away from fraud detection toward a new goal of determining whether financial statements gave a full and fair picture of financial position, operating results, and changes in financial position.¹⁰⁶

In addition to the new shareholders, auditors became more responsible to governmental agencies, stock exchanges representing these new investors, as well as to other parties who might rely upon the financial information.¹⁰⁷

The word audited when applied to financial statements, means that the balance sheet and the statements of income and cash flows are accompanied by an audit report prepared by independent public accountants, expressing their professional opinion as to the fairness of the company's financial statements.¹⁰⁸

2.5.1 Types of Audits

- i. Audits of financial statements: This type of audit ordinarily covers the balance sheet and the related statements of income.¹⁰⁹ The goal is to determine whether these statements have been prepared in conformity with a certain standard in use.¹¹⁰ Management, investors, bankers, creditors, financial analysts and government agencies are usually users of such audits.¹¹¹
- ii. Compliance audit: This is an audit to determine the company being audited is complying with criteria or standards such as laws or regulations set by a higher competent authority or the organization's policy and procedures.¹¹²
- iii. Operational audit: This is the study of a specific unit of an organization for the purpose of measuring its performance (evaluation of efficiency and effectiveness).¹¹³

¹⁰⁴ Ibid

¹⁰⁵ Ibid, p. 9

¹⁰⁶ Ibid

¹⁰⁷ Ibid

¹⁰⁸ Ibid

¹⁰⁹ Ibid

¹¹⁰ Ibid

¹¹¹ Ibid

¹¹² Ibid

¹¹³ Ibid

iv. Forensic audit: forensic audit can be defined as an activity of collecting, verifying, processing, analysing and reporting data in order to obtain facts and evidence that could be used in forensic financial disputes arising from criminal activities.¹¹⁴ It is the application of methodologies and technologies by an independent entity to obtain a detailed understanding of underlying economic risks facing an organization.¹¹⁵

Unlike financial audit, forensic audit is not a periodic event but an ongoing process.¹¹⁶ This would mean that while financial audit is an auditor's expression of his/her opinion on the financial statements of a company for a certain period of time, there is no specific timeline for forensic audit and the process may last until an alleged fraud is discovered.¹¹⁷

A forensic auditor provides a specialized report intended for legal proceedings and there is no generally accepted standards prescribed for it.¹¹⁸ Therefore, unlike the external auditor, a forensic auditor is not limited by auditing standards and can perform professional activities outside the auditing standards in use with the objective of investigating and detecting fraud.¹¹⁹

v. Tax audit: Tax audit is an examination to determine if taxpayers have correctly assessed and reported their tax liability.¹²⁰ It is the process in which a tax collection authority reviews the reports of an individual or a company to see if all incomes, deductions, and/or credits reported accurately reflect reality.¹²¹ Tax audit may be done on a random basis or when something appears remiss on a tax return.¹²² It is a type of forensic audit conducted by government auditors¹²³ which may involve physical enquiries such as the inspection and examination of goods in stock and premises.¹²⁴

2.5.2 The Notion of Auditor

Auditor is a person who conducts audit professionally and is required to certify that the accounts produced by the client company have been prepared in accordance with a certain accounting standards

¹¹⁴ Predrag Vukadinoviae , Goranka Knezeviae, and Vule Mizdrakoviae, The Characteristics of Forensic Audit and Differences in Relation to External Audit, (2015) p. 203 available at : <http://finiz.singidunum.ac.rs/portal/wp-content/uploads/sites/3/2015/12/202-205.pdf>

¹¹⁵ Stevenson Smith and Larry Crumbley, "Defining a Forensic Audit", *Journal of Digital Forensics, Security and Law* , Vol. 4, no. 1, p. 65

¹¹⁶ Ibid, P.77

¹¹⁷ Vukadinoviae et al, supra note 114, p.204

¹¹⁸ Ibid

¹¹⁹ Ibid ,

¹²⁰ *Strengthening Tax Audit Capabilities: General Principles and Approaches* (2006), p. 9 available at <https://www.oecd.org/tax/administration/37589900.pdf>

¹²¹ Farlex Financial Dictionary, (2009), available at <http://financial-dictionary.thefreedictionary.com/Tax+audit>

¹²² Ibid

¹²³ <http://www.businessdictionary.com/definition/tax-audit.html>

¹²⁴ Strengthening Tax Audit, Supra note 120, p. 9

and represent a true and fair view of the company.¹²⁵ An auditor is a representative of the shareholders, forming a link between government agencies, shareholders, investors and creditors.¹²⁶

2.5.3 Types of Auditors

1. Internal auditors

Internal auditors are auditors employed by the organisation for which they perform audits.¹²⁷ Their responsibilities vary and may include financial statement audits, compliance audits and operational audits.¹²⁸ They may assist the external auditors in completing the financial statement audit or perform audits for use by management within the entity.¹²⁹ Internal auditors must have no operating involvement in activities they audit.¹³⁰

2. Independent auditors/ External auditors

Independent auditors are usually referred to as certified public accountants (CPA).¹³¹ The opinion of an independent auditor about financial statements makes the statements more credible to such users as investors, bankers, labour unions, government agencies and the general public.¹³² Three key points about the independent audit are:¹³³

- Management remains responsible for preparing and presenting the company's financial statements
- The External Auditor is responsible for forming and expressing an opinion on the financial statements prepared by management
- The audit of the financial statements does not relieve management of any of its responsibilities

3. Government auditors

Government auditors work in various government agencies performing financial, compliance and operational audits.¹³⁴ Even if government auditors perform different activities such as financial,

¹²⁵ Fernando, Supra note 19, P.227

¹²⁶ Ibid

¹²⁷ Ibid

¹²⁸ Ibid

¹²⁹ Ibid

¹³⁰ Ibid

¹³¹ Ibid

¹³² Ibid

¹³³ The International Finance Corporation, supra note 2, P.544

¹³⁴ Fernando, Supra note 19, p. 227

compliance and operational audit like internal auditors, they are the employees of governments and their purpose is to verify a company or any other institution they audit is abiding by relevant laws.¹³⁵

In Ethiopia, OFAG can audit or cause to be audited accounts of private or public organizations with a view to protect government and public interest.¹³⁶ The NBE can also cause to be audited a bank, an insurance company or a micro financing company by an auditor that is different from the one appointed by such companies whenever it is not satisfied by the audit report of their independent auditors.¹³⁷ These kinds of auditors in Ethiopia can be categorized under government auditors.

2.6 The Need for Audit of Financial Statements by an External Auditor

The need for audit can be best explained by the Latin maxim that goes ‘nemo judex in causa sua’ asserting that no one can be a judge in his own case. Management can hardly be expected to be entirely impartial and unbiased in reporting on its own administration of business.¹³⁸ This becomes even more important where there is separation of ownership and control in companies. Regardless of the case of the misstatements management may commit, whether deliberate falsifications or accidental errors, the risk for those who rely on the information is the same and needs to be minimized if it can not be absolutely eliminated. Therefore, auditing is needed to provide an objective check.

Audit by independent auditors who have no material personal or financial interest in the business is mainly needed for its independence and the credibility it adds to the financial statements which relied upon by shareholders, lenders, government regulators, customers and other interested third parties.¹³⁹

Audit promotes efficient allocation of economic resources since inadequate accounting and reporting could conceal waste and inefficiency.¹⁴⁰ Having regard to the credibility gap unaudited financial statements prepared by management leaves when transmitted to outsiders, audited financial statements are the accepted means by which business corporations report their operating results and financial positions.¹⁴¹ The OECD principles provides that an annual audit should be conducted by an independent, competent and qualified auditor in order to provide an external and objective assurance to

¹³⁵ *ibid*

¹³⁶ Office of the Federal Auditor General Establishment(Amendment) Proclamation, 2010, Art. 5(5), Proc.No.669, *Neg.Gaz*, Year 16, no.20

¹³⁷ The Insurance Business Proclamation No.746/2012 and The Banking Business Proclamation No.592/2008 empower the Nation Bank of Ethiopia to appoint its own auditors whenever it is not satisfied with the report of the external auditors of such companies. The National Bank is given the same authority over micro-financing institutions under article 13(2) of the Micro financing Business Proclamation No.626/2009

¹³⁸ Whittington & Pany, *Supra* note 101,P. 7

¹³⁹ *Ibid*, p. 6

¹⁴⁰ *Ibid*

¹⁴¹ *Ibid*, P .7

shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.¹⁴²

2.7 The Link between Audit and Corporate Governance

As stated in the introduction chapter, corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment and corporate auditing is one of the mechanisms of proving assurance to the investors and other stakeholders. And one of the aims of corporate governance is tackling problems arising out of the separation of ownership from management which forces management and directors to report on their stewardship by means of the annual report and financial statements sent to the shareholders. One key element of corporate governance is ensuring shareholders' rights to obtain relevant and material information on the corporation on a timely and regular basis and auditors play a key role in attesting to the reliability of information presented to shareholders.¹⁴³ The audit provides an external and objective check on the way in which the financial statements have been prepared and presented, and it is an essential part of the checks and balances required.¹⁴⁴ In discussing the role of auditors it is important to raise a misconception regarding the investing public's conception of the role of auditors as guarantors of perfectness of financial statements which is usually referred to as the expectation gap. But auditors are not guarantors of the accuracy or the reliability of financial statements.¹⁴⁵ The principal characteristics of ensuring effective corporate governance such as transparency, accountability and integrity are enhanced with conduct of audit into the affairs of a corporation.¹⁴⁶

¹⁴² OECD Principles, Supra note 7, principle V,C

¹⁴³ OECD Principles, Supra note 7, Principle II A

¹⁴⁴ Ibid

¹⁴⁵ Treadway Report on Fraudulent Financial Reporting (1987), P.6

¹⁴⁶ Alabede, Supra note 17, P. 115

CHAPTER THREE

ENSURING GOOD CORPORATE GOVERNANCE THROUGH AUDITORS

3.1 The Role of Auditors in Ensuring Good Corporate Governance

Corporate governance has two fundamental aspects which are the supervision and monitoring of management performance and the accountability aspect dealing with ensuring accountability of management to shareholders and other stakeholders.¹⁴⁷

The financial audit remains an important aspect of corporate governance that makes management accountable to shareholders for its stewardship of a company. The control of the board by auditors is not only the most common, but also the most prominent control mechanism.¹⁴⁸

In raising audit as an essential tool for good corporate governance, it is important to make distinction between internal and external audit. The internal auditor can play a significant role in working with management, external auditors and the audit committees in ensuring the effectiveness of internal controls and in bringing any weakness to the attention of the appropriate parties.¹⁴⁹ The external auditor's role is enhanced by the internal audit.¹⁵⁰ Internal audit programmes, all internal audit reports and findings should be made available to the external auditor at the earliest possible opportunity who should make use of them and decide whether and to what extent reliance can be placed on the conclusions and the work of the internal auditor.¹⁵¹ Internal audit therefore contributes tremendously to the external auditor's role in corporate governance.

However, the internal auditor usually occupies a unique position as an employee, who at the same time is expected to review the conduct of management.¹⁵² This does not itself impair their objectivity.¹⁵³ But it is still a difficult role that can create significant tension, particularly where the internal auditor has to bring to light issues relating to lack of compliance or irregularities.¹⁵⁴ In addition to this,

¹⁴⁷ Marianne, Supra note 22, P.1

¹⁴⁸ Ibid, p.6

¹⁴⁹ The Report of the Review Group on Auditing , p. 202 , available at:

www.odce.ie/portals/0/Documents/company/companylawandyou/corporateGovernance/ReviewGrouponAuditing-Report.pdf

¹⁵⁰ Ibid, P. 204

¹⁵¹ Ibid

¹⁵² Ibid, p.203

¹⁵³ King Report on Corporate Governance for South Africa (2002), P.13

¹⁵⁴ The Report of the Review Group on Auditing, Supra note 149,P.203

depending on certain circumstances related to the effectiveness of the management, a company's board may also choose not to establish internal audit functions.¹⁵⁵

The external audit on the other hand in addition to being a statutory requirement for public companies almost everywhere, it provides an independent and objective check on the way in which the financial statements have been prepared and presented by the directors.¹⁵⁶ The external auditor would facilitate a situation where managers are encouraged or compelled to be held more accountable.¹⁵⁷ For these reasons ensuring good corporate governance through auditors in this paper is discussed in relation to the external auditor.

3.2 Mechanisms of Ensuring Good Corporate Governance through Auditors

Contemporary discussions of corporate governance tend to refer to principles raised in three documents: UK's Cadbury Report of 1992, the OECD Principles of Corporate Governance (OECD 2004) and the Sarbanes-Oxley Act of 2002 informally referred to as SOX, which is an act by the Federal Government in the United States.¹⁵⁸ King Report on Corporate Governance for South Africa, 2002 (King II) is also known for being broadminded and advanced.¹⁵⁹ Therefore, discussions and analysis in ensuring good corporate governance through auditors in this paper will be made in reference to these documents.

To ensure good corporate governance through auditors, they should first be able to discharge their obligations without obstacles in an environment that enhances their effectiveness. Situations that threaten auditors' independence have an impact on each of the obligations and duties of auditors.¹⁶⁰ The independence of auditors is thus the key factor in ensuring good corporate governance.

3.2.1 Reduction of Conflict of Interest

It has already been established that the main role of auditors is providing objective check and balance on management of publicly held companies. Conducting checks and balances inevitably calls for independence of the auditor from the company. Independence is the most essential factor in the existence of the auditing profession.¹⁶¹ Where independence is the pillar of audit, then it can be

¹⁵⁵ King Report, supra note 153, P.12 and UK corporate governance code, supra note 4, c.3.5

¹⁵⁶ Ibid, p.16

¹⁵⁷ Marianne, Supra note 22, p.5

¹⁵⁸ Cally Jordan, "Cadbury Twenty Years On", *Villanova Law Review*, Vol. 58 no.1 (2013), P.18

¹⁵⁹ Garratt, Supra note 51, P. 41

¹⁶⁰ Ownership Rules Of Audit Firms and Their Consequences for Audit Market Concentration, (2007), p.197 available at: www.europa.eu

¹⁶¹ Whittington & Pany, Supra note 101, p. 35

concluded that ensuring good corporate governance through auditors can not be achieved without ensuring their independence and objectivity.

King II states that external auditors should observe the highest level of business and professional ethics and, in particular, their independence should not be impaired in any way.¹⁶²

Independence can be defined as an environment where auditing bodies are not affiliated with or controlled by a company, and therefore are more likely to issue an objective opinion.¹⁶³ Relationships that may pressure, seduce, or tempt external auditors not to act as diligent judgmental monitors of their corporate clients must be eliminated or reduced.¹⁶⁴ Safeguards which exist to ensure that threats to auditor's independence are mitigated may take different forms. The International Organization of Securities Commissions (IOSCO) Principles of Auditor Independence and the Role of Corporate Governance states that standards of auditor independence should establish a framework of principles, supported by a combination of prohibitions, restrictions, other policies and procedures and disclosures, that addresses at least: self-interest, self-review, advocacy, familiarity and intimidation.¹⁶⁵

Prominent measure taken by most corporate governance instruments with this view of ensuring independence are discussed below.

3.2.2 Limits on Multiple Roles and Services by Auditors

The OECD principles states that provision of non-audit services by the external auditor to a company can significantly impair their independence.¹⁶⁶ The obvious theory behind limitation on the multiple services by auditors is that, without certain kinds of limitations, an auditor whether an individual or a body corporate, will be tempted to accede to pressure by client company managers to go along with dubious accounting judgments and obscure presentations.¹⁶⁷ This is mainly because the auditor may fear losing profitable non-auditing business if it does not cooperate.¹⁶⁸ This possible adverse effect of some non-audit services performed for audit clients has been debated continually over the past.¹⁶⁹

It is argued that providing non-audit services is important for audit companies to enable their staff to obtain a broader knowledge and understanding of companies.¹⁷⁰

A lack of familiarity with the company could also depending on the nature of the service result in a non audit service provided by a provider other than the auditor being of lower quality, as the other

¹⁶² King Report, supra note 153, P.16

¹⁶³ Sanjay Anand, The Sarbanes-Oxley Act: An Introduction, (2008), Van Haren Publishing, P.12

¹⁶⁴ Robert Charles, corporate governance Change in the wake of the Sarbanes Oxley Act: A morality tale for Policy makers too (Harvard law school discussion paper No.525, September 2005), p. 5

¹⁶⁵ The International Finance Corporation, Supra note 2, P. 548

¹⁶⁶ OECD Principles, Supra note 7, P. 55

¹⁶⁷ Charles, Supra note 164, P.6

¹⁶⁸ Ibid

¹⁶⁹ Treadway Report, Supra note 145, P.44

¹⁷⁰ Implementation of the EU Audit Directive and Audit regulation, (2014), P.32 available at: <https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Consultation-Auditing-and-ethical-standards-implem-File.pdf>

provider might not recognise issues that would be evident to the auditor with its knowledge of the company.¹⁷¹

The restrictions on providing non-audit services to an audited entity may also reduce audit firms' incentive to invest in audit innovation.¹⁷²

Having to obtain a non-audit service from another provider other than the auditor could increase costs for the company being audited if that other provider had to obtain knowledge of the company that the auditor already possessed.¹⁷³ But it is also possible that greater competition to provide such services could reduce prices.¹⁷⁴

On the other hand, some non audit services add commercial pressures to the audit examination and as a result impair independence.¹⁷⁵ At the very least, the auditor's performance of management advisory services places him/her in the role of management and raises the perception of impaired independence.¹⁷⁶

The pros and cons of provision of non audit services by auditors to their audit client has thus to be regulated in a fashion that strikes balance and maintains the objectivity and independence of the auditor to the extent possible.

SOX and king II acknowledge that independence of auditors could be jeopardized as a result of provision of other non audit services to their audit client.

Under SOX section 201 external auditors are prohibited from providing certain kinds of non-audit services to their auditing clients. These services include:

- Bookkeeping services, appraisal or valuation services, actuarial services, internal audit outsourcing services, management functions or human resources, investment banking services, legal services, and other services that might be determined by regulation to be impermissible.

An exception to this rule is made should non-audit services that are not prohibited be pre-approved by the board of directors audit committee.¹⁷⁷ The Audit Committee should, however, disclose these services to investors in periodic reports.¹⁷⁸

¹⁷¹ Ibid

¹⁷² Ibid, p.34

¹⁷³ Ibid, p.32

¹⁷⁴ Ibid,p.55

¹⁷⁵Treadway Report, Supra note 145,P.44

¹⁷⁶Ibid

¹⁷⁷The International Finance Corporation, Supra note 2, P. 551

¹⁷⁸ Ibid

King II also proposes that audit committee be entrusted to decide on a case by case basis to select its external auditor for non audit services.¹⁷⁹ The committee is expected to have the necessary business acumen to address external auditor independence on a case by case basis; thereby preserving the company's ability to select its external auditor for non-audit services if that is in the best interests of the company and its investors.¹⁸⁰

3.2.2.1 Approaches to Limiting Non Audit Services

In restricting non audit services by auditors, there are two approaches that could be followed.¹⁸¹

1. A 'black list' of prohibited non-audit services with other services allowed subject to evaluation of threats and safeguards by the auditor and/or audit committee, and
2. A 'white list' of allowed services with all others prohibited

In following the white list approach there is a risk that with hindsight it becomes evident that certain services have been omitted, and therefore effectively prohibited, which could have been included.¹⁸² Also, new services could arise that might be considered appropriate for the auditor to undertake, but are not on the list. If a white list is established, the responsible regulatory body would need to periodically review it, but it would inevitably take a period of time to update.¹⁸³ On the other hand the benefits to the perception of the auditor's independence may be considerable because there would be much greater clarity as to what is permissible and therefore eliminate the perception of the underlying threat to the auditor's independence.¹⁸⁴

Prohibiting certain services that are deemed material to the financial statements and/or present an insurmountable threat to auditor independence, whilst allowing other services if safeguards are put in place, may not completely avoid possible impairment of auditor independence.¹⁸⁵ For this reason auditors apply a common safeguard which is putting a separate team in place to perform the non audit service.¹⁸⁶ This is of course assuming that the auditor is a firm of a certain kind. This by itself may be challenged as not being effective against a threat which could operate through unseen and perhaps subtle influences within the audit firm partnership that may, for example, simply come from the auditor knowing that the non-audit relationship is important to the firm.¹⁸⁷

¹⁷⁹ King Report, Supra note 153, P. 16

¹⁸⁰ Ibid

¹⁸¹ Implementation of the EU Audit Directive, Supra note 170, p.7

¹⁸² Ibid, p. 32

¹⁸³ Ibid

¹⁸⁴ Ibid

¹⁸⁵ Ibid, p. 33

¹⁸⁶ Ibid

¹⁸⁷ Ibid

It is therefore very difficult to think of an absolute independence of auditors. Although it is impossible to overcome such challenges unless audit is completely quarantined from non audit services, which would be absurd,¹⁸⁸ placing limitations on non audit services an auditor may provide to audit clients is a key corporate governance principle.

3.2.3 Disclosure of Non Audit Services by Auditors

Another safeguard measure to ensure independence of auditors is requiring public companies to disclose the size of fees received from audit and audit-related services versus permitted non-audit services.¹⁸⁹ The Cadbury committee in its report strongly supported full disclosure of fees paid to audit firms for non-audit work.¹⁹⁰

In theory, such disclosure allows investors to better gauge how much the external auditor may still be pulled by a conflicting interest.¹⁹¹ If the ratio of non-audit services to audit services is too high, the company gets a lower governance rating, and shareholders are advised to take this into account when making investments.¹⁹² In a severe case, a shareholder resolution requesting that the company's board reduce the non-audit services may be made.¹⁹³

If the external auditor provides non-audit services, this fact must be reported in the Annual Report, explaining how the auditor retains objectivity and the audit committee and other concerned bodies such as the remuneration committee should attend the annual general meeting and be ready to answer questions.¹⁹⁴

Similarly, under the UK Corporate Governance Code, if the external auditor provides non-audit services, the annual report should include an explanation of how auditor objectivity and independence are safeguarded.¹⁹⁵ Disclosure of the amount paid for non-audit services with a detailed description in the notes to the annual financial statements of the nature thereof, together with the amounts paid for each of the services described is also proposed under king's report.¹⁹⁶

3.2.4 Setting Audit Tenure and Restricting Personnel Flow

The personal relationship between auditors and the client company managers may, with time, become so strong as to weaken the resolve of the former to act as diligent judgmental monitors and term limits

¹⁸⁸ The Cadbury report stress that potential gains in objectivity from absolute quarantining of non audit services would not outweigh the disadvantages such quarantine brings to the company.

¹⁸⁹ Charles, Supra note 149, p.6

¹⁹⁰ The Cadbury Committee Report, supra note 18, p.35

¹⁹¹ Charles, supra note 164, p. 6

¹⁹² Ibid

¹⁹³ Ibid

¹⁹⁴ David Martin, Corporate governance: Practical guidance on Accountability Requirement, (2006), Thorogood publishers, London, P.59

¹⁹⁵ UK corporate governance code Supra note 4, c.3.7 & c.3.8

¹⁹⁶ King Report, Supra note 153, P.16

are considered to be remedies to such problems.¹⁹⁷ The SOX under section 203 requires that audit engagement partners and audit reviewing partners (the most important auditing firm employees who deal with the executives of an auditing client) must be rotated off the engagement after five years of audit service.

And regarding personnel flow, section 206 provides that it shall be unlawful for an audit firm to perform for a company any audit services, if a chief executive officer, controller, chief financial officer, chief accounting officer, or any person serving in an equivalent position for the company was employed by that firm and participated in any capacity in the audit of that company during the 1-year period preceding the date of the initiation of the audit.

In addition, there is mandatory one year wait for audit firm employee who worked on audit, before becoming higher-level financial employee at client.¹⁹⁸ This is designed to tackle the fear that audit firm employees anticipating such a presumably nice career shift will be tempted to favour the executives whose financial oversight they are supposed to be monitoring and judging.¹⁹⁹

3.2.5 Audit Committees

Audit committees are an Anglo-Saxon corporate governance mechanism.²⁰⁰ They have gradually gained broad acceptance in many European governance codes; in countries with both a one-tier corporate governance systems, where it is a sub-committee of the main board, and in countries with a two-tier corporate governance system, where it is a sub-committee of the supervisory board assisting it in its oversight role.²⁰¹ Audit committee development has been driven by concerns about the credibility of financial reporting, particularly in relation to the issue of auditor independence.²⁰²

The theoretical framework for audit committees generally applied in an Anglo-Saxon setting is in the agency theory and they are primarily an institution to align the interests of owners and management.²⁰³

The establishment of audit committees within the unitary board system is regarded as a reaction to information asymmetries between the owners of a company and its management.²⁰⁴ From an agent's perspective, the implementation of systems or procedures that can provide reliable performance

¹⁹⁷ Charles, supra note 164, p. 7

¹⁹⁸ Ibid, P. 8, note 10.

¹⁹⁹ Ibid, p.8

²⁰⁰ Paul Collier and Mahbub Zaman, Convergence in European Codes: The Audit Committee Concept, (2004), p. 4

²⁰¹ Ibid, p.23

²⁰² Laura F. Spira, The Audit Committee: Performing Corporate Governance, (2002), p.16

²⁰³ Annette G. Kohler, "Audit Committees in Germany: Theoretical Reasoning and empirical Evidence", Schmalenbach Business Review, Vol.57, (2005), P. 234

²⁰⁴ ibid

information may serve as a signalling device.²⁰⁵ Audit committee formation initiated by the management signals that management behaviour aligns with the principal's expectations.²⁰⁶

The Cadbury report reveals the appointment of properly constituted audit committees as an important step in raising standards of corporate governance.²⁰⁷

The establishment of effective, Vigilant and informed audit committees to oversee a company's financial reporting process are a key practice that can help companies meet their responsibilities and reduce the incidence of fraudulent financial reporting.²⁰⁸

3.2.5.1 Role of audit committees

There are fewer consensuses on the audit committee's role in financial reporting, external auditor selection and internal control and risk assessment.²⁰⁹ Similarly, there are inconsistencies among several Codes with regard to specification of audit committee structure concerning membership, financial qualification, and frequency of meetings.²¹⁰ Nevertheless, oversight of internal and external audit is almost universally seen as the central purpose of audit committees.²¹¹

Under the SOX, audit committee is given responsibility for the appointment and oversight of the auditors, for recommending their fees and it also must:²¹²

- Approve all audit and non-audit financial functions;
- Ensure auditors rotate according to the tenure set by law and cooling periods are observed;
- Ensure the auditors report to them on matters involving critical accounting policies, alternative treatments of financial matters, and communication with management (especially any constraints placed upon them during their audit); and
- Examine any conflicts of interests involving the auditors.

Kings II proposes the following roles of audit committees:²¹³

- Review the functioning of the internal control system and internal audit department;
- Review the risk areas of the company's operations to be covered in the scope of the external and internal audits;

²⁰⁵ Ibid, P.235

²⁰⁶ Ibid

²⁰⁷ The Cadbury Committee Report, supra note 18, p.67

²⁰⁸ Treadway Report, Supra note 145,p.6

²⁰⁹ Collier and Zaman, Supra note 200, p.23

²¹⁰ Ibid, p. 23

²¹¹ Ibid, p. 19

²¹² Martin, Supra note 194, P. 62

²¹³ King Report, supra note 153, P.19

- Review the reliability and accuracy of the financial information provided to management and other users of financial information, and whether the company should continue to use the services of the current internal and external auditors;
- Review any accounting or auditing concerns identified as a result of the internal or external audits;
- Review the company's compliance with legal and regulatory provisions, its articles of association, code of conduct, by-laws and the rules established by the board;
- Encourage communication between members of the board, senior executive management, the internal audit department and the external auditors;
- Develop a direct, strong and candid relationship with the external auditors;
- Review the scope and results of the external audit, its cost effectiveness and the independence and objectivity of the external auditors (and in so doing should review the nature and extent of any non-audit services provided to the company by the external auditors);
- Consider the rotation policy of the external auditors and whether there is a need to change the audit partner or senior staff engaged in the audit;
- Draw up a recommendation to the board for the appointment and removal of the external auditors; and
- Investigate any matters within its terms of reference and safeguard all information supplied to it.

According to the UK Corporate Governance Code the audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors.²¹⁴

In a number of companies the audit committee is specified as the contact point for employees who wish to report concerns about unethical or illegal behaviour that might also compromise the integrity of financial statements.²¹⁵

Audit committees do not only serve as internal monitoring devices which support good corporate governance, they are also considered to be mechanisms of ensuring that an appropriate relationship exists between the auditor and the management whose financial statements are being audited.²¹⁶ They enable non executive/independent directors to contribute an independent judgement and play a positive

²¹⁴ The UK Corporate Governance Code, Supra note 4, c.3.7

²¹⁵ OECD principles, supra note 7, annotations to Principle VI D 6

²¹⁶ Marianne, Supra note 22, p.6

role in an area for which they are particularly fitted, and it offers the auditors a direct link with the non executive directors.²¹⁷

3.2.5.2 Audit Committee Membership, Size and Expertise

For the audit committee to be effective it is generally recognised that it should comprise of a sufficient number of outside/ independent directors.²¹⁸ The concept of independent audit committee membership is recognised in a majority country codes and principles that acknowledge audit committees.²¹⁹ In the case of unitary structures committee members are non-executive /outside directors while in the case of two tier boards, all are to be appointed from supervisory board members.²²⁰ Auditor independence would be safeguarded if audit committee were made up of a majority of independent and nonexecutive directors, and this might signify that their independent status would contribute to auditor's independence through bridging communication network.²²¹ Nonexecutive directors can be defined as those who do not perform any management functions within the company or any of its subsidiaries whereas independent directors are defined as directors independent of executive management and of dominant shareholders and free from any business or other relationships which could interfere with their independent judgement apart from their remuneration and shareholding in the company.²²²

Auditing committee will be able to exercise power over management which will give independence to the auditor and that will result in authentic financial reporting meeting the expectation of all the stakeholders and mainly shareholders.²²³ Independent directors of audit committees are anticipated to boost the quality of monitoring because they are not associated with the company either as bureaucrats or human resources; thus they would act as the shareholders' watchdog.²²⁴

Under the UK Corporate Governance Code the board should establish an audit committee of at least three, or in the case of smaller companies, two members, who should all be independent non-executive directors.²²⁵ According to the Cadbury Report, non executive directors are independent means that apart from their directors' fees, they are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgement.²²⁶ Similarly under SOX section 301 all members of the audit committee are required to be independent.

²¹⁷ The Cadbury Committee Report, supra note 18, p. 28

²¹⁸ Collier and Zaman, Supra note 200, p. 14

²¹⁹ Ibid, p. 16

²²⁰ Ibid

²²¹ Hetal Pandya, "Corporate Governance: Role of Auditor and Auditing Committee," IPASJ International Journal of Management , Vol.1 , no.2 (2013), p.2

²²² Collier and Zaman, Supra note 200, p 16

²²³ Pandya, supra note 221, P.3

²²⁴ Ibid

²²⁵ C.3.1 of UK corporate governance code requires that the board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.

²²⁶ The Cadbury Committee Report, supra note 18, p. 21

According to this section, for a director to qualify as independent, he/she should not accept any consulting, advisory, or other compensatory fee from the company.

The composition of audit committees from non executive directors and requiring their independence is a prominent principle.²²⁷

Their independence is important given that audit committees should serve as representative of shareholder interests and is required to facilitate a process whereby management and external auditors can be questioned and held to account if need be.²²⁸

3.2.5.3 Enhancing Effectiveness of Audit Committees

Audit committees are dependent on the information provided by management and could, at times, be briefed selectively by management and it may in certain circumstances decide to suppress or delay the disclosure of important information to the audit committee.²²⁹ As a consequence, the mere existence of audit committees will not in itself ensure that the interests of the shareholders and especially the general public interest are protected in the interaction between the management of a company and the external auditors.²³⁰ The challenge therefore is to improve the effectiveness of audit committees in enhancing auditor independence.²³¹

The effectiveness of audit committees depends on their having a strong chairman who has the confidence of the board and of the auditors, and on the quality of the non-executive directors.²³² The chairperson should be an independent non-executive director with the requisite business, financial, communication and leadership skills and should not be the chairperson of the board.²³³ King II recommends that the board chairperson should not be a member of the audit committee. Membership of the audit committee should be disclosed in the annual report and the chairperson of the committee

²²⁷ The Cadbury Committee recommends that audit committees should have a minimum of three members, membership confined to non-executive directors. The SOX section 407 specifies that at least one member should be a financial expert. King II does not specify the size of the audit committee but recommends that the board should appoint an audit committee that has a majority of independent non-executive directors the majority among which should be financially literate. It also recommends that the board chairperson should be prohibited from membership to the committee. Audit committees should be composed exclusively of non executive or supervisory directors that are wholly independent. The Blue Ribbon Committee recommends audit committees to be wholly independent and independence is defined as having "no relationship to the corporation that may interfere with the exercise of their independence from management and the corporation". Similarly the European Commission (2004) recommendation stresses that that the audit committee should be composed exclusively of non-executive or supervisory directors, of whom the majority are independent.

²²⁸ Marianne, supra note 22, P. 4

²²⁹ The Report of the Review Group on Auditing , Supra note 149, p. 197

²³⁰ Ibid

²³¹ Ibid

²³² The Cadbury Committee Report, supra note 18, P.29

²³³ Treadway Report, Supra note 145,p 41

should be available to answer questions at the annual general meeting. Composition of audit committees from independent directors is also advocated for by OECD principles.²³⁴

No one other than the audit committee's chairman and members should be entitled to be present at a meeting of the audit committee.²³⁵ Besides, If meetings or correspondence of the committee with internal and external auditors are regularly scheduled regardless of the identification of irregularities or problems, independent dialogue between the audit committee and the internal auditor no longer imply treason against management which in other words means, the internal auditor is relieved of tension that arises from its being "employed" by management.²³⁶

Another important factor that would enhance the effectiveness of audit committees is having a charter of their own. The audit committee should encourage procedures that promote accountability among management, internal auditor and external auditor, ensuring that management properly develops and adheres to a sound system of internal control, that the internal auditor objectively assesses management's accounting practices and internal controls, and that the external auditors, through their own review, assess management and the internal auditor's practices.²³⁷ The audit committee should seek to affirm the existence of these nexuses of accountability by learning the roles and responsibilities of each of these participants.²³⁸ These roles and responsibilities should be commonly understood and agreed to by each of the other participants in the process, preferably in writing.²³⁹

King II proposes that the audit committee should have written terms of reference dealing adequately with its membership, authority and duties. The terms of reference of the audit committee should be confirmed by the board and reviewed every year and companies should disclose in their annual reports whether or not the audit committee has adopted formal terms of reference and, if so, whether or not the committee has satisfied its responsibilities for the year in compliance with its terms of reference.²⁴⁰ OECD principles take similar stand in on the matter.²⁴¹

²³⁴ Annotations to OECD principle VI E 1 provides that boards should consider establishing specific committees, assigning a sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest. Examples of such key responsibilities are ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination of board members and key executives, and board remuneration.

²³⁵ Collier and Zaman, Supra note 200, p.17

²³⁶ Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees ,(1999), p.39

²³⁷ Ibid

²³⁸ Ibid

²³⁹ Ibid

²⁴⁰ King Report, supra note 153, P.18

²⁴¹ Annotations to Principe VI E 2 provides that when committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board and Such information is

It should be noted that no matter how effective audit committees can be, they cannot be solely relied upon to secure auditor independence from management, to protect the public interest or to improve compliance if the auditor is not prepared to tackle these issues.²⁴²

3.2.6 Determining the Body to Hire and Compensate Auditors

In ensuring good corporate governance, it is important to eliminate a relationship in which managers choose and pay the auditor that is asked to audit the financial process overseen by those managers as that may tempt auditors not to act as diligent judgmental monitors, as opposed to reciprocating friends.²⁴³

Taking this in to account, there are different approaches to the selection of auditors. In a number of countries external auditors are appointed at least formally by the general meeting of shareholders or in two tier systems by the supervisory board and in others by the board itself.²⁴⁴

Under the SOX section 307(2), audit committees are directly responsible for the appointment and oversight of auditors. The power to hire, fire, and compensate the external auditors thus resides in the company's audit committee, as opposed to the management or the board of directors as a whole.²⁴⁵ The placing of such power in the hands of the audit committee is done in the effort to ensure the appointment of auditors by the company's body which is independent of management. Such a conclusion can be made from the fact that certain accommodation are made to foreign companies that issue shares in the US to which this requirement is normally applicable. The accommodation is that foreign corporate governance schemes which do not have audit committees identical to the US are taken in to account as long as those with oversight responsibility for a company's external auditors are independent of management.²⁴⁶

It is important to note that placing such power in the board as a whole could be dangerous since a board is not required to consist entirely of independent directors.²⁴⁷ The board as a whole may thus be too easily influenced by the managers' preferences and interests.²⁴⁸

The UK corporate governance system recognizes the role of audit committees in the appointment of auditors but sets out a different approach than the SOX. The audit committee has the primary responsibility for making a recommendation to the board of directors regarding the appointment,

particularly important in the increasing number of jurisdictions where boards are establishing independent audit committees with powers to oversee the relationship with the external auditor and to act in many cases independently.

²⁴² The Report of the Review Group on Auditing, Supra note 149, P.197

²⁴³ Charles, supra note 164,p.10

²⁴⁴ Corporate governance: A survey of OECD countries (2004), P.99

²⁴⁵ Charles, supra note 164,p.7

²⁴⁶ A survey of OECD countries, Supra note 229, P.99

²⁴⁷ Charles, supra note 164,p.7

²⁴⁸ Ibid

reappointment and removal of external auditors for it to put to the shareholders for their approval in general meeting.²⁴⁹ It is possible for the board not to accept the audit committee's recommendation but in such cases it should include in the annual report, and in any papers recommending the appointment or re appointment, a statement from the audit committee explaining the recommendation and the reason why the board has taken a different position.²⁵⁰

Moreover, IOSCO principles on auditor oversight sets out that there should be a governance body, an audit committee that is in both appearance and fact independent of management of the entity being audited and acts in the interests of investors which should oversee the process of selection and appointment of the external auditor and the conduct of the audit.²⁵¹

3.2.7 Oversight of Auditors

Auditors should be subject to oversight by a body that acts and is seen to act in the public interest.²⁵² There is a growing consensus internationally as to the benefits of an auditor oversight system that is not based exclusively or predominantly on self-regulation.²⁵³ An effective oversight of independent audits is critical to the reliability and integrity of the financial reporting process.²⁵⁴ Oversight of auditors is therefore critical in ensuring that they play their role in good corporate governance effectively. An oversight to this effect can occur in several ways, including within audit firms, by professional organizations, public or private sector oversight bodies, and through government oversight.²⁵⁵ Oversight may also be provided by supervisory boards and audit committees representing investors in matters relating to individual companies.²⁵⁶

The IOSCO provides 6 principles for auditor's oversight that can be summarized as

- Oversight of qualification
- Oversight of independence
- Subjection of auditors to the discipline of an auditor oversight body that is independent of the audit profession

²⁴⁹ The UK corporate governance code, Supra note 4, c.3.6 & c.3.2

²⁵⁰ Ibid

²⁵¹ A survey of OECD countries, Supra note 229, P.99

²⁵² Technical Committee of the International Organization of Securities Regulators(IOSCO) Principles for Auditor Oversight, (2002), P.3

²⁵³ Ibid,P.2

²⁵⁴ Ibid

²⁵⁵ Ibid,p.3

²⁵⁶ Ibid

An auditor oversight body should establish a process for performing regular reviews of audit procedures and practices of companies that audit the financial statements of companies.²⁵⁷ This oversight process may be performed in coordination with similar quality control mechanisms that are in place within the audit profession, provided the oversight body maintains control over key issues such as the scope of reviews, access to and retention of audit work papers and other information needed in reviews, and follow-up of the outcome of reviews.²⁵⁸ Reviews should be conducted on a recurring basis, and should be designed to determine the extent to which audit firms have and adhere to adequate quality control policies and procedures that address all significant aspects of auditing.

²⁵⁹Matters to be considered include:²⁶⁰

- Independence, integrity and ethics of auditors;
- Selection, training, and supervision of personnel;
- Acceptance, continuation and termination of audit clients;
- Consultation on difficult, contentious or sensitive matters and resolution of differences of opinion during audits;
- Communications with management, supervisory boards and audit committees of audit clients;
- Communications with bodies charged with oversight over the financial reporting process, for example, on matters such as regulatory inquiries, changes in auditors, or other matters as may be required;
- Provisions for continuing professional education: an auditor oversight body also should address other matters such as professional competency, rotation of audit personnel, employment of audit personnel by audit clients, consulting and other non-audit services, and other matters as deemed appropriate; and
- An auditor oversight body should have the authority to stipulate remedial measures for problems detected, and to initiate and/or carry out disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate.²⁶¹

Having in place a regulatory framework that ensures a company's external auditor maintains and continuously carries out a high quality assurance is a vital element in maintaining investor confidence and provides the deterrence that is critical to reducing the incidence of fraudulent financial reporting²⁶²

²⁵⁷ A consultative document on auditors' roles and Responsibilities by the corporate law reform committee for the companies commission of Malaysia, (2007) p. 45, available at:

http://www.maicsa.org.my/download/technical/technical_clr_auditors.pdf

²⁵⁸ Ibid

²⁵⁹ Ibid

²⁶⁰ Ibid

²⁶¹ Ibid, p. 46

²⁶² Treadway Report, Supra note 145,p 6

3.2.7.1 Oversight of Qualification

Since the effectiveness of an audit in detecting fraudulent financial reporting is related directly to the quality of that audit, the importance of audit quality to the financial reporting process cannot be overstated.²⁶³ For this reason, the accounting profession must be subjected to extensive regulation to ensure that independent public accountants provide reliable auditing services.²⁶⁴

According to the IOSCO, establishing qualification requirements and requiring maintenance of professional competency should improve the quality of auditing. Moreover, the risk that authorization can be revoked for failure to have or maintain the necessary qualification should be an incentive for compliance and adherence to auditing standards.

In the US, auditors must pass a rigorous qualifying examination developed by the AICPA (American Institute of Certified Public Accountants) to be eligible to practice. Applicants for the CPA license should be generally required to

1. Have experience in the practice of accounting,
2. Show evidence of moral character, and
3. Undertake continuing professional education.

Increasing the accounting curricula's emphasis on analytical and problem-solving skills, ethical values, and historical and cultural awareness is believed to be a useful groundwork for future participants in the financial reporting process.²⁶⁵

3.2.8 Non Financial Statement Audit

Different kinds of corporate illegality, such as noncompliance with various laws and regulations, may have a material effect on financial statements.²⁶⁶ Even though the misleading financial statements are a by-product or a result, rather than the objective of the illegal acts, they result in delivering false information to the investing public.²⁶⁷ Therefore, a strong control environment is essential and laws should require the auditor to assess the company's control environment, including its management, in planning the audit.²⁶⁸ Apart from the requirement of auditors to assess the company's control environment, properly designed system of internal control to reduce the incidence of fraudulent

²⁶³ Ibid, p. 68

²⁶⁴ Ibid

²⁶⁵ Ibid, p. 79

²⁶⁶ Ibid, p. 32

²⁶⁷ Ibid

²⁶⁸ Ibid, p. 51

financial reporting will inherently increase the prevention and detection of noncompliance with laws and regulations.²⁶⁹

3.2.9 Accountability and Reporting Mechanism

In determining to whom auditors should be accountable, it appears very important to consider the manner of their appointment. The OECD principles of corporate governance states that the appointment of auditors by a shareholders' meeting directly upon the recommendation of an audit committee or an equivalent body clarifies that the external auditor should be accountable to the shareholders.²⁷⁰ It also underlines that the external auditor owes a duty of due professional care to the company rather than any individual or group of corporate managers that they may interact with for the purpose of their work. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.²⁷¹ The External Auditor should divulge (potential) errors, misconduct, and violations of legislation or the company's internal rules during audits, and report them immediately to the Board of Directors' Audit Committee or Supervisory Board.²⁷² The External Auditor should make the company aware, as soon as practical and at an appropriate level of responsibility, of material weaknesses in the design or operation of the accounting and internal control systems, which have come to an auditor's attention and the audit committee or the supervisory board should take appropriate steps to remedy these problems.²⁷³

Regarding how the auditor's report should be prepared, it is generally recognized that it could be either qualified or unqualified.

Under the UK companies act an auditors' report must include the following:²⁷⁴

- Include an introduction identifying the annual accounts that are the subject of the audit and the financial reporting framework that has been applied in their preparation;
- State clearly whether, in the auditor's opinion, the annual accounts give a true and fair view of an individual balance sheet, or profit and loss account of the state of affairs of the company as at the end of the financial year;
- Include a reference to any matters to which the auditor wishes to draw attention by way of emphasis without qualifying the report;

²⁶⁹ Ibid, p.32

²⁷⁰ OECD principles, supra note 7, P. 57

²⁷¹ Ibid, Principle V D

²⁷² The International Finance Corporation, Supra note 2, P. 554

²⁷³ Ibid

²⁷⁴ UK Companies Act of 2006, article 495&496

- State whether in his opinion the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts;
- If the auditor fails to obtain all the information and explanations which, to the best of his knowledge and belief, are necessary for the purposes of his audit, he shall state that fact in his report.²⁷⁵

For auditors to carry out their responsibilities properly their rights to have access at all times to the company's books, accounts and vouchers in whatever form they are held, and require information from any officer or employee of the company, or from any such persons or auditors of subsidiary undertaking should be recognized.²⁷⁶

In addition to these, an auditor must be entitled to receive all notices of, and other communications relating to, any general meeting which a member of the company is entitled to receive and thus attend such meeting as well as be heard on matters which concern him as an auditor.²⁷⁷

²⁷⁵ Ibid, article 498 (3)

²⁷⁶ Ibid, article 499

²⁷⁷ Ibid, article 502

CHAPTER FOUR

APPRAISAL OF THE ETHIOPIAN LEGAL REGIME GOVERNING THE ROLES AND RESPONSIBILITIES OF AUDITORS

4.1 Overview of the Ethiopian Legal Framework on Corporate Governance and Auditors

The major corporate governance legal framework for Ethiopian companies is the 1960 Commercial Code which devotes section to governing the roles of auditors in a share company. With regard to auditors, the Financial Reporting Proclamation 847/2014 and Regulation no 332/2014 enacted under it constitute the major body of laws governing auditors in Ethiopia. The corporate governance of companies engaged in the financial sector and their audit process is governed by various pieces of legislation, mainly directives, issued by the National Bank of Ethiopia. This chapter aims to assess the various laws governing auditors of companies in Ethiopia and evaluate whether the existing legal framework enables the ensuring of good corporate governance through auditors.

4.2 The Roles and Responsibilities of Auditors under the 1960 Commercial Code

The roles of auditors of share companies under the Commercial Code include the following

1. Verifying and reviewing with directors report prepared by experts of the Ministry of Commerce and Industry (Currently Ministry of Trade and Ministry of Industry) on valuation of contributions made in kind within six months from the date of formation of a share company;²⁷⁸
2. They should convene a general meeting for election of directors when there are no surviving directors and may carry on general management of the company until the next shareholders general meeting;²⁷⁹
3. They should prepare and submit to the general meeting special report on dealings made between a company and a director or another organization in which one of the directors is an owner, partner, agent, director or manager.²⁸⁰ The auditors should be notified of such transactions;

²⁷⁸ Commercial Code, Supra note 40, Art. 315(3)

²⁷⁹ Ibid, Art. 351 (4) & (5)

²⁸⁰ Ibid, Art. 356 (3)

4. Audit the books and securities of the company, verify the correctness and accuracy of the inventories, balance sheets and profit and loss accounts, to certify that the report of the board of directors reflects the correct state of the company's affairs;²⁸¹
5. Submit to the annual general meeting a written report on the manner in which they have carried out their duties along with their comments on the report of the board of directors;²⁸²
6. Recommend approval of the accounts and make such comments thereon as they think fit or refuse to recommend approval by giving reasons for referring the matter back to the directors;²⁸³
7. They may comment on the proposed distribution of profits;²⁸⁴
8. Inform the directors of any irregularities or breaches of legal or statutory requirements and notify the general meeting whenever the breach is grave;²⁸⁵
9. Inform the public prosecutor of any matters which would appear to disclose the commission of an offence²⁸⁶
10. Call a general meeting where the directors fail to do so or when shareholders representing at least 20% of the capital so request.²⁸⁷
11. Call a general meeting according to article 391(2) of the Commercial Code;
12. Auditors shall be present at shareholders' meetings and at the annual general meeting;²⁸⁸
13. Give a reasoned advice to the general meeting on the mode of presentation of the accounts or the methods of valuation;²⁸⁹ and
14. The auditors may at any time make on the spot such audits and checks as they think necessary (including holding company's) and may call for any information, agreements, books, accounts, minute books and such other documents as may be required for the proper execution of their duties.²⁹⁰

²⁸¹ Ibid, Art.374

²⁸² Ibid, Art.375(1)

²⁸³ Ibid, Art.375(2)

²⁸⁴ Ibid, Art.375(3)

²⁸⁵ Ibid, Art.376

²⁸⁶ Ibid, Art.376

²⁸⁷ Ibid, Art.377

²⁸⁸ Ibid, Art.378(2)

²⁸⁹ Ibid, Art.448 (1)

²⁹⁰ Ibid, Art.378(1)& 379

4.3 Assessment of the Commercial Code Provisions Governing the Roles and Responsibilities of Auditors in Light of the OECD Principles of Corporate Governance

4.3.1 OECD Principle II - The Rights of Shareholders and Key Ownership Functions

One of the corporate governance principles under the OECD principles is facilitating the exercise of shareholder's rights.²⁹¹ Under this principle the shareholders should obtain relevant and material information on the company on timely basis.²⁹²

The Commercial Code under article 375(4) prohibits the general meeting to consider the balance sheets in the absence of the auditors' report. Presence of the auditors at share holders' meetings and annual general meetings is also a mandatory requirement as per article 378(2) of the Code. The company's auditor's report and explanations on any questions that may be raised are therefore recognized as shareholders' decision making process.

The OECD principles do not only call for the availability of material and relevant information to shareholders but also the availability of the information on a timely manner.²⁹³ In this regard, the Commercial Code recognizes the right of any shareholder to inspect and take copies at the head office of the balance sheet, the profit and loss account and the directors' and auditors' reports to be submitted at the annual general meeting during the fifteen days which precede an annual ordinary general meeting and extraordinary meeting.²⁹⁴ The Code provides that reports of the auditor should be readily available for interested shareholders at least 15 days before the shareholders' meeting and this promotes the right of shareholders to acquire relevant material and relevant information on a timely manner.

OECD Principle II.C.3 provides that effective shareholder participation in key corporate governance decisions, such as the nomination and election of board members, should be facilitated.

The role of auditors in ensuring good corporate governance in this regard becomes evident when the company is left without any surviving director. Although such instances appear to be rare, the legislature has regulated the situation by entrusting the auditors with the responsibility of convening a general meeting for the election of directors.

4.3.2 OECD Principle V- Disclosure and Transparency

This principle of corporate governance addresses disclosure and transparency and provides illustrative list of activities that demand timely and accurate disclosures. One of the listed items is related party

²⁹¹ OECD principle, Supra note 7, Principle II

²⁹² Ibid, principle II.A.3

²⁹³ Ibid, principle II.C.1 & II.A.3

²⁹⁴ Commercial code, Supra note 40, Arts.417 &422

transactions under OECD Principle V.A.5 which dictates that the company should run with due regard to the interests of all its investors and to this end the company has to fully disclose material related party transactions. Annotation to the principle define related parties as entities that control or are under common control with the company, significant shareholders including members of their family and key management personnel. According to this definition, transactions with directors or an entity where one of the directors of the company is owner, partner, agent, director or manager of such entity could qualify as related party transactions.

The Commercial Code does not absolutely prohibit transactions between a director and the company except under article 357(1) but subjects the transaction to the approval of the board of directors according to article 356(1). The auditors should be given notice of the approved transaction and they shall present a special report on the matter to the general meeting which may take the action it sees fit.²⁹⁵

OECD Principle V.B requires that information should be prepared and disclosed in accordance with high quality standards of accounting and financial and non-financial disclosure. Auditors' role in this regard and under the Commercial Code can be seen in relation to their advisory role on mode of presentation of the accounts and the method of valuation as provided under article 448. Through their reasoned expert opinion on the mode of valuation and presentation of accounts auditors contribute to the good corporate governance of the company.

4.3.3 OECD Principle VI- the Responsibilities of the Board

Another key corporate governance principle, Principle VI.A, dictates that board members should act on fully informed basis.

According to the annotations to the principle this should be taken to mean that the board should be satisfied that key corporate information and compliance systems are fundamentally sound and underpin the key monitoring role of the board.

The role of auditors in ensuring good corporate governance in this regard can be seen in light of article 374 and 376 of the Commercial Code. Whenever auditors inform directors of irregularities or breaches of legal or statutory requirements according to these provisions, they are enabling the board to act on fully informed basis and take appropriate measures.

²⁹⁵ Ibid, Art.356(1)&(3)

4.4 Appraisal of Provisions Governing Auditors under the Commercial Code

If auditors are to ensure good corporate governance in a company, it is already established that it is a must to first ensure their independence from their audit client. In the previous chapter, four prominent mechanisms designed to ensure good corporate governance through auditors were raised and they basically involve ensuring their independence. These mechanisms will be discussed in relation to the Ethiopian scenario in the following subsections.

The concept of audit and auditors in the Commercial Code is raised in relation to share companies and private limited companies to a certain extent. The provisions on auditing are derived from the UK Company act of 1948 which was later amended by the Company Act of 1967.²⁹⁶

The Commercial Code nowhere provides for a definition of an auditor and does not expressly use the term external auditor. The aforementioned UK Company Acts from which the provisions on auditing in the Commercial Code are borrowed from do not also use the term external auditor. According to these acts, auditors of a company shall make a report to the members of the company and each annual general meeting shall appoint or reappoint an auditor.²⁹⁷

The Commercial Code in article 375 provides that auditors shall report and provide their recommendations and comments to the annual general meeting of shareholders. In article 371 of the Code it is provided that it is the shareholders that can appoint or remove them. This means that the auditors in the Code are watchdogs of shareholders' interests and do not depend on the acceptance of their works by the management unlike internal auditors who do.²⁹⁸ Internal auditors, although their works are similar with that of the external auditor, work as an aid to management and depend on the acceptance of their work by the latter.²⁹⁹ Internal auditing is often seen as an overall monitoring activity with responsibility to management for assessing the effectiveness of control procedures.³⁰⁰ As a result of such responsibility to the management of a company, internal auditors are called "the eyes and ears of management" and there is no legal requirement to appoint an internal auditor in the Commercial Code.³⁰¹ Therefore, the term auditor in the Commercial Code stands for and addresses external auditor.

²⁹⁶ Peter Winship, Background Documents of the Ethiopian Commercial Code of 1960, 1974, p. 64.

²⁹⁷ UK Company Act of 1967, section 14(1) and UK Company Act of 1948, section 159 (I)

²⁹⁸ Wolderuphael, *Supra* note 45, p. 12

²⁹⁹ *Ibid*

³⁰⁰ Hamdu Kedir, Arega Seyom and Addisu Gemedu, "Internal auditing standards and its practice the case of East Arsi Zone, Ethiopia", Basic Research Journal of Business Management and Accounts, Vo. 3, No.6 (2014), p. 81

³⁰¹ Wolderuphael, *Supra* note 45, p. 12

4.4.1 Appointment of Auditors

The manner of appointment of auditors has a direct implication on their independence and consequently their role in ensuring corporate governance. It has been already established that auditors of a company should not be subject to the hire and fire power of management whose activity they are going to audit as this would impair their objectivity and inflict fear of loss of one's job.

Auditors of share companies are initially appointed by the meeting of subscribers and by the annual general meeting after the company has come into existence.³⁰² This means that the power to appoint auditors is left to the shareholders. This is in line with the accountability of auditors to the shareholders and the company. However, details as to the appointment process are not provided for in the Code. Basic questions relating to who would propose the auditor for appointment by the annual general meeting and the manner thereof are not addressed.

These questions may not be of importance where the company is formed as between founders but they become of great significance where the company is formed by public subscription of shares to numerous shareholders.³⁰³ Appointment of auditors by the annual general meeting obviously presupposes that a survey is conducted to select an auditor from the market beforehand. Otherwise it is practically impossible for the annual general meeting, the meeting of shareholders with the board and management, to come up with an auditor right at the meeting. Appointment in such a manner is moreover a formality matter in many countries as shareholders are there to approve nominations by a certain body which could be the board or a subcommittee of the board.³⁰⁴

In the absence of a clear provision determining the body proposing the appointment by the general meeting and a restriction on management from participating in the auditor selection process, it is possible that managers may get involved in hiring auditors which puts the latter's independence at stake.

4.4.2 Personnel Flow

In the Commercial Code auditors are prohibited from appointment as managers or directors of their audit client, its subsidiary, or its holding company within three years from the date of termination of their function as auditors.³⁰⁵

³⁰²Ibid, Art. 369(1)

³⁰³ Winship, *Supra* note 296. The problem of auditing of share companies has been one of the most fundamental problems of the law and made with reference to the British law at the time. The most refined and the most effective of all the solutions appeared to be that which submits the auditing of accounts of public or semi public organisations with a very high standing. This implies that audit in the commercial code seems to have been mainly associated with public or semi public companies.

³⁰⁴ Report of the Review Group, *supra* note 149, p. 227

³⁰⁵ Ibid, Art.370(2)

A prohibition of the kind found in the Commercial Code is also available in other legal systems with the view to prevent auditor independence impairment that may result from enticing job offers from their client company upon termination of their audit service. As mentioned in the preceding chapter, SOX imposes one year wait for audit firm employee who worked on audit, before becoming higher-level financial employee at client.

In this regard, the Code is upholding auditor's independence at a significant level and thereby creating conducive environment for good corporate governance. However, the legislature's limitation of the prohibited posts auditors could not assume in their audit client to director and manager appears to be narrow both in terms of nomenclature and scope if the intended outcome is to be achieved. The prohibition from becoming directors in the specified period may achieve its goal of ensuring objectivity of auditors since directors of a company will form the board of directors making it easier to establish who a director is. However, managerial posts may be offered to the ex auditor in disguise.

In addition, as long as prohibitions are limited to directorship and management, the effort in achieving auditor's objectivity through this means will be futile as there are varieties of posts that a company may offer to its former auditors as a lure to compromise their judgement.

To curb such situations, the law should take this in to account and also distinctly determine the persons to whom the bar is applicable in cases where the auditor is a firm.

The other limitation of the provision is its failure to govern the reverse scenario. There is no cooling off period required for managers and directors of a company if they wish to cease their position and decide to become an auditor.

4.4.3 Non Audit Services

Auditors should not be under any pressure or fear of loss of income from their client in carrying out their duties if they are to maintain their independence and discharge their professional duty in the best possible way. Rendering other services than auditing is one cause of potential pressure resulting in biased judgement. A biased judgement may not necessarily come from pressure of losing income from the other services: the mere fact of rendering certain types of non audit services will impair independence. The SOX under section 201 prohibits auditors from rendering book keeping services to their audit client because otherwise they will be auditing what they themselves have done. Independence could be impaired due to external pressure by the audit client and at times it doesn't even exist to be impaired when the auditor is placed to judge his/her own work.

The regulation of non audit services that auditors may and may not provide to the company alongside auditing is one way of ensuring that they promote good corporate governance of their client companies.

The Commercial Code provides a somewhat non audit services restriction under article 370(1) (c).

Art. 370. - Persons not competent.

(1) The following persons may not be elected as auditors:

(a) Founders, contributors in kind, beneficiaries holding special benefits, directors of the company or of one of its subsidiaries or of its holding company;

(b) Spouses or relatives by consanguinity or affinity to the fourth degree inclusive, of the persons mentioned in sub-art. (1) (a);

(c) Persons who receive from the persons mentioned in sub-art. (1) (a) a salary or periodical remuneration in connection with duties other than those of an auditor.

Accordingly, persons who receive a salary or periodical remuneration for non audit services from founders, contributors in kind, beneficiaries holding special benefits, directors of the company or of one of its subsidiaries or of its holding company are declared incompetent to become auditors of the company.

However, the provision does not clearly prohibit non audit services that could be given to the company. Receiving periodical remunerations or salary presupposes that there is an ongoing relationship between the persons making and receiving such payments and the auditor is perpetually dependent on the individuals for his/her income. This restriction is of course very important in preserving the auditor's objectivity.

It may be argued that if rendering non audit services to the individuals mentioned in article 370 makes the person providing the service incompetent to become an auditor of the company, provision of such services to the company itself should be prohibited for stronger reason. Broadly interpreted in such a manner, article 370 would mean that individuals receiving periodical remuneration or salary from a company may not be auditors of the company. This in other words is excluding employees of a company from becoming auditors thereof.

In fact, legislation governing share companies engaged in the financial sector clearly provide that employees of such companies may not become auditors.

Nevertheless, article 370 will still fall short of governing non audit services since non audit services that could be delivered on contractual basis with lump sum payment arrangements are not prohibited. Such contractual relationships if involving huge amount of payment are equally, if not more, capable of impairing auditors' objectivity in conducting audit.

An absolute ban on auditors from rendering non audit service to their audit client is detrimental not only to the auditor but also to the audit client, bearing a negative consequence on its corporate governance. Restrictions that intend to safeguard auditors' objective judgement from compromises

resulting from rendering other services to the same client are better achieved either by putting fee caps that may be received from the non audit services and/or identifying those services that may jeopardize his/ her independence and prohibiting delivering them to their audit client.

4.4.3.1 Auditors as Interim Managers

Under article 351(5) of the Code, auditors are allowed to provisionally carry on the management of the company with a view to tackle situations where there are no surviving directors of the company.

Article 351

*4) Where there are no surviving directors, the auditors shall convene a general meeting **without delay** for directors to be elected. (Emphasis added).*

5) During the period prior to the calling of the general meeting under sub article (4), the auditors may carry on the management of the company.

The auditor's involvement in the management of the company will be for a short period of time if they choose to carry on since sub article 4 requires them to convene a general meeting without delay for the election of directors.

However, even if they may be in such a position for a limited period of time, their independence can be at stake and they might end up auditing their own works.³⁰⁶

Setting a time frame for convening the meeting for this purpose can also foster good governance of the company since the phrase "without delay" is subject to interpretation.

4.4.4 Setting Audit Tenure and Auditor's Rotation

As discussed in the previous chapter, the setting of a maximum period of time in which auditors could serve a company is a common mechanism designed to prevent them from building intimate relationship with management. This, in turn, enhances their role in the good corporate governance of companies they audit. In Ethiopia, both extended audit tenures and short audit tenures may be a source for the emergence of threats to auditor independence and audit quality with the risk even higher when auditors have extended audit tenures.³⁰⁷

An auditor of a share company is initially appointed by the meeting of subscribers and holds office until the next annual general meeting.³⁰⁸ An auditor appointed at an annual general meeting may hold

³⁰⁶ Recommendations and position paper of the business community on the revision of the commercial code of Ethiopia, p. 29, available at: <http://www.ethiopianchamber.com/data/sites/1/psd-hub-publications/position-of-the-business-community-on-the-revision-of-the-commercial-code-of-ethiopia.pdf>

³⁰⁷ Amsalu Gelaneh, *The Impact of Extended Audit Tenure on Auditors Independence And Audit Quality In Addis Ababa*, (2011, unpublished, Department of Accounting and Finance A.A.U), p.79

³⁰⁸ Commercial Code, Supra note 40, Art. 369(1)&(2)

office for three years.³⁰⁹ The Code does not prohibit an auditor appointed by the meeting of subscribers from being reappointed at the annual general meeting. Therefore, the maximum period an auditor could continuously serve a share company could be four years.

The tenure of audit firms is usually governed taking into account the service years of the key audit partner. Under the French system for example, companies must consider audit contracts for renewal or change at least every six years and while the same auditing company may be retained for a new mandate, the principal audit partner must be rotated.³¹⁰ The SOX in regulating audit tenure of audit firms under Section 203 states that it shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.

The Commercial Code does not make distinction between audit firms and individual auditors in their audit tenures. Regulating the tenure of individual auditors and audit firms distinctly with a relatively longer service years for audit firms along with requirement of key audit partner rotation could be beneficial to the company being audited as well as the audit firm.

However, the Code tries to avoid situations whereby auditors and their audit clients build close relationship that may compromise the former's independence. This in turn ensures auditors effective contribution to the good corporate governance of their audit client.

4.4.5 Excluding Individuals Affiliated to the Audit Client from the Role of Auditing

Article 370(1) of the Commercial Code provides a list of individuals that may not be elected as auditors of a company. These individuals include;

- Founders;

According to article 307 of Commercial Code, founders include persons who sign the memorandum of association and subscribe the whole of the capital. Where a company is formed by the issuance of shares to the public, persons who sign the prospectus bring in contributions in kind or persons who are to be allocated a special share in the profits are also considered founders. A person who has initiated plans or facilitated the formation of the company is also given the status of a founder according to the provision.

- Beneficiaries holding special benefits;

³⁰⁹ Ibid, Article 369(2)

³¹⁰ Related Party Transactions and Minority Shareholder Rights, OECD (2012), P.11, available at <http://dx.doi.org/10.1787/9789264168008-en>

The Code does not define who beneficiaries holding special interest are but special interest could be based on classes of shares and the term may encompass shareholder with preference shares as per article 336 of the Code.

- Directors of the company , its subsidiaries or its holdings company;

The term director is also not defined in the Commercial Code. The Banking Business Proclamation No. 592/2008 under article 2(6) defines the term as any member of the board of directors of a bank, by whatever title he may be referred to. Similarly, article 2(10) of the Insurance Business Proclamation No.746/2012 defines director as any member of the board of directors of an insurer, by whatever title he may be referred to. Generally, Director may be defined as a person having control over the direction, conduct, management or superintendence of the affairs of the company.³¹¹

- Contributors in kind
- Spouses or relatives by consanguinity or affinity to the fourth degree of the aforementioned individuals
- Persons who other than as an auditor receive salary or periodical remuneration from the founders, contributors in kind, beneficiaries of special interest, directors of the company or one of its subsidiaries or its holdings company

By Such restrictions, the law attempted to ensure that auditors render an objective judgement which is not affected by personal interest and familial or occupational affiliations.

Exclusion of persons with such kinds affiliation to a company (or spouses, relatives by affinity or consanguinity to the affiliated persons) from becoming an auditor thereof is a common approach to ensuring auditor independence and good corporate governance in other legal systems as well.³¹²

The scope of this exclusion appears to be broad especially since restriction on the basis of relationship by affinity and consanguinity extends to the fourth degree. However, given the conflict of interest such exclusions aim to avoid, the provision fails to effectively regulate certain meaningful relationships that may impact the audit.

If conflict of interest is to be avoided, persons affiliated to employees who contribute to the bookkeeping or preparation of books of accounts of the company or other documents on which the auditor needs to form opinion should be incompetent to become auditors. As the financial audit involves investigating the works of such employees, an auditor affiliated to them will be in a difficult position to pass an objective judgement on works done by them.

³¹¹ Fernando, Supra note 19, p. 189

³¹² Ownership Rules Of Audit Firms, supra note 160

Another important issue in relation to auditors' independence is the consequence of works done by them while they were in circumstances that are believed to impair their independence. In this regard, the Commercial Code under article 370(3) provides that reports of auditors adopted by the annual general meeting shall not be invalid except in case of fraud merely by reason of the fact that they fall under the category of persons incompetent to be auditors under the Code.

The reason for prohibiting the individuals from audit of the company is obviously the need to avoid probable conflict of interests. Apart from that, these individuals are assumed to be professionally competent. It is therefore sound not to invalidate works done by them where no fraud exists in the execution of audit by the mere fact that they are in certain ways placed in positions entailing probable conflicts of interests.

Where the work of the auditor has been adopted, the legislature chooses to hold the report valid except in case of fraud regardless of it declaring the auditors incompetent to do the work initially.

As logical as this may be, it nonetheless opens room for what the legislature intended to avoid in the first place. As modern day audits do not involve checking each and every detail of the audit clients' financial statements, books of account or other documents, the crafting of article 370(3) gives leeway for the auditor to commit fraud. Detecting and proving fraud can also be very difficult.

For these reasons, a strictly proactive approach needs to be adopted with no room for auditors in the mentioned scope of incompetency to undertake audit of the company. To this end, auditors should declare that they do not fall within the incompetency ambit with a consequence for any false declaration.

4.5 Audit Committee

The concept of audit committee with roles and responsibilities that can positively enhance the role of auditors in the corporate governance of a company as discussed in the previous chapter is nowhere to be found in the Commercial Code although there is no prohibition of board sub committees.

The newly enacted Bank Corporate Governance Directive No.SBB/62/2015 and Insurance Corporate Governance Directive No.SIB/42/2015 have introduced Audit committees to the banking sector.

4.5.1 Audit Committee Composition and Membership

An audit committee under Directive No.SBB/62/2015 and Directive No.SIB/42/2015 is a mandatory sub committee of the board of director of banks and insurance companies.

The committee should have a minimum of 3 directors one of whom should have accounting or auditing expertise or experience in the field of finance and the sub-committee is entrusted with various roles

and responsibilities.³¹³ The committee reports to the full board and is therefore answerable to the Board of Directors.³¹⁴

The responsibilities of the sub-committee are similar to proposed roles of audit committees under King report as discussed in the previous chapter.

The concept of audit committee is based on the existence of non executive/ independent directors. It is such independence of members of the committee that is considered to give them the intended role of watchdogs of shareholders' interests. Composition of audit committees from independent directors is a recognized principle in the OECD principles, King Report, SOX, Cadbury report and the UK Corporate Governance Code.

In the absence of a requirement of independence of members of the committee, its establishment alone might not have significant effect on the corporate governance of banks or insurance companies. They could of course enhance the efficiency of the board from the division of labour point of view as a sub-committee having at least one member with expertise in the field of audit, accounting or finance and the mandatory monthly meetings.

The full fledged benefits of audit committees however presuppose the existence of independent or non executive directors to a certain level. Even if non-executive directors play a significant role in providing independent and objective guidance and direction of management and company, the Commercial Code and other relevant laws do not require companies to have independent non-executive directors and do not distinguish the roles of the board from that of the management besides its failure to define independence of board of directors.³¹⁵ It can thus be concluded that the audit committee under both directives do not reflect the essence of audit committees as in well developed corporate governance guidelines and principles. The directives also do not prohibit the board chairperson from membership to the audit committee but the prohibition is important if the committee is to discharge its responsibilities without hindrance.

The audit committees are entrusted with the power to approve the provision of non audit services by the external auditor and ensure that there are proper checks and balances in place so that the provision of such services does not interfere with the exercise of independent judgment of the auditors.³¹⁶

In the absence of the notion of non executive directors or certain criteria for the independence of the audit committee from management, the exercise of such power by the committee can not ensure the desired goal of ensuring auditor's independence. There is also need to put in place some legal

³¹³ Bank Corporate Governance Directives, 2015, Directive. No. SBB/62, Annex III on the role of Audit Committees

³¹⁴ Ibid

³¹⁵ Hussein Ahmed, "Reforming Corporate Governance In Ethiopia: Appraisal Of Competing Approaches" , Oromia Law Journal , vol .3, no. 1, p.184

³¹⁶Bank Corporate Governance Directives, Supra note 297, Annex III, no iii, 9& 10 on the role of Audit Committees

framework on provision of non audit services giving clarifications on the types of services that audit committees may consider for approval.

4.6 Auditors in the Financial Sector

The legal regime governing auditors of the financial sector is different from the other sectors in some aspects.

Even if the main legal framework for the sector remains to be the Commercial Code provisions on share companies it is also governed by other Proclamations and directives by the National Bank of Ethiopia. The role of auditors in companies engaged in the financial sector will thus be discussed in light of these laws under the following sub-sections.

4.6.1 Appointment of Auditors

Appointment of auditors for banks follows a similar approach for other share companies governed by the provisions of the Commercial Code but involves the recommendation of audit committee.

According to articles 6 (6.1.2) and article 10 (10.4.3) of bank corporate governance directives No. SBB/62/2015, the board of directors proposes the appointment to the general meeting of shareholders who finally decides upon the appointment.

The directive under article 6(6.1.2) clearly provides that the power of the general meeting of shareholders to decide upon the appointment of auditors can not be delegated to any other organ in the bank structure.

In addition to the decision of the shareholders, the appointment of an auditor must be approved by the National Bank.³¹⁷ This is clearly a stricter criteria and oversight of auditors of banks which makes the National Bank the ultimate body with the power to appoint auditors indirectly.

In this process of appointing auditors, the directive provides that audit committees have the duty to recommend the appointment of the auditors.

The appointment of auditors of insurance companies is governed identically and needs to be approved by the National Bank.³¹⁸ Auditors appointed by microfinance institutions on the other hand need not go through the process of approval by the National Bank but need to be appointed with yardsticks satisfactory to the Bank.³¹⁹

The clear stipulations of the power of shareholders to appoint auditors as non delegable for the banking sector and the requirement of approval by the National Bank may contribute towards the enhancement in quality of the audit process in the banking and insurance sector. This would mostly be true because

³¹⁷ Banking Business Proclamation, 2008, Art. 24(1) , proc .No. 592, Neg. Gaz., year 14, no.57

³¹⁸ Insurance Business Proclamation, 2012, Art. 28(1), proc. No746, Neg. Gaz., year18, no. 57 and Insurance Corporate Governance Directives, 2015, Directive. No. SBB/42, Annex III on the role of Audit Committees

³¹⁹ Micro-financing business Proclamation, 2009, Art. 12(1), proc. No. 626, Neg. Gaz. , year 15, no. 13

shareholders might simply endorse proposal by the board at the annual general meetings as it is mostly the case in other countries where appointment of auditors by shareholders meeting is simply a matter of formality than carefully deliberated decision.

Given the impact of financial companies on the economy, subjection of the appointment of auditors to approval by the regulatory body may add to the good corporate governance of the companies.

4.6.2 Persons Incompetent to Be Auditors of Companies in the Financial Sector

Criteria for competency of auditors of companies engaged in the financial sector are found in different legislation governing the sector.

Under article 24(2) of Banking Business Proclamation No.592/2008, the following persons are incompetent to be auditors of banks:

- a) A shareholder, director or employee of that bank;
- b) A spouse or relative by consanguinity or affinity to the first degree to a person falling within the categories provided under paragraph (a) of this sub-article; or
- c) A firm of auditors of which any partner or a staff member falls within the categories provided under paragraph (a) or (b) of this sub-article.

Similar prohibitions are found under article 28 of the Insurance Business Proclamation No.746/2012 and article 12(4) Micro-financing Business Proclamation No.626/2009.

These prohibitions are additions to the ones under the Commercial Code broadening the scope of incompetency of auditors.³²⁰

In the legislature's ambition to eliminate conflicts of interest; spouse or relative by consanguinity or affinity to the first degree of employees and shareholders without any distinction are restricted from becoming auditors of the company.

However, the need to avoid conflict of interest in the case of audit should not unreasonably overshadow the other needs of the company in promoting its own good corporate governance through auditors.

The prohibitions under the Proclamations unnecessarily restrict companies' access and choice of auditors from the market.

Under the existing legal framework a company in the financial sector is effectively prohibited from appointing a renowned audit firm for a price which it considers fair for the mere fact that one of the staffs of the audit firm has a sister in law who is employed as a secretary in the company. The situation would make sense if the audit firm's staff member is participating in the audit as a key audit partner or assistant or if the sister in law is involved in tasks that would be subjected to audit.

³²⁰ Article 60(3) of the Banking Business Proclamation No. 592/2008 and article 59(3) of the Insurance Business Proclamation No.746/2012 state that nothing proclaimed therein shall be construed so as to relieve these financial institutions from compliance with the provisions of the Commercial Code

Affiliation to such individuals employed in the company does not in all cases make the auditor prone to impairment of independence.

Restrictions should not therefore be blindly imposed. Rather, situations and relationships that would make the auditor vulnerable and biased should be identified so as to effectively do away with conflict of interest.

The National Bank may issue directives on audit tenure of auditors of banks, insurance companies and micro-financing institutions. Article 25(3) of the Banking Business Proclamation No.592/2008, article 29(1) of the Insurance Business Proclamation No.746/2012 and article 12 (3)(c) of Micro-financing Business Proclamation No. 626/2009 provide for the power of the NBE to issue directives on audit tenures of the auditors of the respective companies.

4.7 Auditors of Private Limited Companies

Private limited companies constitute the overwhelming majority of companies in Ethiopia and their contribution to the economy is also significant. Good corporate governance in terms of private limited companies should therefore be considered by the legal framework on good corporate governance.

PLCs established according to the Commercial Code are obliged to have auditors where there are more than 20 members.³²¹ In such cases, not less than three auditors shall be appointed in the memorandum of association.³²²

A cross reference to the provisions of the Code governing auditors of share companies is made only with regard to duties and liabilities of auditors.³²³ Apart from singling out these provisions, a mutatis mutandis application of the provisions of the Code governing auditors of share companies is not called for and notable different rules are found in the Code.

One of such provisions is the requirement of a minimum of three auditors under article 538(1). While the maximum number of members of a PLC could not be more than 50 and where there is no limitation of member size for share companies, the reason for requiring a minimum of one auditor for share companies but three for private limited companies is illogical. The reason behind such imposition is not clear and it obviously subjects the company to an extra expenditure for remuneration of auditors.

Once auditors are appointed in the memorandum of association they may be re-appointed at such periods and under such conditions as may be provided in the articles of association as provided for under article 538(2).

³²¹ Commercial code, Supra note 40, Art.525(2)

³²² Ibid, Art.538(1)

³²³ Commercial code, Supra note 40, Art.538

This would mean that the details of re-appointment are governed by the articles of association and no tenure limitations, competency requirements or appointment procedures in the case of share companies are applicable to PLCs.

Auditors of a private limited company may, therefore, stay in office for a period of time which is prolonged enough to jeopardize their independence through close relationship with management of the audit client.

The Code also does not provide for cases of incompetency to be an auditor of a PLC neither does it regulate auditor's future relationship as potential employee of the company.

In such conditions, it is almost impossible to ensure the good corporate governance of PLCs through auditors. The audit of these companies needs to be properly regulated and emphasis given to them should not be any less than that given to share companies. This is mainly because the limited liability status granted to a company is meant to be accompanied by a mechanism of assuring the credibility of the financial affairs of a company which can only be provided through audit and more importantly, such companies can be public interest entities regardless of their size.³²⁴

The notions of a 'Reporting Entity' and 'Public Interest Entity' in the Financial Reporting Proclamation and their implication on the requirement for PLCs to appoint auditors need to be discussed at this point.

The Proclamation under article 2(18) provides for a definition of a reporting entity as any entity, other than public bodies and micro enterprises, required by law to submit financial reports whereas micro enterprises are defined as enterprises the AABE will determine as such in its directives based on its own criteria. Furthermore, reporting entities have the obligation to have their financial statements audited as per article 9 of the Proclamation.

It could therefore be a requirement for all private limited companies to have auditors if AABE does not disregard them as micro enterprises.

According to article 2(17) of the Proclamation, the Board could also from time to time qualify a reporting entity that is of significant public relevance (because of the nature of its business, its size or its number of employees) as a public interest entity. The provision clearly qualifies a company whose securities are admitted to trading on a regulated capital market, banks, insurance companies and any other financial institutions and public enterprises as public interest entities.

Based on these provisions, PLCs could be among those companies the Board could qualify as public interest entities in the directives it will issue from time to time.

³²⁴ Hussein, Supra note 315, p. 193

AABE has not issued any directives until this point in time when the writer conducted the study. Forthcoming directives by the Board should take into account that PLCs constitute majority of business entities in the country and need to be strictly regulated.

4.7 The Role of Auditors in the Protection of Minority Shareholders

The protection of minority shareholders is one of the pertinent issues in ensuring good corporate governance and the role of auditors in protecting minority shareholders in the Ethiopian context will be discussed under this sub-section.

The concept of minority shareholder is frequently understood to mean a shareholder that does not exercise a substantial degree of control or influence over a company's affairs.³²⁵

Black's law dictionary defines minority shareholders as shareholders who own less than half of the total share outstanding and thus cannot control the corporation's management or singlehandedly elect directors.

The Commercial Code neither clearly defines minority shareholders nor explicitly refers to their right.³²⁶

The OECD principles of corporate governance calls for the protection of minority shareholders and provides that they should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.³²⁷

It can be generally said that a legal regime which incorporates the following provides protection to minority shareholders.³²⁸

- the right to proxy voting;
- the right of shareholders to bring derivative suits;
- cumulative voting or proportional representation of minorities on board of directors;
- pre-emptive rights of shareholders whenever new shares are issued which can be waived only by shareholders' vote ;
- a minimum percentage of share capital that entitles a shareholder to call ordinary general meeting set to be less than or equal to 10 percent; and
- No compulsion of shareholders to deposit their shares prior to shareholders' meeting.

³²⁵ Protection of Minority Shareholders in Listed Issuers, Technical Committee Of The International Organization Of Securities Commissions (2009) p.6 , available at : <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD295.pdf>

³²⁶ Article 352 of the Commercial Code attempts to address minority rights but the use of the term 'shareholders with different legal status' lacks clarity and makes it difficult for implementation.

³²⁷ OECD Principles, Supra note 7, principle III A 2

³²⁸ Fekadu, Supra note 28, p.18

These being general mechanisms of protecting minority shareholders that a company law regime might consider in extending protection to minority shareholders, it is needless to mention that the role of auditors in protecting minority shareholders is closely related to disclosure of the company's affairs. This is mainly because the role of auditors as mentioned in previous chapters is verifying whether the financial statements of the company, reports of management and the board of directors are correct and reflects the correct state of the company.

Disclosure of a company's affairs is one of the keys to protecting minority shareholders.³²⁹ One of the major concerns in a company's affairs in relation to minority shareholders that require disclosure is related party transactions which can be abused by executives and controlling shareholders.³³⁰

Special reports prepared by auditors about the terms and conditions of such transactions are important in equipping shareholders with sufficient information to make a judgement.³³¹ In various jurisdictions, external auditors provide an assurance to the board and shareholders that material information concerning related party transactions is fairly disclosed and alert them of any significant concerns with respect to internal control.³³²

The Commercial Code under article 356(1) & (2) lays down that auditors shall be given a notice on any dealings made directly or indirectly between a company and a director and they shall submit a special report on the dealings to the general meeting so that it may take any action it thinks fit.

The special report auditors prepare upon being notified of the dealings (disclosure) is an important tool in shareholders' decision making process in relation to such dealings approved by the board. In addition to the special audit report, the requirement of approval of the dealings can also protect minority shareholders where there exists a representation of these shareholders in the board of directors.

However, the day to day businesses of the company are managed by the general manager who may not be a member of the board as provided under article 348 and the Code requires auditor's special report only on dealings directors make with the company. The absence of a legal requirement to notify auditors of dealings the general manager and other persons performing key management function may make with the company either directly or indirectly could be detrimental to shareholders in general and minority shareholders in particular.

The role of auditors in protecting minority shareholders' interests in the Commercial Code is also found under article 377(2) which obliges auditors to call a general meeting upon the request of

³²⁹ OECD principle, supra note 7, p.42

³³⁰ Related party Transactions, Supra note 330, p.11

³³¹ Ibid, p. 34

³³² Ibid, p.28

shareholders holding less than 20% of the capital. Article 368(2) also allows such shareholders to select an auditor.

In addition to the aforementioned special rules in the interest of minority shareholders, it should be noted that the roles and responsibilities of auditors in a company will in general benefit the entire shareholders, minority and controlling alike.

4.9 Oversight of Auditors

The oversight of auditors and their licensing has been the role of OFAG and Civil Service College. Their power with regard to issuance, renewal, suspension and cancellation of certificate of competence of auditors as provided under article 5(16) & (17) of the Office of the Federal Auditor General establishment (amendment) Proclamation No.669/2010 and article 5(3) of the Civil Service College reestablishment Regulation No. 121/2006 is repealed and entrusted to newly established bodies by the Financial Reporting Standards Proclamation No.847/2014. The Accounting and Auditing Board of Ethiopia (AABE) is now entrusted with licensing of auditors and the institute of certified public accountants (not established yet) has also been given a role in the licensing and registration process.³³³ Continuing professional education as may be specified in Directives of the Board enacted as per article 18 (4) of AABE Establishment Regulation can enhance the role of auditors in ensuring good corporate governance through their professional development. Furthermore, reporting entities are obligated to submit their financial report to the AABE as per article 8 of the Financial Reporting Proclamation broadening its oversight power.

The Board is established as an autonomous government organ having its own legal personality accountable to the Ministry of Finance and Economic Development.³³⁴ This basing of the auditor oversight system on a government organ is consistent with the wide international consensus of a system that is not based exclusively or predominantly on self regulation.

4.9.1 Overview of the Roles of the Accounting and Auditing Board of Ethiopia (AABE)

The principles for auditor oversight by IOSCO provide that a mechanism to require that auditors have proper qualifications and competency before being licensed to perform audits, and maintain professional competence should be put in place. A mechanism should also exist to withdraw authorization to perform audits of publicly traded companies if proper qualifications and competency are not maintained.

³³³ Financial Reporting Proclamation, 2014, Art. 18(4)(a) & Art 2(4), proc. No. 847, Neg. Gaz., year20, no.81

³³⁴ Establishment and Determination of the procedure of the Accounting and Auditing Board of Ethiopia Council of Ministers Regulation, 2014, Art.3, Reg. No 332, Neg. Gaz., year21, no. 22

Consistent with this, AABE is empowered to issue directives related to the professionals including for the acceptance or rejection of application, suspension, cancellation or renewal of certificate and registration.³³⁵ It is also empowered its own examination and quality requirement directives.³³⁶ A quality assurance scheme is also considered.³³⁷ The number of qualified professional accountants in the country is too small and falls short of meeting national demand in both the private and public sectors, including the academia.³³⁸ AABE recognizes that it needs to promote awareness of the accountancy profession at universities and influence curricula for accountancy education to align it with entry requirements to professional accountancy education.³³⁹ The Board's plans to work on enhancing qualification through influencing curricula can in turn enhance its effectiveness in oversight of qualifications.

The other principle by IOSCO is putting in place mechanism to require that auditors are independent of the enterprises that they audit, both in fact and in appearance. Effective standards, regular assessments, and regulatory oversight generally increase the likelihood that independence is maintained.

Auditors in Ethiopia shall not engage in any activity that is likely to impair their professional independence as auditors whether independence in appearance or independence of mind.³⁴⁰ One of the objectives of AABE as provided under article 5(5) of the Establishment and Determination of the Procedure of AABE Regulation No. 332/2014 is protection of the professional independence of accountants and auditors. However, the existing framework does not provide for effective standards to ensure independence.

IOSCO suggests that auditors should be subjected to the discipline of an auditor oversight body that should also have the authority to stipulate remedial measures for problems detected, and to initiate and/or carry out disciplinary proceedings to impose sanctions on auditors and audit firms, as appropriate. AABE under article 6(1) of the above mentioned regulation should establish a code of conduct. It also conducts quality assurance reviews of public auditors, audit firms and persons associated with them to determine where they have complied with applicable auditing standard.³⁴¹ As per article 6(6) of the Regulation, AABE facilitates arbitration or conciliation to amicably resolve disputes between professionals and their clients. It also takes disciplinary actions where appropriate as

³³⁵ Ibid, Art. 6(2)

³³⁶ Ibid, Art. 6(3)

³³⁷ Ibid, Art. 26

³³⁸ Accounting and Auditing Board of Ethiopia (AABE) Five Year Strategic Plan (Fiscal years 2016-2021), p.24

³³⁹ Ibid

³⁴⁰ Financial Reporting Proclamation, Supra note 333, Art. 33(1)(b)

³⁴¹ Ibid, Art.4(2)(i)

provided in article 6(12). AABE could also initiate proceedings where its directives and the Financial Reporting Proclamation appear to have been violated.³⁴²

Auditors are under the oversight of the AABE and the framework in place recognizes the fundamentals of auditors' oversight although details are not yet in place.

4.10 Auditors' Responsibilities

In the Commercial Code, auditors have the responsibility to inform public prosecutors of any matter which would appear to disclose the commission of an offence.³⁴³

With regard to companies engaged in the financial sector, auditors of an insurance company have a duty to report their audit findings and conclusions to the NBE.³⁴⁴ They should also immediately notify the NBE of grave irregularities and offences.³⁴⁵ Auditors of banks also have similar responsibilities.³⁴⁶ The Banking Business Proclamation No.592/2008 further provides under Sub article 3 of article 26, which deals with duties of auditors, that a person appointed as an auditor of a bank may not operate an account with, or be granted any type of loan, advance or facility from that bank except in the normal course of business and at an arm's length basis.

Auditors of micro financing institutions also have similar responsibilities of reporting irregularities and offences.³⁴⁷ They should also submit to the NBE their audit findings and conclusions.³⁴⁸

According to article 31 of the Financial Reporting Proclamation No.847/2014, auditors, both public and certified, should notify the officers and all members of the board of the reporting entity they audit of any material irregularity and unless they are satisfied that no such irregularity has taken place or the board of the entity have taken adequate steps to remedy the irregularity, they should report to the AABE within 30 days from the time of issuance of the notice to the board of the company.

According to article 33 (1) (b) of the Financial Reporting Proclamation, an auditor should not engage in any activity that is likely to impair his professional independence as an auditor whether independence in appearance or independence of mind.³⁴⁹ However, From the reading of article 33 (2)

³⁴² Ibid, Art. 38

³⁴³ Commercial code, Supra note 40, Art. 376(1)

³⁴⁴ Insurance Business Proclamation, Supra note 318, Art.30

³⁴⁵ Ibid, Art.31(5)

³⁴⁶ Banking Business Proclamation, Supra note 317, Art. 27(4)

³⁴⁷ Micro-financing business Proclamation , Supra note 319, Art.13(5)

³⁴⁸ Ibid, Art. 13 (1)

³⁴⁹ Article 33(6) of the Financial Reporting Proclamation No. 847/2014 defines independence of mind as the state of mind that permits the provision of opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism. Independence in appearance on the other hand means the avoidance of any fact or circumstance creating on an informed and reasonable

of the Proclamation, it can be understood that an auditor or his partner or any person employed by him or any person working under his supervision and control or under the supervision and control of his partner is not effectively prohibited from keeping the books, records or accounts of an audit client. Participation in the book keeping will undoubtedly give rise to auditing one's own work.³⁵⁰ Such participations should be absolutely prohibited non audit services and excluded even under those categories impliedly permissible upon disclosure.

With a view to maintain the independence of auditors, the Proclamation under article 34 also obliges auditors(both individuals and audit firms) to withdraw from auditing any reporting entity when they consider that it may have a conflict of interest or lack professional independence.

4.11 Auditing Standards

Auditing standards have a role in ensuring that factors such as objectivity, integrity and independence, factors which are essential in the external auditor's performance of his/her responsibilities are respected.³⁵¹

This being the case, the implementation of auditing standards is dependent on accounting standards in use.³⁵² The quality of accounting standards along with other institutional factors such as the existence and enforcement of laws governing investor protection also affects the quality of financial information.³⁵³

Despite the impact of accounting standards on the quality of financial information and the impact of auditing standards on the external auditor's performance of his/her responsibilities, the Commercial Code has no requirement for compliance with accounting and auditing standards.³⁵⁴

The Financial Reporting Proclamation No. 814/2014 aims to rectify the absence of requirement for compliance with accounting and auditing standards in the Commercial Code and other laws by repealing provisions of the Code pertaining to financial reporting and introducing a new set of financial reporting standards and auditing standards.

Article 5 of the Proclamation provides that applicable financial reporting standards to be used when preparing financial statements shall be standards issued by the International Accounting Standards

observer the impression that the integrity, objectivity or professional scepticism of a firm or member of an audit team has been compromised.

³⁵⁰ Martin, Supra note 194, p.61

³⁵¹ Marianne, Supra note 22, P. 7

³⁵² Ethiopia – Accounting and Auditing Report on the Observance of Standards and Codes, (2007),P.12 available at: www.worldbank.org/ifa/rosc_aa_ethiopia.pdf

³⁵³ Marianne, Supra note 22, P. 7

³⁵⁴ Ethiopia- Accounting and Auditing Report, Supra note 352 p.1

Board, the International Public Sector Accounting Standards Board or their successors. The provision also empowers the AABE to adapt or amend any of the standards.

These reporting standards are:

- International financial reporting standards;
- International financial reporting standards for small and medium enterprises ;and
- International public sector accounting standards applicable to charities and societies.

In addition to determining financial reporting standards that should be used in preparing financial statements, the Proclamation under article12(1) stipulates that the auditing standards to be used by auditors in Ethiopia shall be the International Standards for Auditing issued by the International Federation of Accountants or its successor as adopted, adapted or amended by AABE.

The absence of requirement for compliance with accounting and auditing standards both in the Commercial Code and other laws and the problems associated therewith can therefore be rectified by these rules in the Financial Reporting Proclamation.

4.12 Concluding Remarks and Recommendations

4.12.1 Conclusion

Corporate governance is defined differently by authors in different disciplines. The concept is eclectic and a pressing issue given the impact of corporations in various aspects of human affairs. The different privileges companies enjoy exclusively call for a greater transparency and accountability. Audit has been a mechanism of monitoring management performance and check and balance system since the industrial revolution to aid in ensuring the accountability of corporations. The concept and scope of audit has developed over the years and has gained the status of corner stone in the governance of companies.

The impact of auditors' role in corporate governance has been brought to the forefront after the collapse of big companies like Enron. Although such debacles revealed auditors have failed to discharge their professional responsibilities, their role in corporate governance remains undoubted. The response to the collapse of companies has thus been reforming corporate governance systems and legislation on the role of auditors in companies and putting in place a strong oversight body on auditors and the auditing profession.

In discussing the role of auditors in corporate governance, both internal and external auditors have significant roles and the latter will benefit from the work of the former and should decide on how to

make use of it and the extent of reliance on such works. Although internal audit contributes significantly to corporate governance, the external auditors are in a better position to provide the necessary check on a company's management and board of directors. The role of auditors in ensuring good corporate governance thus mainly refers to audit through external auditors.

The very concept of audit is founded on checking whether works subject to the audit conform to a certain set of standards that serve as an objective standard. Audit has historically emerged on the conception that managers can not be judges of their own work. This shows that the effectiveness of auditors is inherently related to their independence and objectivity. Literatures on audit provide that the auditing profession can not exist in the absence of independence from the body subject to audit.

Taking this into account, corporate governance systems and legislative reforms in different countries conducted with the view to ensure good corporate governance through auditors revolve around ensuring the independence of auditors. The oversight of auditors and the auditing profession are equally based on objectivity and independence.

To ensure good corporate governance through auditors, their independence is considered by different corporate governance mechanisms from the start of their duties, i.e. from the hiring process to the accomplishment of their duties and even after the termination of their services.

The most prominent legislation and documents dictating the subject of corporate governance like the OECD principles, the SOX, King Report on Corporate Governance for South Africa, the Cadbury report, and the UK Corporate Governance Code all stress on the independence of auditors to ensure good corporate governance through them. Requiring transparency from auditors is also recognized as an important measure to ensure good governance of companies. The writer has relied on these documents in conducting this work.

Ensuring that auditors are not subjected to the hire and fire power of management is the first step that is taken to enhance their role. When managers are empowered to hire and fire auditors, their independence is greatly endangered. The placement of external auditors in the presence of internal audit function within a company is basically the search for auditors free from control by managers. The selection of auditors by the company's members (shareholders) is intended as a solution to this problem and is a common trend across the world. However, a requirement that auditors be appointed by shareholders has not been sufficient to ensure their independence. Recent developments try to ensure that managers do not get involved in the appointment process. The SOX requires appointment of auditors of public companies by audit committees of independent directors while UK Corporate

Governance Code requires auditors be recommended by independent committee (audit committee) to the board of directors for presenting it to appointment by shareholders. The board of directors is required to provide justifications for any rejection of the recommendation by the board of directors.

Excluding auditors affiliated to certain shareholders, directors, managers, and employees of a company from the audit of such companies is the other prominent method of ensuring auditors' independence thereby their role in ensuring good corporate governance. The degree of relationship that is taken as a cause for the 'incompetency' of auditors varies among different countries but all of them have ensuring objectivity of the auditor at the heart.

A regulation of non audit services auditors may provide to their audit client is the other measure with similar objective. An absolute ban on provision of such services is believed to be detrimental to the company and not advocated for to ensure good corporate governance. Services that could jeopardise the auditor's independence because of their nature are identified and prohibited by law. The SOX has list of services that auditors may not give to their audit client. Other non audit services are subjected to the approval by independent subcommittee of the board in case of unitary board structure and by supervisory boards in where two tier board systems exist. An obligation to disclose fees paid for non audit services is also devised to ensure the independence of auditors and also enable creditors and investors in general to gauge the reliability of auditor's reports.

This also assists oversight bodies to take appropriate measures.

Audit tenures are regulated by the law to prevent auditors from creating close friendship with management of the company and end up covering for any fraud or irregularity they should reveal in their reports or to the management itself. Different timeframes exist among countries in this regard.

The control of personnel flow is the other technique in upholding the objectivity of auditors. Company laws ensure that cooling periods are in place for auditors to become high level employees of their audit client. Likewise, managers, financial officers or directors are required to follow cooling period before they become the auditor of the company they served in that capacity.

Mechanisms that are designed to ensure corporate governance through auditors once they are elected to carry out audit also involve imposing an obligation to conduct audit in accordance with high quality auditing standards, work closely with internal audit and audit committees, and oblige them to report irregularities to the board of directors or management and sever cases to regulatory bodies.

The subjection of the audit profession to government regulation rather than self regulatory regime is the other important step countries have taken to ensure good corporate governance through auditors.

This work appraised the Ethiopian legal regime governing auditors to see if it enables ensuring good corporate governance through them. The writer has analysed the Commercial Code provisions on auditors, Proclamations enacted to govern the financial sectors and subsequent directives, the Financial Reporting Proclamation and the regulation enacted under it in the appraisal.

The Ethiopian legal regime was appraised in light of developed corporate governance principles and laws. The laws have mechanisms to safeguard auditors' independence and objectivity which are in essence similar to prominent corporate governance systems of other countries.

However, the details of the laws do not address the issues they ought to resolve adequately. With regard to the election auditors, the Commercial Code provisions only provide that they shall be elected by shareholders in case of share companies and members in case of PLCs. Other stipulations that ensure managers do not involve in the election are not provided. The appointment of auditors of companies in the banking and insurance sectors are on the other hand subjected to the approval by the regulatory body of the sector, the NBE, which may add to the good corporate governance of such companies. A directive by the NBE has also introduced audit committees into the governance of such companies. Although the roles of the committee is similar with other systems where the concept is well developed, audit committees in companies engaged in the financial sector in Ethiopia lacks the very essence of audit committees which is independent members.

Although PLCs can not be as large as share companies in terms of members' size generally, they can be of public interest as a result of the amount of money involved in running their business and the limited liability privilege they enjoy. However, the Commercial Code does not have detailed rules governing their auditors as in the case of share companies. Neither does it provide a *mutatis mutandis* application of the provisions on share companies.

Incompetency of becoming an auditor of a company on the ground of affiliation is also found in the Commercial Code and Proclamations on the financial sector. The writer believes the relationships the legislator took into account to draw the incompetency scope on the basis of familial relationships need to be changed taking in to account the present day society and mainly practicality. Relationships of affinity or consanguinity to the fourth degree under the Code can be difficult for implementation. On top of that the Code does not impose proactive measures to ensure such auditors do not involve in the audit of the company.

Non audit services that could impair auditors' independence are not identified and prohibited. The Commercial Code does not have adequate rules on this regard and s does not tackle potential impairment of independence and objectivity.

The banking and insurance sectors Proclamations add to the Commercial Code prohibitions and exclude auditors affiliated to employees of the institutions either by affinity or consanguinity up to the second degree from becoming auditors of such companies.

The setting of audit tenure and control of personnel flow are also found in the Commercial Code. A maximum of 4 years is provided for auditors of share companies but the tenure of auditors of PLCs is not set by the law. Personnel flow limitations in the form of a cooling period is available only with regard to auditors who want to become directors or managers of their audit client. The reverse of the situation and enrolling in other financial positions are nevertheless unregulated.

The Financial Reporting Proclamation has brought new developments in audit and corporate governance and requires independence of mind and appearance from auditors. Some of the provisions however do not uphold the independence of auditors as the writer noted. It has done away with the problems associated with the absence of auditing standards and also laid the foundation an auditor a governmental oversight body, AABE. The board has powers that an auditor oversight body should have as recommended by IOSCO. However, as it is a newly established entity, it has not yet enacted directives on the issues it is empowered to regulate. Even though the Financial Reporting Proclamation has introduced changes in accounting and auditing standards, financial reporting processes and oversight of the auditing profession, it is auditors appointed in accordance with Commercial Code that will audit Ethiopian companies.³⁵⁵ The proclamation repealed the Commercial Code's provisions pertaining to financial reporting only and other provisions remain operative.

The writer has analysed the existing legal regime governing the roles of auditors in Ethiopia in light of well developed corporate governance Codes and principles and considers the following recommendations appropriate in ensuring good corporate governance of Ethiopian companies.

4.12.2 Recommendations

It has been said that the foundations for ensuring good corporate governance through auditors generally exist. The Commercial Code is under revision and the newly established Accounting and Auditing Board of Ethiopia which is empowered to issue directives on wide range of issues concerning auditors is expected to come up with new directives. So it should be seen to it that the reforms ensure independence of auditors and enhance their role in the good governance of Ethiopian companies.

³⁵⁵ Financial Reporting Proclamation, Supra note 333, Art. 10(1)

- The rules on the appointment of auditors of share companies should provide in detail how auditors should be presented to the shareholders' meeting for appointment. The processes preceding the presentation of auditors for appointment by shareholders should explicitly prohibit the involvement of managers.
- Companies that the AABE is expected to qualify as public interest entities should be made to have audit committees. Although the concept of non executive/independent directors does not exist in the law, members of the audit committee should be subjected to certain criteria of independence. Requiring a certain degree of independence from members of existing audit committees of companies in the financial sector and audit committees in other companies for the future will enable the companies to fully benefit from such committees. The board chairperson should also be prohibited from becoming a member of an audit committee.
- With regard to non audit services, the legislature should prohibit auditors from providing to their audit clients non audit services that may compromise their objectivity. (the SOX may be taken as guideline).
- The Financial Reporting Proclamation No.847/2014 which is permissive of the rendering of book keeping services under article 33 should be amended to leave no room for provision of such services by auditors.
- The independence of auditors can be enhanced and good corporate governance can be ensured through them if the personnel flow rules imposing three years wait on auditors before becoming managers and directors of the audit client under the Commercial Code are rephrased to include not only becoming managers and directors but also financial officers.
- A cooling off period should be provided for ex directors, ex managers and ex financial officers of a company if they wish to become auditors thereof.
- Another point that should be considered is the incompetency scope for becoming an auditor for financial sectors. Such limitations have in mind ensuring the auditors' independence and objectivity and they should be geared towards this purpose. A company's choice of auditor should not be unnecessarily limited and restrictions should also be possible to implement. The limitations in these laws which are based on relationships of consanguinity and affinity to employees should be narrowed down to employees significantly contributing to the book keeping, and preparation of documents the auditor is bound to certify. Auditors should also be made to make a declaration that they are not excluded by such incompetency rules with sanction for any false declaration.
- As long as audit is considered a necessity for share companies, the legislator should ensure that the audit conducted best contributes for the company and other stakeholders. Therefore,

incompetency scope for becoming an auditor for financial sector, once the aforementioned amendment is made, should be applicable to share companies and PLCs in the other sectors.

- With regard to PLCs, the Commercial Code provision requiring them to appoint a minimum of 3 auditors should be revised and the minimum number of auditors should be reduced to 1.
- The minimum rules on audit tenure and incompetency of PLCs should be set by the law in a fashion similar to share companies and not be left among matters to be determined under the memorandum of association.
- The criteria for the exemption of PLCs from appointing external auditors should be shifted from members' size to financial status and employee size as in the case of the UK Company Act.
- Personnel flow restrictions similar to share companies need to be put in place where PLCs have external auditors.

Bibliography

Books and Journal Articles

1. Alabede ,James O. (2012), “The Role, Compromise and Problems of the External Auditor in Corporate Governance”, Research Journal of Finance and Accounting , Vol. 3, no. 9
2. Anand, Sanjay, The Sarbanes-Oxley Act: An Introduction , Van Haren Publishing, 2008
3. Claessens, Stijn, Corporate Governance and Development , IBRD , Washington DC, (2003)
4. Collier and Zaman , Convergence in European Codes: The Audit Committee Concept, 2004
5. Corporate governance: A survey of OECD countries, 2004
6. Fekadu Petros(2010), “Emerging Separation of Ownership and Control in Ethiopian Share Companies: Legal and Policy Implications”, Mizan Law Review , vol.4 no.1
7. Smith Stevenson and Crumbley Larry, “Defining a Forensic Audit”, Journal of Digital Forensics, Security and Law , Vol. 4, no. 1,
8. Fernando, A., Corporate Governance: Principles, Policies and Practices, Pearson Education, India, 2006
9. Garratt, Bob, Why Corporate Governance Matters and How to Measure and Improve Board Performance, Nicholas Brealey publishing, UK, 2006
10. Hamdu Kedir, Arega Seyom and Addisu Gemedu (2014), “Internal auditing standards and its practice the case of East Arsi Zone, Ethiopia”, Basic Research Journal of Business Management and Accounts, Vo. 3, No.6
11. Hussein Ahmed (2012), “Overview of Corporate Governance in Ethiopia: The Role, Composition and Remuneration of Boards of Directors in Share Companies”, Mizan Law Review, Vol. 6, No.1
12. Hussein Ahmed, “Reforming Corporate Governance In Ethiopia: Appraisal Of Competing Approaches” , Oromia Law Journal , vol. 3, no. 1
13. Jordan, Cally (2013), “Cadbury Twenty Years On”, Villanova Law Review, Vol. 58 no.1
14. Kohler, Annette G (2005), “Audit Committees in Germany: Theoretical Reasoning and empirical Evidence”, Schmalenbach Business Review, Vol.57
15. Martin, David, Corporate governance: Practical guidance on Accountability Requirement, Thorogood publishers, London,2006
16. Minga Negash(2013), “Corporate Governance and Ownership Structure: The case of Ethiopia”, Ethiopian E-Journal For Research And Innovation Foresight, vol.5, no.1
17. Naciri, A. (ed.), Corporate Governance around the World, Routledge , New York, 2008
18. Pandya, Hetal(2013), “Corporate Governance: Role of Auditor and Auditing Committee,” IPASJ International Journal of Management , Vol.1 , no.2

19. Solomon Abay, Financial Market Development, Policy And Regulation: The International Experience And Ethiopia's Need For Further Reform, 2011
20. Spira, Laura F. ,The Audit Committee: Performing Corporate Governance , Kluwer Academic Publishers, New York, 2002
21. T.Karagiorgos, G.Drogalas , E. Gotzamanis and I. Tampakoudis ,(2010) “Internal Auditing as an Effective Tool for Corporate Governance ” , Journal of Business Management , vol.2, no.1
22. The International Finance Corporation Corporate Governance Manual, (2nd ed.), BACSON, Hanoi, 2010
23. Tomasic, Roman, The failure of corporate governance and the limits of law : British Banks and the Global Financial Crisis in Corporate Governance and the Global Financial Crisis : International Perspectives, 2011
24. Tricker, R. I. Twenty Practical Steps to Better Corporate Governance, 2010
25. Using the OECD Principles of Corporate Governance: A Boardroom Perspective, 2008
26. Whittington and Pany, Principles of Auditing and Other Assurance Services (13th ed.) , McGraw-Hill companies Inc. ,2001
27. Winship, Peter, Background Documents of the Ethiopian Commercial Code of 1960 Faculty of Law, HaileSelassie I University, Artistic Printers, Addis Ababa, 1974
28. F" Ç ' @_éS, yx!T x' !Ã yk#ENÃ HG ,2004> .M

Dictionaries

1. Black's Law Dictionary (8th ed. 2004)

Internet Sources

1. A consultative document on auditors' roles and Responsibilities by the corporate law reform committee for the companies commission of Malaysia, (2007) available at: http://www.maicsa.org.my/download/technical/technical_clr_auditors.pdf
2. Ethiopia – Accounting and Auditing Report on the Observance of Standards and Codes, (2007), available at: www.worldbank.org/ifa/rosc_aa_ethiopia.pdf
3. Farlex Financial Dictionary,(2009),available at <http://financial-dictionary.thefreedictionary.com/Tax+audithttp://www.businessdictionary.com/definition/tax-audit.html>
4. Implementation of the EU Audit Directive and Audit regulation, (2014), available at: <https://www.frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Consultation-Auditing-and-ethical-standards-implem-File.pdf>

5. Marianne Ojo, The Role of External Auditors in Corporate Governance: Agency Problems and the Management of Risk, (2009), available at: <http://mpra.ub.uni-muenchen.de/15989/>
6. Ownership Rules Of Audit Firms and Their Consequences for Audit Market Concentration, (2007), available at: www.europa.eu
7. Protection of Minority Shareholders in Listed Issuers, Technical Committee Of The International Organization Of Securities Commissions (2009), available at : <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD295.pdf>
8. Recommendations and position paper of the business community on the revision of the Commercial Code of Ethiopia, available at: <http://www.ethiopianchamber.com/data/sites/1/psd-hub-publications/position-of-the-business-community-on-the-revision-of-the-commercial-code-of-ethiopia.pdf>
9. Related Party Transactions and Minority Shareholder Rights, OECD (2012), available at: <http://dx.doi.org/10.1787/9789264168008-en>
10. Strengthening Tax Audit Capabilities: General Principles and Approaches (2006), available at: <https://www.oecd.org/tax/administration/37589900.pdf>
11. The Report of the Review Group on Auditing , available at: www.odce.ie/portals/0/Documents/company/companylawandyou/corporateGovernance/ReviewGrouponAuditing-Report.pdf
12. Vukadinoviae Predrag et al, The Characteristics of Forensic Audit and Differences in Relation to External Audit, (2015), available at : <http://finiz.singidunum.ac.rs/portal/wp-content/uploads/sites/3/2015/12/202-205.pdf>

Reports and Other Bibliographic Materials

1. Accounting and Auditing Board of Ethiopia (AABE) Five Year Strategic Plan (Fiscal years 2016-2021)
2. Charles, Robert (2005), corporate governance Change in the wake of the Sarbanes Oxley Act: A morality tale for Policy makers too (Harvard law school discussion paper No.525, (2005)
3. Commonwealth Association for Corporate Governance Guidelines (CACG) Principles For Corporate Governance In The Commonwealth ,1999
4. Ethiopia Commercial Law and Institutional Reform and Trade Diagnostic., USAID,2007
5. King Report on Corporate Governance for South Africa (2002)
6. Organization for Economic Cooperation and Development (OECD)Principles of Corporate Governance (2004)
7. Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees ,(1999)

8. Technical Committee of the International Organization of Securities Regulators(IOSCO) Principles for Auditor Oversight, (2002)
9. The Cadbury Committee Report on the Financial Aspects of Corporate Governance, (1992)
10. Treadway Report on Fraudulent Financial Reporting (1987)

Unpublished materials

1. Amsalu Gelaneh, *The Impact of Extended Audit Tenure on Auditors Independence And Audit Quality In Addis Ababa* , Department of Accounting and Finance, A.A.U, (unpublished) 2011
2. Muluneh Beyene, *Auditors Professional Responsibilities and Legal Liability with Regard to Private Auditors in Ethiopia*, Department of Accounting and Finance A.A.U (unpublished) 2007.
3. Wolderuphael Woldegiorgis, *the Role of Auditors Ethiopian Laws*, Faculty of Law, Haile Selassie I University, (Unpublished) 1978.

Laws

1. Directive No. SBB/62/2015 Licensing and Supervision of Banking Business Bank Corporate Governance, NBE
2. Directive No. SIB/42/2015 Licensing and Supervision of Insurance Business Insurance Corporate Governance, NBE
3. Proclamation No. 592/2008, Banking Business Proclamation, Negarit Gazeta, Year 14, No. 57
4. Proclamation No. 626/2009, Micro-Financing Business Institutions Proclamation, Negarit Gazeta, Year 15, No. 33
5. Proclamation No. 746/2012, Insurance Business Proclamation, Negarit Gazeta, Year 18, No. 57
6. Proclamation No847/2014, Financial Reporting Proclamation, Negarit Gazeta, Year 20, No.81
7. Regulation No. 332/2014, Establishment and Determination of the procedure of the Accounting and Auditing Board of Ethiopia Council of Minsters Regulation, Negarit Gazeta, Year 21, No. 22
8. Sarbanes-Oxley Act of 2002 (SOX)
9. The Commercial Code of the Empire of Ethiopia, Proclamation No. 166/1960, Negarit Gazeta, Year 19, No. 3
10. The UK corporate governance Code(2014)
11. UK companies Act of 1948
12. UK companies Act of 1967
13. UK companies Act of 2006