Challenges of Corporate Governance in Nigeria: The Roles of Auditors and Institutional Investors

Joseph. U. B. Azubike
Department of Accounting,
Michael Okpara University of Agriculture,
Umudike, Umuahia,
Nigeria
jubelazubike@yahoo.com

Austin U. Nweze
Department of Accountancy
Enugu State University of Science and Technology.

Abstract
Good corporate governance has continually remained necessary as businesses grow and as the principal agent relationship holds sway. The attention that has been drawn to good corporate governance, globally, should also be linked to the spate of business failures in both advanced and growing economies. To this end, the collapse of Enron and WorldCom readily come to mind. The activities that would lead to good corporate governance in any business should not be taught of as the "headache" for only the board of directors and management. Other stakeholders such as institutional investors, auditors and audit committees have immense role to play in corporate governance. The paper, therefore, presents the challenges facing these stakeholders in corporate governance. It concludes that an appropriate balance should be struck among the various stakeholders in order to ensure integrity and credibility of market institutions. It recommends quality assurance auditing and discourages the outsourcing of internal audit functions to external auditors.

Keywords: *Corporate Governance, Audit committees, Institutional Investors*

1. Introduction

The subject of corporate governance has assumed greater significance following a series of corporate scandals and the consequential losses in America, Europe and even in emerging economies in Asia and Africa. Poor corporate governance at both the supervisory and operator levels could result in corporate failures as evidenced in the Baring (UK), WorldCom, and Enron (USA) cases as well as recent experiences in Nigeria.

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled (OECD, 2004). O'Donovan (2004) defines corporate governance as an internal system encompassing policies, processes and people, which serves the needs of shareholders and other stakeholders, by directing and controlling management activities with good business savvy, subjectivity and integrity. Corporate governance also includes the relationships among the many players involved (the stakeholders) and the goal for which the corporation is governed. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal-agent problem.

Sound corporate governance is reliant on external market place commitment and legislation plus a healthy board culture which safeguards policies and processes. Corporate governance is about commitment to values, about ethical business conduct and about making a distinction between personal and corporate funds in the management of a company. It is an ethics and moral duty (Cadbury, 1996).

2. Statement of the Problem

Issues of corporate governance have become so pervasive in recent years. It is important to recognize that economic performance of any country is shaped largely by the quality of effectiveness of the nation's corporate governance. The impact of good governance on economic performance can be appreciated when we recognize that growth is positively related not only to the size of investment but also to the efficiency of its allocation. A good corporate governance system ensures that directors and managers of enterprises carry out their duties within a framework of accountability and transparency. Presently, the various stakeholders on corporate governance notably auditors, audit committees, and institutional investors appear uncertain about their roles in improving corporate performance. It is being erroneously taught that corporate governance is solely the problem of board of directors and management.

3. Objectives of the Study

The objectives of the study are:

- **i.** To ascertain the roles of auditors, audit committees and institutional investors in corporate governance.
- **ii.** To establish the need for good corporate governance for corporate and economic growth and survival.

4.0 Literature Review and Conceptual Framework

4.1 Parties in Corporate Governance:

The parties of involved in corporate governance include the regulatory body, the Chief Executive Officer, Board of Directors, management and stakeholders. Other stakeholders who take part include suppliers, employees, creditors, and the community at large. In a corporation, the shareholders delegate decision rights to the managers to act in the principal's best interests. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions. Because of this separation of the parties, a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders. All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organization.

4.2 Corporate Governance Principles:

Key elements of good corporate governance principles include: honesty, trust and integrity, openness, performance orientation, responsibility and accountability, mutual respect and commitment to the organization.

The commonly accepted principles of corporate governance include:

- **Rights and equitable treatment of shareholders:** Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by effectively communicating information that is understandable and accessible and encouraging shareholders to participate in general meetings.

- **Interest of other stakeholders:** Organizations should recognize that they have legal and other obligations to all legitimate stakeholders.

- **Role and responsibilities of the board:** The Board needs a range of skills and understanding to be able to deal with various issues and have the ability to review and challenge management performances. It needs to be of sufficient size and have an appropriate level of commitment to fulfill its responsibilities and duties.

- **Integrity and ethical behaviour:** Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making. Compliance and Ethics programs help to minimize the risk that the firm steps outside of ethical and legal boundaries.

- **Disclosure and transparency:** Organizations should clarify and make publicly known, the roles and responsibilities of board and management to provide shareholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting.

The following issues, therefore, emanate from corporate governance principles (Sanusi, 2003): oversight of the preparation of the entity's financial statements, internal controls and the independence of the entity's auditors, review of the compensation arrangements for the chief executive officer and other senior executives, the way in which individuals are nominated for positions on the board, the resources made available to directors in carrying out their duties, oversight and management of risks as well as dividend policy.

4.3 Importance of Corporate Governance

While some countries and their companies emphasize on wealth creation for shareholders, a number of other countries tend to adopt an inclusive "stakeholder" approach where companies are considered as social institutions with responsibilities and accountability, not just to shareholders but also to employees and the wider community in general. While approaches may differ, there is global appreciation of the Organization for Economic Co-operation and Development (OECD)'s generic corporate governance principles for responsibility, accountability, transparency and fairness.

- Responsibility of the directors who approve the strategic direction of the organization within a framework of prudent controls and who employ, monitor and reward management.
- Accountability of the board to shareholders who have the right to receive information on the financial stewardship of their investment and exercise power to remove the directors entrusted to run the company.
- Transparency of clear information with which meaningful analysis of a company and its actions can be made. The disclosure of financial and operational information and internal processes of management oversight and control enable outsiders to understand organization, and
- Fairness that all shareholders are treated equally and have the opportunity for redress for violation of their rights.

Corporate governance is a key element in enhancing investor confidence, promoting competiveness, and ultimately improving economic growth. Wolsefensohn (2004) emphasized that the governance of companies is more important for world economic growth than the government of the countries.

Cultural, political and economic norms influence the way in which a society approaches corporate governance and its impact on board leadership, management oversight and accountability. The challenge of policy makers is to reach an appropriate balance of legislative and regulatory reform, taking into consideration international best practices to promote enterprise, enhance competiveness and stimulate investment. Much of the recent emphasis on corporate governance has risen from high-profile corporate scandals, globalization and increased investor activism.

- **Corporate scandals:** High profile corporate collapses due to a number of circumstances including financial reporting irregularities leading to a lack of investor confidence and public trust.
- **Globalization:** Improved technology and private sector development increasing capital flows to large developing economies such as China. Developing economies need to demonstrate good corporate governance to instill investor confidence thereby encouraging access to the global capital necessary for job creation and economic growth.
- **Shareholder Activism:** Institutional investors pursue good corporate governance when managing long-term investments and often take an active role in bringing under-performing companies to task.

Recent new legislative and self-regulatory corporate governance requirements have helped to instill global market confidence. This includes improved integrity and oversight of management, scrutiny over board composition and independence, effective use of internal and external audit functions, higher levels of disclosure and transparency and greater engagement with investors.

There is overwhelming evidence that investors value companies with corporate governance. For instance, a survey of over 200 institutional investors by McKinsey and Company and CBN in 2001 shows that 80% of respondents would pay a premium for well-governed companies, from 11% in Canada to 40% in Egypt (Global Investor Opinion, 2002).

4.4 Role of Accountants and Auditors

Financial reporting is a crucial element necessary for the corporate governance system to function effectively. The accountants and auditors are the primary providers of information to capital market participants. The directors of the company should be entitled to expect that management prepares the financial information in compliance with statutory and ethical obligations and rely on auditor's competence.

Current accounting practice allows a degree of choice of method in determining the method of measurement, criteria for recognition, and even the definition of accounting entity. The exercise of this choice to improve apparent performance popularly known as "creative accounting" improves extra information costs on users. In this extreme, it can involve non-disclosure of information.

One issue of concern is whether the accounting firm acts as both the independent auditor and management consultant to the firm it is auditing. If this is the case, it may result in a conflict of interest which places the integrity of financial reports in doubt due to client pressure to appease management consulting services and more fundamentally, to select and dismiss accounting firms contrasts the concepts of independent auditor. The Enron collapse is an example of misleading financial reporting. Enron concealed huge losses by creating illusions that a third party was constantly obliged to pay the amount of any losses. However, the third party was an entity in which Enron had a substantial economic interest a related company. Sanusi (2002) opines that good financial reporting is not a sufficient condition for the effectiveness of corporate governance if users do not process it, or if the information user is unable to exercise a monitoring role due to high costs.

4.5 Role of Institutional Investors

In the past, buyers and sellers of corporation stocks were individual investors, such as wealthy businessmen or families, who often had a vested, personal and emotional interest in the corporations whose shares they owned. Markets have become highly institutionalized with buyers and sellers largely institutions, example, pension funds, insurance companies, mutual funds, hedge funds, investor groups and banks. The rise of institutional investors has brought with it some increase of professional diligence which has tended to improve regulation of the stock market. The growth occurred primarily by way of individuals turning over their funds to professionals to manage such as mutual funds. In this way, the majority of investment now is described as "institutional investment" even though the vast majority of the funds are for the benefit of individual investors.

Institutional investors own significant stake in companies and therefore, exercise significant influence on directors and prevent abuses; have better access to information a better monitoring capabilities and are aware of the fact that there is no positive correlation between good corporate governance and market performance. The active involvement of institutional investors should ensure that:

- Board members have adequate experiences and are truly independent,
- Executive remuneration is not excessive,
- Early warning signals are detected from the wealth of information, and
- Company funds are not diverted to non-core activities (Al-Faki: 2004).

4.6 Role of Audit Committees

The audit committee is appointed by the Board of Directors to assist the board in fulfilling its oversight functions. Nigerian government through its legislative powers has promulgated laws that require companies to establish audit committees. The key government statutes on this requirement include: the Companies and Allied Matters Act (1990) and the Banks and other Financial Institutions Act (1991), as subsequently amended.

The primary duties and responsibilities of audit committees are as follows:

i. To monitor the integrity of the company's consolidated financial statements, financial reporting processes and systems of internal controls regarding finance and accounting and the company's compliance with legal and regulatory requirements,

ii. To appoint, compensate and monitor the qualifications, independence and performance of the company's independent auditors as well as monitor the performance of the company's internal audit department, and

iii. To provide an avenue of communication among the independent auditors, management, the internal audit department and the board of directors (Bean, 2004).

A good audit committee charter organizes committee members' responsibilities, providing a systematic structure for discussions between the committee and management, the public and others.

Audit committees play a critical role in preventing fraudulent reporting. Accordingly,

i. Only independent directors should serve on the committee,

ii. The committee should meet at least quarterly,

iii. The committee should make regular inquiries to ensure that the public accountant remains independent,

iv. The committee should actively solicit information about the appropriateness of the internal controls in place,

v. The committee should report to the shareholders on its activities and findings,

vi. Management and the Chartered Accountants should fully inform the committee about any financial irregularities; regulatory investigations, potential liabilities or other sensitive information,

vii. The committee should have the resources and authority to conduct investigations (Bean, 2004; CBN 2006).

The tone of a company's control environment is set at the top, by the board of directors in general and the audit committee in particular, the rest of the board often relies on the audit committee to notice and question any unusual business practices, aggressive accounting methods or violations of the company's code of business conduct. But in many companies, audit committee members may not have the expertise in matters of internal control that Chartered Accountants do, and some people serving on audit committees have little or no accounting or financial background at all. Accordingly, audit committee members need a reference guide to their responsibilities. This is the function of an audit committee charter.

The audit committee charter is analogous to an employee job description, listing the employee's responsibilities, the employer's expectations for the employee and the rest of the board and the shareholders, and its charter details what the shareholders reasonably can expect the committee members to do.

5.0 Conclusion and Recommendations

Along with corporate responsibility, corporate governance provides the foundations of market integrity and, thus, imposes a lot of responsibility on the board of directors that involves striking a delicate balance between the various stakeholders. All these revolve around embracing good corporate governance that sets the rules and practices that govern relationship between managers and shareholders of corporations as well as stakeholders.

Striking an appropriate balance between various stakeholders' interest is a prerequisite for the integrity and credibility of market institutions. It facilitates the building of confidence and trust that allows corporation access to external finance and to make reliable commitments to creditors, employees and shareholders. It is this contract that underpins economic growth in a market economy.

Based on the findings, from the study, the underlisted recommendations are posited:

i. The internal auditor should report directly to the Board Audit Committee but forward a copy of the report to the Managing Director,

ii. The audit committee should have access to external auditors to seek for explanations and additional information without management presence,

iii. The external auditors should maintain arms-length relationship with the company they audit,

iv. The external auditors should not provide management or consultant services such as bookkeeping, actuarial services, valuation or appraisal services, internal audit outsourcing services and human resources functions, and

v. Quality assurance auditing should be engaged whenever there is a suspicion of cover-up by auditors.

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