OVERVIEW OF THE POSITION OF AUDITORS IN THE CORPORATE GOVERNANCE UNDER THE ETHIOPIAN COMMERCIAL CODE IN THE LIGHTS OF INTERNATIONAL BENCHMARKS

Lemessa Berber Wogena*

Abstract

Auditors are important organs of corporate governance under any system. As a result, they protect the interest of the shareholders against the excessive or unauthorized powers of board of directors. Auditors popularly regarded as "watch dogs" of the interests of shareholders. To this end, a strong and independent auditor is vital as a guardian for the protection of the interest of shareholders. The Ethiopian Commercial Code does not have comprehensive provisions on governance issues related to auditors or audit committee. Hence, this short article deals Ethiopia's Commercial Code with specific reference to appointment, responsibilities, independence and liabilities of auditors in light of international benchmark best practices and principles of corporate governance. Finally, it argues that Ethiopia should enact and provide comprehensive company laws related to auditors or audit committee as to best protect the interest of shareholders of the companies.

Keywords: *Appointment of auditors, responsibilities of auditors, independence of auditors, liabilities of auditors, Ethiopian commercial code.*

1. Introduction

In contemporary business world, good corporate governance improves and builds the attitudes of investors toward the investment and enhances the business atmosphere of the state.[197]This envisages that good corporate governance requires strong and independent auditing organ as a protector of the company from excessive powers of board of directors. The auditing systems of the companies are governed by the companies legislations and rules made by the respective countries. This is to ensure the impartiality, objectivity and independence of auditors that the statute prescribed the statutory auditors.[198]In light of this, the Commercial Code of Ethiopia incorporates provisions relevant to the governance of share companies. Nevertheless, these

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*LLB, LLM & PhD Research Scholar; Dr.B.R. Ambedkar College of Law; Andhra University (A U).

[197] See 'Indonesia's Code of Good Corporate Governance,' (National Committee on Governance, 2006), Preamble.

[198] See Indrajit Dube,(2012), 'Corporate Governance, Rajiv Gandhi School of Intellectual Property law,' Indian Institute of Technology, Kharagpur, p.135.

provisions are not sufficient to address specific issues related to auditors. Thus, this article deals the Commercial Code provisions relevant to the appointment, responsibilities, independence and liabilities of auditors with a view to overcome loopholes and suggests the solutions in lights of internationally recognized benchmarks of corporate governance. Lastly, it provides conclusions.

2. Auditors/ Audit Committee in General

In different jurisdictions, many developing economies give due attention for having a good corporate governance. This is for the fact that it brings success to a given economy by attracting domestic investment and ensuring greater inflow of foreign direct investment.[199]To this end the existence of strong and independent auditor or audit committee is vital to enhance and control the financial affairs. The audit committee is a subcomponent of the main board which is responsible for overseeing the company's financial reporting process. According to the best practice set by Sarbanes-Oxley Act (SOX) of 2002, the audit committee is required to be composed of more than three members, of which at least two third from outside directors and at least one being financial expert. This committee ensures that accounting policies are sound and financial statements are properly prepared and audited.[200] The existence of these experts in the firm will create a transparent and credible environment between management, external auditors and the board members. The audit committee typically is responsible for the financial reporting process; providing oversight of the bank's internal and external auditors; approving, or recommending to the board or shareholders for their approval, the appointment,[201] compensation and dismissal of external auditors; reviewing and approving the audit scope and frequency; receiving key audit reports;[202] and ensuring that senior management is taking necessary corrective actions in a timely manner to address control weaknesses, non-compliance with policies, laws and regulations and other problems identified by auditors. In addition, the audit committee should oversee the establishment of accounting policies and practices by the share company.

[199] See Claessens, S.,(2006), 'Corporate Governance and Development,' World Bank Research Observer, 21(1), 91-122.

[200] See Green, S,,(2005),'Sarbanes-Oxley and the Board of Directors: Techniques and Best Practices for Corporate Governance,' New Jersey: John Wiley and Sons, Inc.,

[201] In some jurisdictions, external auditors are appointed directly by shareholders, with the board only making a recommendation.

[202] As well as risk management and compliance reports, unless the bank has separate board committees for these areas.

Moreover, it is advisable that the audit committee consists of a sufficient number of independent non-executive board members. In jurisdictions where external auditors are selected by the audit committee, it is beneficial for the appointment or dismissal of external auditors to be made only by a decision of the independent, non-executive audit committee members. The evidence suggests that having experts with qualification of accounting and finance in the audit committee improves governance quality. For instance, the study of some scholars designated a positive reaction of the market for firms having an audit committee which is composed of accounting background than those with non accounting background.[203] Likewise, audit committee with the member qualification of a Certificate of Professional Accounting (CPA) or similar degrees had also resulted in fewer restatements of firms' financial report as compared to committees with other qualifications.[204] At a minimum, the audit committee as a whole should have recent and relevant experience and should possess a collective balance of skills and expert knowledge commensurate with the complexity of the banking organization and the duties to be performed in financial reporting, accounting and auditing.

3. Appointment, Responsibilities, Independence and Liabilities of Auditors

3.1. Appointment of Auditors

According to OECD principles, it is increasingly common for auditors (particularly external auditors) to be recommended by an independent audit committee of the board or an equivalent body and to be appointed either by that committee/body or by shareholders directly.[205] The benefit of making appointment through this committee includes the opportunity to discuss about any problem, directly interact with auditors and discuss matters of concern and take remedial measures.[206] Hence, in many cases there is a registration process for individual auditors to confirm their qualifications and ensure the competency of audit profession.[207] This needs to be supported by ongoing training and monitoring of work experience to ensure an appropriate level of professional competence. The practice that external auditors are appointed

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[203] See Defond, M., et al,(2005), 'Does the Market Value Financial Expertise on Audit Committees of Boards of Directors?' Journal of Accounting Research, 43(2), 153-193.
[204] See Agrawal, A., & Chadha, S.,(2005), 'Corporate Governance and Accounting Scandals,' Journal of Law and Economics, 48(2), 371-406.
[205] See Organization for Economic Co-operation and Development (OECD) principles of Corporate Governance (2004), p.55.
[206] See Indrajit Dube, (2012), Supera Note 2.
[207] See OECD principles (2004), Supera Note 9.

either by that committee/body or by the shareholders' meeting directly can be regarded as good practice since it clarifies that the external auditor should be accountable to the shareholders.[208] 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.[209]

In India, unlike the appointment process at each annual general meeting under the 1956 Indian Company Act, the auditor will now be appointed for a period of five years, with a requirement to ratify such an appointment at each annual general meeting by the shareholders under the 2013 Act.[210] Moreover, this Act provides the possibility of appointment of a firm as the auditor of a company.[211] Also, the 2013 Act specifies that where a firm is auditor, only those partners who are chartered accountants shall be authorized to act and sign on behalf of the firm.[212]

Further, the 2013 Act prescribes an additional list of disqualifications, and extends the disqualification to also include relatives holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company of face value exceeding one thousand rupees or such sum as may be prescribed. [213] Additionally, a person or a firm who has business relationship with the company will be disqualified from being appointed as an auditor. Hence, appointment is the powers only assigned to shareholders.

In Ethiopia, as a rule, auditors are appointed by the subscribers meeting or later on by the general meeting of shareholders.[214]Besides, the rule permits a natural person or a firm (accounting firm) to be appointed as an external auditor. However, in many cases shareholders meeting delegate its powers of appointment of auditors to the board of directors.[215]As a result such kind of delegation may affect the auditor's independence in their day to day activities.[216]This kind of practice may affect the powers of shareholders towards the appointment of the auditors. However, Ethiopian commercial code does not recognize the trend

208 Ibid,p.56
209 Ibid
210 See section 139(1) of 2013 Act of India.
211 See section 139(4) of 2013 Act of India.
212 See section 141 of 2013 Act of India.
213 See section 141 of the 2013 Act of India.
214 See Commercial Code article 368 of Ethiopia.
215See Fikadu Petros,(2012), 'Ethiopian Company Law,' Addis Ababa University School of Law,p.178.
216 Ibid

of audit committee and its roles in the corporate governance. There is no such kind of organ which involve in the process of selection of auditors in the Ethiopian system. An auditor has to neutrally execute the business of auditing. For this purpose auditors have to be neutral. Thus, a person to be appointed as an auditor should not have relationship with the person to be audited. Accordingly, certain persons that have got relationship with the business to be audited or persons whose activity to be audited are ineligible for the appointment.[217] Hence, the Ethiopian law permits board of directors to appoint auditors.

3.2. The Responsibilities of Auditor

Pursuant to OECD principles, auditors should carry out their comprehensive accounting and auditing functions based on established rules of Accounting and Auditing Standards to improve the corporate governance.[218] Likewise, the Standards on Accounting and Auditing have been accorded legal sanctity in the 2013 Company Act of India. Auditors are now mandatorily bound by the 2013 Act to ensure compliance with Standards on Accounting and Auditing.[219] To this effect, the audit committee generally acts as a liaison between the auditor and the board of directors and its activities may include the review of the nomination of auditors, overall scope of the audit, results of the audit, the internal financial controls and financial information for publication.[220] This is to enable auditors to exercise their responsibilities appropriately and efficiently in accordance with the rules of accounting and auditing standards.

In the Ethiopian context, the major responsibilities of auditors are auditing the company's account, certifying and preparing reports which are submitted to shareholders general assembly;[221] inform to shareholders or public prosecutors for directors' breach of legal and statutory obligations;[222] convening shareholders meetings in directors' failure.[223] These are the crucial responsibilities that the auditor should undertake seriously. However, even though the commercial code states the above responsibilities, it failed to require auditors to carry out their accounting and auditing functions based on established rules of Accounting and Auditing Standards.

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[217] See Commercial Code Article 370 of Ethiopia.
[218] See OECD principles (2004), Supera Note 9.
[219] See Companies Act, 2013, 'Key Highlights and Analysis, Significant changes and implications (PWC India),' 30th November, 2013, p.8.
[220] See AISG (1977), quoted in Collier (1992), p.2, Spira, Lura F, (2002), 'The Audit Committee: Performing Corporate Governance,' Kluwer Academic Publication, Hingham, MA, USA, p.5.
[221] See Commercial Code articles 374 &375 of Ethiopia.
[222] See Commercial Code article 376 of Ethiopia.
[223] See Commercial Code article 377 of Ethiopia.

3.3. Independence of Auditors

The OECD principle underlines the need of independent, competent and qualified auditors to control the financial positions of the companies.[224] The auditor should be free of any influence in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects.[225]As a result many countries have introduced measures to improve the independence of auditors and to tighten their accountability to shareholders.

In the Indian context, the independence of audit committee, while performing its functions, is granted under company legislations.[226]To this effect clause 49 of the listing agreement clearly deals about the independence of audit committee. Furthermore, the 2013 Company Act of India addresses the independence of auditors in their day to day performance of responsibilities. In addition to this auditors should perform their responsibilities without any interference of internal and external bodies.[227] This shows that auditors shall perform their works as to control the unnecessary acts against the productivity of the company.

In Ethiopia, though delegating the power of appointment and selection of auditors simplifies and make easy the process, the trend of delegating may affect the auditor's independence.[228]Based on the existing practices and the readings of some specific provisions of commercial code, it seems that this power is totally delegated to the board of directors. Hence, there is potential fear that board of directors can easily affect, interfere in the affairs of auditors, take away the shareholders power and coerce the auditors not to control them. There is clarity problem and the need to rectify of the existing law in this area. Thus, there is a need of clear and comprehensive laws to secure the independence of the auditors from influence of the board of directors in the case of Ethiopia.

3.4. Liabilities of Auditors

[224]See OECD principles (2004), Supera Note 9, p.56.
[225] Ibid,p.54
[226]See Singh.S, (2005), 'Corporate Governance: Global Concepts and Practices,' Excel Books, 1sted, New Delhi, p.231.
[227] See Myneni,S.R,(2014), 'Corporate Law I,' 1sted, Asian Law House, Hyderabad,p.417.
[228] See Fekadu Petros(2012), Supera Note 19.

The OECD principles further underlines that auditors (particularly external auditors) owe a duty of due professional care to the company.[229] Hence, failure to take care results liability. The liability can be civil or criminal. Similarly, the scope and extent of the auditor's liability, has been substantially enhanced under the 2013 Company Act of India. Apart from introducing new concepts such as rotation of audit firms and class action suits, the 2013 Act also increases the auditor's liability substantially in comparison with the previous Act.[230]Rotation of audit firm is vital to improve the quality of audit. In Ethiopia, as it is stated above auditors have assigned with different powers and obligations that improves the efficiency of the companies. Thus, auditors are duty bound to perform these obligations and responsibilities. Finally, auditors will be liable both civil and criminally if they failed to observe their obligations provided under the Commercial Code of Ethiopia.[231]Though the Ethiopian system acknowledges the liability of auditors, there is no trend of rotation of audit firms and class suite.

Conclusion

Though auditors actually do not execute the daily business of companies, they look for the affairs of companies and may hold the position of managing. It is mandatory for companies to audit their financial records. Whenever irregularities are detected, the auditor's report the matter to the general body of the shareholders. To this end the existence of strong and independent auditor is necessary. Eligibility for appointment, responsibilities, independence and liabilities of auditors in Commercial Code of Ethiopia are examined in this short article. Auditors should maintain their independence from any interference. This article shows that the Commercial Code of Ethiopia does not sufficiently address issues related to auditors in share companies. As a result Ethiopia should enact and provide comprehensive company laws related to auditors and audit committee as to best protect the interest of shareholders of the companies. Ethiopia should develop the system of audit committee as to strength the powers of auditors. Hence, during revision time due attention should be given for the consideration of international benchmark best practices and principles of corporate governance specifically the Indian practice or OECD principles.

[229]See OECD principles (2004), Supera Note 9, p.54.
[230] See Companies Act, 2013, 'Key Highlights and Analysis, Significant Changes and Implications (PWC India),' 30th November, 2013, p.8.
[231] See Commercial Code article 380 of Ethiopia.