Introduction
Corporate governance has re-emerged as one of the most talked about business topics in the twenty-first century after the failure of some of the large public-listed companies (Banks, 2004). Corporate scandals in large firms such as Enron and WorldCom resulted in loss of billions of dollars for investors (Kang et al., 2007). Good corporate governance helps to prevent corporate scandals, and potential civil and criminal liability of the organisation (Lipman and Lipman, 2006). It enhances the reputation of the organisation and makes it more attractive to investors, lenders, customers and employees (Lipman and Lipman, 2006), which is expected to add value to the company. Therefore, it is important to analyse and compare corporate governance practices among countries and firms.
The purpose of this report is to analyse and compare corporate governance systems and their compliance in four countries – the UK, the USA, Australia and Germany. One way of implementing a control mechanism is to give more information to external stakeholders of a firm since this would help them in making better decisions and raise relevant questions regarding the steps being taken to safeguard their interests. The disclosure requirements in three main areas (Board of Directors, audit committee, internal control and risk) are evaluated. The disclosure requirements in 5 companies in each of the 4 countries are also evaluated to notice similarities and differences in their emphasis on good corporate governance. The comparison is done by quantitatively assigning score to each company on the basis of two aspects: (a) whether or not the company followed a practice; and (b) the relative information disclosed to external stakeholders. Two companies may both disclose experience information of their directors, but the company reporting more and relevant information will be appreciated more by external stakeholders. The evaluation and comparison of each company is done with regards to three important parameters of corporate governance: Board of Directors, audit committee, internal control and risk.

The information in annual reports is used by many stakeholders to make economic decisions. The extent of qualitative information about fraud detection, and internal control and risks is important for stakeholders because of the large scale losses suffered by many of them from corporate frauds in firms like Enron and WorldCom. Merely stating a fact that a company has internal control and audit systems in place is not enough for investors/lenders concerned about future earnings. This report evaluates the extent to which the disclosures relating to audit committees and internal controls provide positive assurance about financial reporting quality and effectiveness of controls to external stakeholders. This is important for building trusts in capital markets. Finally, the report discusses some recommendations about current disclosures to assist stakeholders in assessing the transparency and accountability of companies.

?? Brief overview of corporate governance development in countries

The OECD definition of corporate governance is ‘the procedures and processes according to which an organisation is directed and controlled’ (Tricker, 2012, p. 29). Corporate governance is important because of the separation of the ownership from management (Tricker, 2012). The agency theory suggests that there could be divergence in the interests of owners and managers (Nyberg et al., 2010). Corporate governance is an internal mechanism to minimise this divergence. This section of the report reviews the disclosure requirements in four countries – the UK, the US, Australia and Germany – with regards to board of directors, audit committee, internal control and risk aspects of corporate governance. A brief review of corporate governance development and regulations in each of the four countries is given below before the evaluation of their practices.

a. UK

The Cadbury Committee has played an important role in the establishment of corporate governance practices in the UK, and many other countries. A number of committees, such as Turnbull Report, Myners report and Higgs Report, have refined the corporate governance practices in the UK since the Cadbury Committee report in the early 1990s (Tricker, 2012). The Financial Reporting Council is the UK’s independent regulator responsible for promoting corporate governance. The present form of corporate governance in the UK is as mentioned in the UK Corporate Governance Code which is based on the principle of ‘comply or explain’ (UK Corporate Governance Code, 2012). The public listed companies are required to either comply with the UK Corporate Governance Code or explain non-compliance in their annual reports.

b. US

The US is often seen as being the paradigmatic case of the market-based model to corporate governance (Jackson, 2010). However, corporate governance failure in Enron resulted in high criticism of the corporate culture in the US and caused substantial changes through the Sarbanes-Oxley Act of 2002. Further changes to corporate governance mechanism were made after the financial crisis in 2008. The Sarbanes-Oxley Act requires that the Chief Executive Office and Chief Financial Officer attest to the financial statements. Further, external auditors were barred from providing certain types of consulting services to their audit-clients. Public listed companies are also required to follow additional governance standards stipulated by stock exchanges in the country.

c. Australia

The Corporate Governance Council of the Australian Stock Exchange (ASX) has a guide titled ‘Corporate
Governance Principles and Recommendations, which lists corporate governance guidelines for a public listed firm (ASX, 2010). These principles are guidelines only for firms to follow, that is, firms have the choice either to implement those principles or state reasons for deviations in annual reports in the case of a failure to achieve full compliance (GLG, 2010). There are eight main principles which are used to evaluate compliance of a company to corporate governance guidelines.

d. Germany

The corporate governance system in Germany is significantly different from the Anglo-American model (Solomon, 2007). The listed companies in Germany have to follow the German Corporate Governance Code last amended in May 2013 (German Corporate Governance Code, 2013). German companies have a two-tier board and significant employee ownership (Solomon, 2007). The Supervisory board is intended to provide monitoring function. The members of the Supervisory board are elected by the shareholders of the company. The Management board is responsible for managing the company.

The corporate governance codes in the UK, Australia and Germany follow the ‘comply or explain’ principle, whereas it is the ‘comply or else’ approach in the US (du Plessis et al., 2011). The US approach to corporate governance is based much more on hard law and a regulatory state (Jackson, 2010).

?? Disclosure requirements

This section of the report reviews the disclosure requirements in four countries with regards to board of directors, audit committee and internal controls and risks.

a. Board of directors

The board of directors represent the interest of shareholders, and is accountable to them for a series of specific duties, including oversight of executive management, and implementation of internal controls (Banks, 2004). The best practice regarding the structure of the board of directors is that governing bodies of companies should include completely independent directors and they should preferably constitute a majority of all directors (Lipman and Lipman, 2006).

The main corporate governance disclosures regarding the board of directors of a company are shown in Table 1. 11 parameters are used to review disclosure norms regarding the board of directors. ‘Y’ in a box means that the corporate governance code requires this disclosure in annual reports of companies in that country and ‘N’ implies that this feature is not required to be disclosed. ‘Y/N’ implies that the measure was partially implements. ‘Y’ equates to 1, ‘N’ is 0 and ‘Y/N’ is 0.5.

Table 1: Board of directors disclosure norms

Board structure is analysed by considering three items – separation of the Chairman and CEO; the number and percentage of independent directors; and size of the board (Leblanc and Gillies, 2003). Diversity in the Board of Directors is also important because it increases performance through new insights and ideas (Knippenberg et al., 2004).

Three countries – the UK, the US and Australia – scored full points because the recommended corporate governance policies/codes asked companies to disclose information with regards to all of those elements. Germany scored only 7 out of 11. This does not mean that corporate governance, with regards to board of directors, is substantially low in Germany. The main reason for the low score in the case of Germany is its two-tier board structure. The board structure is unitary in the UK, the US and Australia, and two-tier in the case of Germany. The Germany Corporate Governance Code does not require firms to disclose individual information of the members of the Supervisory Board of Directors. This is partly to do with the fact that many of the members of the Supervisory Board in a company in Germany are its employees only, and were included on the basis of recommendation of worker unions. This nomination process reflects the nature of management-worker relationship in Germany. Disclosure of information about independent directors in the UK, the US and Australia shows the wealth of information they bring to the Board of Directors. The inclusion of names and skills of all directors of Supervisory Board in companies based in Germany is not going to have same information impact on stakeholders. The lack of information regarding the directors on the Supervisory Board is also reflected in the absence of information regarding the members of committees and their individual participation in meetings of those committees. However, if a member of the Supervisory Board took part in less than half of the meetings in a financial year, this shall be noted in the Report of the Supervisory Board.

The German disclosure requirements do not require the qualitative description of the compensation. Other three countries disclose the rationale behind compensation structure of Board of Directors, but this is not
recommended practice in Germany. Du Plessis et al. (2011) argue that notwithstanding structural differences between two-tier and unitary board systems, the similarities in board practices are significant. Both unitary and two-tier board structures recognise a supervisory function and a management function (du Plessis et al., 2011). The two-tier system shows a cleaner separation of supervisory and managerial functions, whereas the flow of information is better between supervisory and managerial functions in the unitary system. Additionally, for Board of Directors to be effective, two more things are required – the selection process of board members and the decision-making process.

b. Audit committee

The purpose of an audit committee is to assist the board in the financial reporting process (Braiotta et al., 2010). Audit committees are formed to improve external auditor independence by reducing the influence of the management on auditors. The main corporate governance disclosures regarding the audit committee are shown in Table 2. 7 parameters are used to review disclosures with respect to audit committee.

Table 2: Audit committee disclosure norms

Again, scores of the UK, the US and Australia were same and 7 out of 7. The score of Germany was 5, which is because of the composition of its Board of Directors. The non-disclosure of individual information about the Supervisory Board of Directors implies that the information regarding the financial experience of audit committee members and their individual attendance cannot be obtained.

Some countries, such as the UK, allow variation in the minimum number of audit committee members on the basis of the size of the company. UK’s Guidance on Audit Committees recommends that there should be at least two independent non-executive directors in an audit committee if the company is below the FTSE 350 index or at least three members if above (Deloitte, 2014). ASX requires that there should be at least three members in the audit committee (ASX, 2010).

As part of a practice to reduce the possibility of financial statement frauds, the UK recommends that all members should be independent non-executive directors. Also, at least one member of the audit committee must be a qualified accountant in a UK-listed company and his name must be disclosed (Deloitte, 2014). Similar requirement is also observed in the three other countries, which illustrates the importance of financial knowledge and experience in detecting and preventing financial statement frauds.

c. Reporting on internal control and risk

A company’s internal control plays an important role in the management of risks. Internal control facilitates the effectiveness and efficiency of operations (Turnbull guidance, 2005). Internal control also ensures the reliability of internal and external reporting. This is especially important because some of the large financial statement frauds, such as Enron and WorldCom, happened because of falsified external reporting. The main corporate governance disclosures regarding internal control and risk are shown in Table 3, 4 parameters are used to review disclosures with respect to internal control and risk. The UK, Australia and Germany scored 3 out of 4, while the US had a score of 4. This is because the Sarbanes-Oxley Act of 2002 requires companies listed in the US stock exchanges to obtain an attestation from external auditor on management’s assessment of internal control. It is a way of indicating that management’s own assessment is not sufficient as exemplified by corporate frauds in large companies.

Table 3: Internal control and risk disclosure norms

Overall, corporate governance codes are very similar in the four countries. The main differences observed were because of the two-tier board structure in the case of Germany.

V. Evaluation of disclosures by companies

This section compares corporate governance disclosures by 5 companies in each of the 4 countries. All data is collected from annual reports of companies in the UK, Australia and Germany, and statements (Schedule 14A information) filed as part of the annual reports in the case of companies in the US.

a. Board of Directors

The data collected was converted into a score for each aspect and then added to arrive at a score for each company (Refer Appendix I for converting data into scores). The maximum possible score was 15. Companies in the UK performed well in this aspect of corporate governance with an average score of 14.2 (Figure 1).
Tesco scored lowest because of the lower percentage of independent directors in the Board of Directors since less than 75% of directors were independent. Also, diversity in terms of experience of directors was relatively low. However, the lower score of Tesco does not reflect poor corporate governance. It is just that its corporate governance practice regarding the percentage of independent directors was considered to be relatively inferior since higher percentage of executive directors reduces the influence of independent directors. Also, this is just a measure of independence of directors. Actual independence depends upon actions taken by the Board of Directors and is not possible to analyze with the data in annual reports.

Figure 1: UK ‘ Board of Directors
Companies in the US scored lower than in the UK since their average score was 12 (Figure 2). Apple and Nike had lowest scores of 10 each. Apple scored low because of the smaller size of the Board of Directors, poor description of skills of directors, and smaller number of sub-committees. Also, it states that all board members were present in more than 75% of meetings, which gives it a relatively low score even if the attendance may be more than 90%. Given the low score of Apple, it would be expected that investors would not like to purchase shares of the company. On the contrary, Apple’s share was one of the best performers in the last decade because of high growth in revenues and profits. Therefore, the simple correlation between the score in this report and actual share price performance is difficult to argue for.

Figure 2: US ‘ Board of Directors
Companies in Australia were similar to the US since their average score was 12.2 (Figure 3). However, this was mainly because of the low score of 9 of Seek Ltd. Seek Ltd had a low score because of the small size of its Board of Directors and higher percentage of executive directors on the Board of Directors. Large companies scored high as compared to smaller ones, mainly because of the large size of their Board of Directors. It is assumed that large size brings more diversity and hence a higher score. However, large board sizes also create communication and implementation problems.

Figure 3: Australia ‘ Board of Directors
German companies had the lowest average score of 9 (Figure 4). This was mainly due to the two-tier board structure and low information sharing regarding the members of the Supervisory Board. No information regarding the directors of the Supervisory Board also makes it difficult to give any score on independence of directors. Further, not every company disclosed the number of meetings. The lowest score of German companies implies that their shareholders may be getting less than expected information to make economic decisions.

Figure 4: Germany ‘ Board of Directors
Overall, firms in the UK were the highest scorer on the Board of Directors corporate governance aspect. They were followed by firms in Australia and the US. German firms were the lowest scorer, mainly due to their two-tier board structure. The two-tier board structure is not bad for corporate governance; it is just that the firms in Germany did not disclose enough information about the directors on the Supervisory Board. However, as significant members of the Supervisory Board are elected by workers, it can result in lower independence of the Board of Directors, as well as less diversity and expertise at the highest level.

b. Audit Committee
The data collected regarding with respect to audit committees was converted into a score for each aspect and then added to arrive at a score for each company (Refer Appendix II for converting data into scores). The maximum possible score was 11. Companies in the UK performed decently in this aspect of corporate governance with an average score of 9.2 (Figure 5). GSK was the best performer with a score of 11, which implies that it fully disclosed all information, as well as had higher number in terms of attendance, number of meetings and size of audit committee. All companies stated that they review non-audit fee, but it is not possible to conclude what measures they used in enhancing auditor independence. There was no mention of the maximum non-audit fees, either as an absolute number or as a percentage of audit fees.

Figure 5: UK ‘ Audit Committee
Companies in the US also performed decently with an average score of 9.0 (Figure 6). Apple was again the lowest scorer among the US companies in this category. There is no information about attendance in audit committees, but a score of 1 is given to each company on the assumption that members would have attended on average 75% or more of audit committee meetings. The review of non-audit fees is more
important in the US because of the regulatory requirement under the Sarbanes-Oxley Act. However, there was no mention of the maximum non-audit fees, either as an absolute number or as a percentage of audit fees, allowed under guidance issued by the audit committee of the company.

Figure 6: US ' Audit Committee
The performance of companies in Australia was also decent with an average score of 8.4 (Figure 7). The diversion in scores was very low. The relatively lower scores of companies in Australia and the UK and the US were because of the smaller size of audit committees in Australia. Companies in Australia also scored lower in the number of audit committee meetings in a year. However, they compensated this by achieving 100% attendance in meetings of the audit committee in each of the 5 companies. The lower score in Australia should not be seen as a reflection of poor corporate governance with respect to the audit committee if smaller size audit committees were equally effective in preventing and detecting financial statement frauds, a parameter beyond the scope of this report.

Figure 7: Australia ' Audit Committee
The performance of companies in Germany was also decent with an average score of 8.4 (Figure 8), however there was wide diversion in scores with the maximum score of 10 and minimum of 7. There was no data regarding the attendance in the audit committee; a score of 1 was awarded to each of the 5 companies. One interesting aspect of the audit committee in Germany was the relatively large size of audit committees. This implies that more emphasis was given on preventing financial fraud than other aspects of corporate governance.

Figure 8: Germany ' Audit Committee
The scores of companies in the UK and the US were similar, while average score of companies in Australia and Germany were lower. Some of the lower score in Germany is because of less information, which means that disclosure is relatively poor even though actual practice may not be.

c. Reporting on internal control and risks
The data collected regarding with respect to reporting on internal control and risks was converted into a score for each aspect and then added to arrive at a score for each company (Refer Appendix III for converting data into scores). The maximum possible score was 5. All companies in the UK achieved a score of 4, which implies that the average score in the UK was 4 also (Figure 9). None of the company scored in the category on attestation by external auditor on management’s assessment of the company’s internal control. The requirement to attest is a regulatory requirement in the US under the Sarbanes-Oxley Act of 2002. Hence, companies in the UK have not shown an interest in implementing this since it will increase their costs due to payments to the external auditor. One important issue in the quantitative analysis of reporting on internal control and risks is the difficulty in capturing substantial differences in the amount of coverage given to this aspect in annual reports of companies. All companies state that they have procedures for risk assessment and measuring effectiveness of internal control, but some corporations devote substantial part of their annual report on describing risks and controls. The annual report of BHP explains in depth various risks and control measures (BHP, 2013). The information in the annual report of BHP on internal control is very helpful for investors and lenders. The difference in the coverage to risks and controls is also because of the variation in size and risks faced by businesses. BHP faces many international risks than, as an example, Tesco. Therefore, the reporting on internal control and risks should be viewed in light of the risks faced by a business.

Figure 9: UK ' Reporting on internal control and risks
The score of all 5 companies in the US was 5 (Figure 10). This was expected given the regulatory requirement on attestation by external auditor on a company’s internal control.
Again, same scores reflect the regulatory requirements.

Figure 10: US ' Reporting on internal control and risks
Scores were similar and 4 each in the case of 4 companies in Australia; only Sonic Healthcare had a lower score of 3 (Figure 11). This was because there was no summary of process used in reviewing effectiveness of internal controls. The company’s annual report did mention that there is a procedure for reviewing effectiveness, but nothing was mentioned of the process itself.

Figure 11: Australia ' Reporting on internal control and risks
The score of each company in Germany was also 4 (Figure 12). Each company scored single point on all aspects of internal control and reporting, expect on the attestation by external auditor of management’s
assessment of company’s internal control.

Figure 12: Germany ‘ Reporting on internal control and risks
The reporting on internal control and risk does not show significant differences among companies. All firms mention about their internal control and risk procedures. However, the amount of description of risk assessment and controls varies in annual reports. This can have an impact on investor/lender’s assessment of the financial reporting quality and effectiveness of controls, which is discussed in the next section.

V. Financial reporting quality and effectiveness of controls
Financial statements are used by many stakeholders to form an opinion about the financial performance and financial position of the company. Existing and potential investors, lenders, government agencies, employees and suppliers use information in financial statements to make economic decisions. Shareholders review financial statements to see trends in past performance to form an opinion about the future earnings of the company. Shareholders are interested in capital gains and dividend income, and therefore they are interested in prospective earnings and risks.

Lenders want to know whether the debts given by them to the company are secured with sufficient safety margin. Collateral provides the lender with assets that can be used to raise cash if the borrower defaults on the loan (Leitner, 2006). Lenders also want to know if the business will generate enough cash in the future to make interest and principal repayments because the collateral has value only to the extent of its market value, and therefore reliance on historic costs may not be the best way to ascertain collateral values. Therefore, lenders rely on historic information in financial reports as well as risk analysis of the management to estimate future cash flows. Between shareholders and lenders, shareholders place more emphasis on the future earnings, and therefore are more interested in risk analysis and internal control.

Suppliers are interested in assessing the ability of a company to meet its short-term obligations as they arise. Government agencies typically use the historic data in financial reports to determine tax obligations of a company, and whether the business is solvent. Current and prospective employees use financial reports to determine whether the business would be a going concern in the short and medium term. They want the company to be profitable to have assurances about their job prospects, but are less concerned than shareholders about the level of profits and returns.

The above analysis shows that various stakeholders use financial reports for economic decision making, but some use it more often than others. Investors and lenders use are interested in all financial reports, whereas government agencies are less likely to review reports unless a company declares or is close to bankruptcy. This suggests that the need for reliability of financial reports is higher in the case of shareholders and lenders. Audit committees, internal control and assessment of effectiveness of internal control measures improve the reliability of financial reports. They give more assurance to users of reports regarding the authenticity of financial statements. However, it is difficult for an outsider to observe the true effectiveness of these measures.

The Blue Ribbon Committee in 1999 argued that audit committee is an important tool in corporate governance mechanism because of its role in monitoring the ‘financial reporting process of a company (Abbott et al., 2000). Hogan et al. (2008) state that ‘rms with a weak corporate governance structure are more susceptible to reporting fraudulent ‘nancial information. Audit committees and internal control systems are two main components of corporate governance structure to give positive assurance to the users of financial information about financial reporting quality. Rezaee et al. (2003) state that earnings restatements by public listed companies and allegations of financial fraud statements have increased the attention on audit committee as a means to increase assurance regarding the quality of financial reports. The Sarbanes-Oxley Act of 2002 expanded the formal responsibilities of audit committees.

Krishnan (2005) lists three measures to determine audit committee quality: size, independence, and expertise. Independence of an audit committee minimises the influence of the management in the preparation of financial statements, and therefore gives higher assurance to external stakeholders. All companies in the UK, the US and Australia have to show whether members of their audit committees are independent or not. This disclosure increases the reliability of information in financial reports to the users, and suggests that financial statements of the company are useful for decision making. PepsiCo described in its annual report the steps taken by it to ensure the effectiveness of the Audit Committee, including the process to ensure that it consists solely of directors who are not salaried employees and free from any relationship that would interfere
with the exercise of independent judgment as a committee member (PepsiCo, 2013). This increases the assurance to investors and lenders.

The experience and skills of the Board of Directors is also useful in analysing whether audit committee members have right skills in assessing financial reports. Tesco stated that at least two members of its audit committee had skills to fully review financial statements and other members of the audit committee had an appropriate understanding of financial matters (Tesco, 2013). This is useful in giving assurance to investors since the skills of the audit committee members would be useful in detecting and preventing financial statement frauds.

However, it is difficult to assess the effectiveness of audit committee members as Fiolleau et al. (2012) stated that management of a company has a major say in hiring both the auditor and the directors on the audit committee. The implication of this statement is that members of audit committees are likely to be less effective than expected by external stakeholders. This is difficult to test in real cases but field experiments regarding the procedure adopted by companies for selecting auditors have found limited involvement of the audit committee in the auditor selection decision (Fiolleau et al., 2012). The management of the company is more involved in assessing external auditors, whereas the audit committee serves as a witness to management’s procedures and approves management’s selection decisions (Fiolleau et al., 2012). This behaviour of audit committee reduces assurance of investors and lenders regarding financial reports.

Internal controls have gained importance after the failure of firms like Enron. A company’s internal control procedures includes policies that (1) pertain to the maintenance of records of transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements; and (3) provide assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company’s assets (Apple, 2013). Internal control and risks disclosure increase information of stakeholders regarding earnings in the future. A sound system of internal control in a company depends on a regular evaluation of the business and financial risks (Turnbull guidance, 2005). Risks are uncertainties which can have a negative impact on profits. Therefore, risk management can positively influence on profits of the firm. It is argued that the perceived lack in risk management, especially by the financial services firms, resulted in the financial crisis in 2008 (ASX, 2010). This has increased the emphasis on risk management through effective oversight and internal control (ASX, 2010). The disclosure of risk management processes provide further positive assurance to investors as it shows that the management is taking steps to safeguard their wealth.

A review of the annual reports of companies shows more emphasis on internal control in the recent year. The assessment of internal controls by external auditors is a regulatory requirement in the US. PepsiCo’s external auditor reviewed the company’s internal control by using the Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (PepsiCo, 2013). The auditors of PepsiCo defined stated that internal control provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes (PepsiCo, 2013). This gives higher assurance to external stakeholders. The objective of the internal control audit by an external auditor is to assess the risk that a material weakness exists within the functions of an organisation, which can have a negative impact on its valuation. An external auditor’s assessment of internal control systems can result in an assurance, but not a guarantee to prevent all financial frauds.

Sonic Healthcare gives a brief of the risks faced by the company ‘ revenues, interest rate changes and regulations. The description appears to be customary, but the company discloses the fee structure and roles of governments in determining revenue of the firm in different countries (Sonic Healthcare, 2013). This is useful for an investor who wants to analyse the impact of government austerity measures on future revenues of the firm.

However, there are inherent limitations in internal controls which imply that they may not prevent or detect financial misstatements. The reporting of the internal control function to the senior management creates doubt about its effectiveness. External stakeholders will be sceptical about the ability of the internal control function to report frauds being conducted by the management. Olympus fraud in Japan resulted in heavy losses for investors. The fraud went on for more than a decade before it became public news. This shows that internal control measures were not effective in preventing the management from committing the fraud.

The above analysis shows that audit committee and internal reporting on control and risks increase assurance
regarding the quality of financial reports to external stakeholders. The audit committee disclosures are useful in increasing assurance regarding the quality and truthfulness of the historic information. The disclosure of internal control and risk reporting gives higher assurance regarding the future earnings of the business. However, there are some limitations in both disclosures, but it is better to have these disclosures than not having them.

VI. Recommendations
This section of the report discusses how current disclosures can be made more informative to assist in assessing the transparency and accountability of corporations. A number of recommendations are made to increase transparency and accountability.

One of the main observations was the way information was presented in the majority of annual reports. All companies had information as required by their national corporate governance codes. However, in many cases the information seemed to be included in annual reports to meet the obligations of being seen as a good corporate entity rather than being done for the purpose of enhancing transparency. As an example, all annual reports had information about the Board of Directors in terms of their skills and experience. However, it was only in the case of BHP Billiton that the management had taken extra effort to present the information in a graphical and user-friendly manner. The annual report of BHP Billiton showed pie charts with age, skill and location distribution of its Board of Directors. This was much easier to grasp than the descriptions seen in the majority of the cases. Users of annual reports would find it much easier to look at these graphics for analysing the diversity and experience of the Board of Directors, and therefore it is recommended that companies should adopt similar presentation formats.

Currently, the management of a company is responsible for its internal control over financial reporting. This has both advantages and disadvantages. The advantage is that the internal control function can quickly get in touch with the management if any issue needs to be reported. If the internal control function were to report to the audit and/or risk committee of the board of directors, there may be delays in communication because of the less number of meetings of audit committees. This may allow the risk or fraud to continue for a longer duration. The disadvantage of this reporting structure is that the internal control may find it difficult to highlight an issue if the senior management engages in financial frauds. It is also expected that employees appointed in the internal control function may have been with the company for some time, and therefore may have developed a personal relationship with the senior management. This also makes it difficult to report any violation by the senior management.

It is recommended that the annual report of a company should disclose all financial frauds over a certain amount or percentage of equity of the company. This would increase the knowledge of investors and lenders regarding the state of corporate governance within the company. It is also recommended that each company should establish a guideline which should state that if a corporate fraud is more than a certain amount or percentage of its equity, then the internal control function would report to the audit committee with regards to investigation of that fraud. This would increase the independence of the internal control function without overburdening the audit committee with small frauds. This step will increase the faith of investors in the financial reports of the company.

It is also recommended that companies should make effort to ensure that users of annual reports find it easier to obtain information on risks and internal control measures. Risk is an important topic in the majority of annual reports, but information on risk is not typically available in one place in annual reports. Companies mention that they have processes on determining the effectiveness of risks but the actual process is mentioned in other areas of the report such as ‘Risk management and discussion’. Some firms, such as Siemens, provided clear links but others failed to point properly to look for material on risk management. The content on risk and internal control can be overwhelming for investors, especially individual investors who wish to know about the future prospects of a company but find it too time consuming to go through all content in an annual report. Since risk has a material impact on the future earnings and cash flows, it is recommended that major risk elements and controls in place to mitigate them should be presented in a bulleted summary somewhere (ideally in early chapters) in an annual report. This will help investors in gaining a better understanding of risks of investing in a business.

Annual reports of companies list a number of risk factors which may influence the performance and financial position of the business in the short and long-term. Listing of risks is useful for investors and lenders but
again the effort seems to be on meeting the obligatory requirements under the national corporate governance codes of countries. The effectiveness of risk disclosure can be improved by including a risk-ranking matrix in annual reports. This will allow investors to focus quickly on major risks and look for steps being taken to mitigate them. It will also help users of annual reports to see if the management of the firm is prioritising more on areas that need greater attention. The matrix may not be a complex one ‘ a simple three-tier ranks of high, medium and low ‘ would be sufficient to help users of annual reports.

Firms should design and put into practice strong whistle-blowing systems to ensure that employees with knowledge of frauds within the company can report them to the Board of Directors without the fear of being prosecuted. In the case of Olympus, the board of the company fired its CEO for questioning suspicious transactions. If this was the treatment given to the CEO, employees at lower level could not have thought of reporting the fraud without being severely reprimanded. Protection of employees is important because most external whistle-blowers first blow the whistle internally (Kaptein, 2011). Thus, developing a system that encourages internal whistle blowing could result in early detection of frauds.

In terms of accountability, there should be more emphasis placed on the accountability of independent and non-executive directors. The Board of Directors are agents of shareholders and it is their fiduciary duty to protect shareholders’ wealth. Currently, accountability rests with the executive board. It is recommended that the non-executive directors are also made more accountable because of the impacts of their actions. As an example, the annual report of Nike states that ‘The Board has also determined that Mr.??Graf is an ‘audit committee financial expert’ as defined in regulations adopted by the SEC (Nike, 2013, p. 41). In the event of failure of the audit committee, the designated independent director should be approached first and his actions should be reviewed. This will increase accountability of independent directors and they will take their role more seriously. There is a risk that some experienced people may not wish to take non-executive director roles because of the increased accountability. This has to be weighed in, but the loss of wealth of shareholders in a large company due to fraud is more important.

VII. Conclusion

The purpose of this report was to analyse and compare corporate governance practices in countries and companies in three main areas: Board of Directors, audit committee, and internal control and risks. Corporate governance is a useful tool to increase faith in capital markets, especially in the case of firms where owners are different from managers. The corporate governance systems across the world have shown convergence, but there are some differences. The corporate governance developments in four countries were briefly reviewed. The Cadbury Committee played an important role in the development of corporate governance code in the UK. The codes are similar in the UK, the US and Australia with some minor differences. The US code is stricter after the Enron scandal. The main difference with the German code on corporate governance is that companies in Germany have two-tier boards.

Independence of directors is important in all countries and was reflected in individual company analysis also. Size of Board of Directors and diversity (skills) are also important. Actual independence depends upon actions taken by the Board of Directors and is not possible to analyse with the data in annual reports. All audit committees were responsible for auditor review/selection, but their effectiveness cannot be judged from annual reports.

Shareholders use historic data to predict future earnings, so they are interested in risks which may reduce earnings and cash flows in the future. Therefore, they rely on audit committees and internal reporting to assure themselves about the quality of financial reporting. All companies had some members on their audit committees who had financial experience. Some companies disclosed the lead person in audit committees with financial expertise. This increases accountability. It was difficult to observe skills in the case of German companies, as they did not disclose individual audit committee members in their annual reports.

Emphasis on internal control has increased and companies disclosed summary of policies for the management of business risks. Management also reported the effectiveness of their management of material business risks. This gives users of annual reports more comfort about the quality of internal controls present in a firm to mitigate risks. However, it is difficult for users to comprehend the actual steps being taken. There should be effort to present major risks and internal control steps in a user-friendly manner to improve the disclosure of risk information.

The report recommended a number of actions which can be taken to increase the effectiveness of disclosures.
Firstly, companies should try to present some key information about directors in a user-friendly visual manner to help readers of annual reports make better judgements. Secondly, the annual report should disclose all financial frauds over a certain amount or percentage of equity of the company. Thirdly, companies should establish a guideline that if a corporate fraud is more than a certain amount or percentage of its equity, then the internal control function would report to the audit committee with regards to the investigation of that fraud. This would increase the independence of the internal control function and reduce the potential of financial statement frauds by the management. Finally, in terms of accountability, it is recommended that independent directors should be held more accountable for their work as the lack of their effective actions can cause substantial losses to shareholders and lenders.

References


Sonic http://www.sonichealthcare.com/media/81169/sh0759_annualreport_web2.pdf

Appendix I ' Board of Directors: Companies data and scores
Scores (scores in brackets)
Statement on how board operates: Yes (1); No (0)
Size of board: More than 10 (2); Between 7 and 10 (1); Less than 7 (0)
Description of skills: Good (2); Medium (1); Low (0)
Number of independent directors: More than 75% (2); Between 50-75% (1); Less than 50% (0)
Diversity of experience: Strong (2); Medium (1); Low (0)
Number of meetings of the board: 6 or more (1); 5 or less (0)
Attendance in board meeting: More than 90% (2); Between 75-90% (1); Less than 75% (0)
Separation of chairman and CEO: Yes (1); No (0)
Number of sub-committees: 5 or more (2), 3-4(1); Less than 3 (0).
UK – Data
UK – Score
US – Data
US ‘ Score
Australia ‘ Data
Australia ‘ Score
Germany ‘ Data
Germany ‘ Score

Appendix II ‘ Audit committees: Companies data and scores
Scores (scores in brackets)
Independent of not: Yes (1); No (0)
Size of the committee: 5 or more (2); 3-4 (1); Less than 3 (0)
Number of experienced members in the committee: 3 or more (2); 2 (1); 1 or less (0)
Number of meetings in a year: 6 or more (2); 3-5 (1); Less than 3 (0)
Attendance in meetings: More than 90% (2); Between 75-90% (1); Less than 75% (0)
Consideration of non-audit fees: Yes (1); No (0)
Responsible for external audit review/selection: Yes (1); No (0)
UK – Data & Score
US – Data & Score
Australia – Data & Score
Germany – Data & Score

Appendix III ‘ Reporting on internal control and risks
Scores (scores in brackets)
Summary of policies for the management of business risks: Yes (1); No (0)
Management to report the effectiveness of the company’s management of its material business risks: Yes (1); No (0)
Review of effectiveness of internal audit review/control functions: Yes (1); No (0)
Attestation by external auditor on management’s assessment of the company’s internal control: Yes (1); No (0)
Summary of process used in reviewing effectiveness: Yes (1); No (0)
UK -Data & Score
US – Data & Score
Australia – Data & Score
Germany – Data & Score

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