

Owning the Auditor Relationship



Nawshir H. Mirza
*Professional Independent
Director*

In recent years, a growing number of corporate frauds have surfaced in listed companies. Fraud itself is not new, but the scale and frequency of deception affecting shareholders, lenders, and the investing public have reached alarming levels. This trend presents a striking paradox. Corporate governance frameworks have never been stronger. Audit committees, independent directors, fraud reviews, and extensive regulatory oversight are now standard features of listed companies. One would expect these mechanisms to reduce fraud. Instead, the opposite appears to be happening.

Auditors occupy a central role in safeguarding corporate integrity. Internal auditors are expected to identify risks—including fraud risks—and recommend controls that both, prevent wrongdoing and increase the likelihood of its detection. External auditors, meanwhile, are tasked with identifying material misstatements and frauds that distort financial statements so as to mislead their users.

Why, then, are major frauds continuing to evade detection?

The answer is uncomfortable but straightforward: auditors either lack the necessary competence or they lack true independence.

This raises an important question. How can such failures occur when audit committees are responsible for appointing auditors and receiving their reports directly? Audit committees are, after all, expected to operate independently and free from management influence. Yet when audits fail, the root cause almost always lies in one

of two areas: insufficient capability or compromised independence.

While competence remains a critical issue, the focus of this article is auditor independence—and the role audit committees must play in protecting and strengthening it.

The Illusion of Independence

Formally, statutory auditors are appointed by shareholders at a company's general meeting. In practice, however, shareholders are typically presented with a single recommendation from the board and can do little more than approve or reject it. The board, in turn, is required to nominate the auditor recommended by the audit committee. Because audit committees are dominated by independent directors, the assumption is that their choice of auditor is free from management or controlling-shareholder influence.

Reality is often quite different.

Controlling shareholders and senior executives naturally prefer auditors who are cooperative and unlikely to create difficulties. Once such a firm is identified, subtle signals may be sent to the audit committee chair indicating a preferred outcome. The committee then follows a formal selection process, complete with presentations and evaluations, before recommending the pre-chosen firm.

Prospective auditors understand this dynamic. Consequently, many devote significant effort to cultivating relationships with controlling shareholders, CEOs, and CFOs. Maintaining a reputation for technical competence remains important, but winning the confidence of those who wield real influence is often the priority.

The result is predictable. Once appointed, an auditor's loyalty may drift toward management or the controlling shareholder rather than toward the audit committee. The relationship with the committee becomes largely procedural, governed by regulations, reporting requirements, and formal interactions rather than trust and mutual confidence.

Why the Audit Committee Must Take Ownership

The importance of auditors to an audit committee cannot be overstated.

The internal auditor serves as the committee's eyes and ears across the organisation, assessing risks and evaluating corresponding controls. The external auditor provides independent assurance over the financial statements that the committee must ultimately approve.

Together, these two functions discharge most of the committee's responsibilities. In effect, they are the committee's agents.

For this reason, both auditors must be loyal to the committee and trusted by it. Their relationship cannot remain merely formal. It must be built on confidence, candour, and mutual respect.

Trust, however, is not established between institutions. It is built between people. In practice, that bond must exist between the chair of the audit committee and the lead audit partner—or, in the case of internal audit, the chief audit executive.

The committee must therefore "own" the auditor relationship.

Building an Environment for Effective Auditing

An effective audit committee can strengthen auditor independence and effectiveness through several practical measures.

1. Establish Regular Private Dialogue

The committee chair should meet privately with the lead audit partner on a regular basis. These conversations create rapport and encourage openness. Auditors must feel confident that concerns raised privately will be taken seriously and pursued appropriately.

2. Hold Executive Sessions with Auditors

Audit committees should meet periodically with auditors without management present. Such sessions allow auditors to discuss concerns they may hesitate to raise in open meetings—particularly those based on intuition, behavioural observations, or incomplete evidence.

Issues such as organisational morale, leadership style, or management integrity often emerge through these conversations.

3. Create a Trusted Channel with the CFO

The committee chair should cultivate a relationship with the CFO that encourages candid discussion of concerns regarding business practices or organisational behaviour. Where appropriate, these concerns can then be communicated to the auditor and incorporated into audit procedures.

4. Share Strategic Developments

Significant board decisions, strategic shifts, or emerging business risks should be communicated to the auditor promptly. These developments may have immediate or future implications for financial reporting and should inform audit focus areas.

5. Publicly Support Auditor Independence

In committee meetings, and in the presence of auditors, the committee should make clear that it expects prudent accounting judgments, conservative assumptions, and full cooperation from management. Such signals strengthen auditors when they face pressure to limit the scope or depth of their work.

6. Ensure Auditors Attend Full Meetings

Auditors should participate throughout audit committee meetings rather than only during agenda items directly related to them. Full attendance provides broader context and deeper insight into organisational risks and governance dynamics.

7. Direct Attention to High-Risk Areas

The committee should actively evaluate how business strategies, transactions, financing structures, and operating practices affect financial reporting. This analysis helps auditors focus their efforts where the risks are greatest.

8. Ask Better Questions

Auditors should be challenged with probing questions regarding:

- The quality and reliability of evidence received
- The conservatism of accounting judgments
- The culture of the finance function
- The adequacy of management explanations
- The time available to conduct the audit
- The effectiveness of internal audit, compliance, secretarial, and whistleblowing functions

A diligent committee strengthens the auditor's position. When management pressures auditors to defer or minimise concerns, auditors can point to the committee's exacting scrutiny and insist that issues will inevitably surface.

9. Demonstrate Genuine Independence

Nothing undermines an audit more quickly than a perception that the committee is aligned with management or beholden to a controlling shareholder. Independence must be demonstrated consistently through conduct, decision-making, and questioning.

10. Challenge Assumptions Relentlessly

Major assumptions, forecasts, valuations, estimates, and management commitments should be rigorously tested. When issues are deferred for future resolution, the committee must satisfy itself that management has both the intention and capability to deliver corrective action.

Failure to follow through on such commitments is often not merely a management failure—it is a governance failure.

11. Inform the Full Board

Significant financial reporting concerns should be communicated to the entire board. Accountability for financial reporting quality must extend beyond the audit committee and auditors to all directors.

The Auditor as Protector

Audit committees must give auditors a full voice and never create the impression that the committees serve primarily as defenders of management's position. The committee's own protection—and that of independent directors—depends upon the effectiveness of the audit process.

Auditors are, in many respects, the committee's protectors. Equally, the committee must protect auditors by creating an environment in which they can exercise independent judgment without fear or favour.

Where committee members are perceived as insufficiently independent, the chair bears a special responsibility to demonstrate, through actions rather than words, that the committee seeks rigorous auditing and financial statements that are both true and fair.

Shared Accountability

The audit committee's responsibility extends beyond appointing a reputable audit firm. It must ensure that the audit team possesses the expertise necessary to challenge management's arguments and understand increasingly complex business arrangements.

If auditors fail to inspire confidence in either their competence or independence, the committee should seek a change.

A failed audit is not solely the auditor's failure. It is also a failure of the audit committee that oversaw the process.

Ultimately, the effectiveness of an audit committee depends heavily on its chair. Leadership, judgment, courage, and independence at the top determine whether the committee merely fulfils formal requirements or genuinely safeguards the company and its stakeholders.

The safety of both the organisation and its auditors may rest on that distinction.

Which raises a provocative question: Is it time for auditors to have a veto over who chairs the audit committee?
