Bazerman, Loewenstein, Moore; *Why Good Accountants Do Bad Audits*; **Harvard Business Review**; Vol. 80, No. 11.; (November 2002).

The identification of bias based in ambiguity, attachment and approval is enlightening as far as it goes, but the "radical remedies" proposed will not solve the fundamental corporate governance problem, even if these remedies mitigated the effects of bias to some degree, which I doubt.

The work of Bazerman, et al. confirms my long-standing belief that bias rooted in the auditor/client relationship contributes significantly to poor audit quality. The answer, however, is not to further regulate the business of the auditor, but to fundamentally change the auditor/client relationship so as to exploit auditor bias to improve audit quality while simultaneously improving the corporate governance process.

Once ownership and control became separated, the shareholders could only look to the board to represent their interests as the owners of the enterprise. Unfortunately, by the time the separation became manifest, boards had become dominated by management and had delegated away much of their responsibility to supervise management conduct. While much of the scholarship of Berle, Means and Douglas is dated, the corporate governance problems they identified almost 70 years ago have not diminished. [*See*, Berle, Adolf A., and Means, Gardiner C., *The Modern Corporation and Private Property*, (1932); Douglas, William O., *Directors Who Do Not Direct*, 47 Harv. L. Rev. 1305 (1934).]

Ideally, the shareholders elect a board of directors to engage managers and take responsibility for the performance of those managers. It is the second part of this undertaking of the board - responsibility for the performance of management - that is currently ineffective. As boards abrogated their oversight responsibility and became dominated with management members, the engagement of auditors was naturally delegated to management. So, the bias identified by Bazerman, et al. became a bias in favor of management with predictable results.

Even properly constituted boards are to some extent disabled in their oversight of management performance by a lack of unbiased information. The information available to the board comes almost entirely from management. While instances of outright misrepresentation may be few, managment does not volunteer information, particularly if it is unfavorable, and all information is filtered by management's perspective. The auditors employed and controlled by management confirm management-biased financial reports. Boards are not incented to change this situation as they currently have only limited legal responsibility for the performance of the enterprise and the veracity of the financial statements prepared by management.

The answer to our periodic corporate government crises (is is amazing how little has changed since William Douglas wrote in 1934 despite all the intervening legislation and litigation) is to separate management from financial reporting. Management shoulod continue to prepare the financial statements, but the auditors should be engaged by the audit committee of the board and the financial statements should be certified by the Chair of the Audit Committee and the Chair of the Board (who should be an independent director, not the CEO). In making this certification, the Chair of the Audit Committee and the Chair of the Board would rely on the auditors' reports together with other information received in their role as directors with no change to current "business judgment rule" jurisprudence. The current scheme under which the CEO and CFO hire and supervise the auditors and then certify the results of the audit creates perverse incentives that should be self-evident.

Placing the engagement of auditors and responsibility for the integrity of the financial statements with the board would have two advantages. First, it would align auditor bias with the interests of the shareholders instead of management. Second, it would provide to the board an additional, relatively unbiased source of information about corporate performance that would make fair the imposition on the board of responsibility for the integrity of financial reporting and would enhance the board's ability to assess the performance of management.

All the other proposals for improving audit quality that would leave management responsible for financial reporting and auditors responsible to management will, I predict, fail.

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