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SELECT COMMITTEE ON SUPERANNUATION AND
FINANCIAL SERVICES

**Reference: Prudential supervision, global financial services and superannuation
guarantee charge**

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SENATE
SELECT COMMITTEE ON SUPERANNUATION AND FINANCIAL SERVICES

Thursday, 23 August 2001

Members: Senator Watson (*Chair*), Senator Sherry (*Deputy Chair*), Senators Allison, Chapman, Conroy, Hogg and Lightfoot

Senators in attendance: Senators Allison, Chapman, Conroy, Hogg, Lightfoot and Watson

Terms of reference for the inquiry:

For inquiry into and report on:

- (a) prudential supervision and consumer protection for superannuation, banking and financial services;
- (b) the opportunities and constraints for Australia to become a centre for the provision of global financial services;
and
- (c) enforcement of the Superannuation Guarantee Charge.

Committee met at 3.53 p.m.

Participants

AGLAND, Mr Reece Graeme, General Counsel, National Institute of Accountants

BARTLEY, Mr Paul, Deputy State Chairman SA, National Institute of Accountants

BROWN, Mr Roger, Senior Manager, Specialised Institutions Division, Australian Prudential Regulation Authority

EAST, Mrs Lesley, Assistant Commissioner, Australian Taxation Office

EDGE, Mr William Rodney, Board Member, Auditing and Assurance Standards Board

HARRIS, Professor Anthony Clement (Private capacity)

McKEAN, Mr David Cameron, Executive Director, Assurance Audit Services Group, Australian National Audit Office

MACKINTOSH, Mr Ian, Chief Accountant, Australian Securities and Investments Commission

MALKIN, Mr Christopher Milton, Vice President Victorian Division, Member, Superannuation Centre of Excellence, CPA Australia

MARTIN, Ms Helen, Senior Vice President, Institute of Actuaries of Australia

MIFSUD, Mr Richard, Executive Director, Auditing and Assurance Standards Board

NIVEN, Mr Douglas David, Deputy Chief Accountant, Australian Securities and Investments Commission

ORCHARD, Mrs Susan Janet, Superannuation Technical Consultant, Institute of Chartered Accountants in Australia

PHELPS, Mr Les, Executive General Manager, Specialised Institutions Division, Australian Prudential Regulation Authority

RASSI, Mr Richard, Chairman, National Superannuation Taskforce, Institute of Chartered Accountants in Australia

REILLY, Mr Keith, Technical Adviser, Institute of Chartered Accountants in Australia

SHANAHAN, Mr John Bernard (Private capacity)

THOMAS, Mr Trevor John, Assistant Commissioner, Australian Taxation Office

VENKATRAMANI, Mr Senthamangalam, General Manager, Diversified Institutions Division, Australian Prudential Regulation Authority

CHAIR—This hearing is held pursuant to the committee's terms of reference for inquiry into prudential supervision and consumer protection for superannuation, banking and financial services. I would like to welcome everybody to this roundtable and to thank you for making your time available. I do hope we will be able to cover all the issues this afternoon.

Senator HOGG—Before we proceed, could we form a subcommittee?

CHAIR—Yes. Is it the wish of the committee that we form a subcommittee?

Senator HOGG—Yes, and I move that the subcommittee comprise you and me.

CHAIR—It is so agreed. As you may be aware, the committee tabled its first report on these terms of reference on Monday. In that report we foreshadowed that we would be holding a roundtable discussion with relevant parties, including peak professional bodies and the regulators. We did this because we are concerned to ensure that trustees, fund managers and regulators can have confidence in the standards of audit reports and rely on them as one mechanism which can give early warning of any potential fund failure. I would also like to acknowledge the contribution made by the National Institute of Accountants in terms of the submission that they put to us before we agreed to hold this roundtable, because it was a thought provoking document which we wanted to explore even further. So thank you very much for your contributions.

In the wake of recent corporate collapses, including the collapse of a number of superannuation funds, the question arises as to whether better auditing standards may have prevented some of those collapses. But we are also concerned at certain perceptions, such as those expressed by the CEO of APRA, Mr Thompson. In a meeting—quoted in *Hansard*, reference 1257—he said:

They feel that their skills and role are largely confined to expressing a view on the adequacy of financial statements and the financial controls in an institution.

That was a little bit of a warning signal to us as parliamentarians. Nevertheless, we appreciate the frankness with which it was given.

As a committee, we also want to continue to ensure that the bar for trustees, fund managers, administrators and auditors is raised to a level at which the whole community can have complete confidence in the safety of their superannuation savings and their retirement incomes. As chair of this committee, I am alarmed from time to time by various statements about the security of retirement savings, the money in superannuation funds. It must be absolutely watertight, as far as I am concerned.

The aim of today's hearing is primarily to explore issues associated with the auditing of superannuation funds. The first issue is the adequacy of auditing and accounting standards. What are the community expectations of auditors? Are auditors doing enough to meet those expectations?

The second issue is the adequacy of reporting requirements under the SI(S) Act. What are the obligations on auditors? Are they adequate? How can they be enforced more effectively? Should those obligations be extended to include reporting directly to the regulator? How can audit independence be assured?

The third issue is the nature of audit reports. Should audit reports include risk assessment? Should they be prepared more frequently? Should they include ancillary reports, such as actuaries' reports?

The fourth issue is the reliability of audit reports. Are the regulators able to rely on audit reports to provide early warnings of potential fund failure? Should the regulators make more use of external audits? A lot of the criticism that has been attributable to APRA could perhaps have been minimised if the statements of some of those superannuation funds had been properly audited.

The fifth issue is the role of professional bodies. How can they ensure adherence by their members to ethical standards? How can they raise the overall standard of the auditing profession?

The sixth issue is the qualifications and experience required of auditors of small, medium and large superannuation funds. What qualifications are currently required? Are they adequate?

With such a large gathering as we have today, there are a lot of issues to cover. We will have three initial short opening statements. There will be one from Mr John Shanahan, a forensic accountant who is doing some work for ASIC on defaulting auditors. We will hear from Mr Richard Rassi, a representative from the peak professional body, the Institute of Chartered Accountants. We will hear a different approach from the Institute of Actuaries, which will be presented by Ms Helen Martin who, I understand, will take a forward-looking view as to the status of the accounts and what they are in terms of being able to satisfy the future liabilities, et cetera, of the membership of that particular fund.

We will then deal with each of the issues in turn. At the commencement of each issue, I will invite one representative to provide some brief remarks. Once the remarks have been made, I will seek input from around the table. We have approximately 20 minutes for each issue, so I hope that people will confine their statements to three minutes—a big ask in a parliament, I know. The issues have generated tremendous interest and we thank all those who have given up their time at such short notice to prepare submissions and come to Canberra to appear before the committee today.

All the witnesses are protected by parliamentary privilege. You know how conscious we are of that in not proceeding before we have a quorum to make sure everybody is adequately protected. The evidence you give is protected by parliamentary privilege. This means that you are given broad protection from any action that might be contemplated from what is said. The Senate has power to protect each witness in respect of any action which disadvantages them on account of evidence given before the committee today.

The committee prefers to conduct its hearings in public. However, if there are any matters which you wish to discuss with the committee in private, the committee will consider your

request. I do not envisage that happening today. I hope we do not have to go in camera because it is a very slow process and the more transparent these hearings are the better. I welcome all the participants to today's hearings. All proceedings are being recorded by Hansard and witnesses will receive a copy of the transcript. I invite Mr Shanahan to begin.

Session 1—The adequacy of auditing and accounting standards

Mr SHANAHAN—Thank you, Senator. I am an independent consultant. Looking at the agenda today the first thing that struck me concerning the adequacy of auditing and accounting standards was: what are community expectations of auditors of superannuation funds? I have a concern. I come from an audit background. I have worked with ASIC in pursuing defaulting auditors. I think we are setting a very high community expectation on the auditors. There was a story in the *Age* last Friday about the loss of value in a superannuation fund in Melbourne and the paper said that an external auditor had been appointed by APRA 'to inquire into investment decisions by the fund'. I think a lot of community expectation is that the auditor is not there just checking financial statements and compliance but that the auditor is somehow a broader type of insurance policy. That concerns me. The auditor will look at financial statements and does have obligations under the SIS legislation and APRA to report on compliance. My view is that a lot of compliance reporting is fairly mundane. Has a trustee been appointed properly? Has he kept minutes for 10 years? Are they properly filed? People are looking for more security on their investment decisions, which is not properly the function of the auditor.

I have my money in an accumulation fund. The accounts say it is fine. If there were another stock market crash, my super fund would lose 25 per cent of value overnight. People would say, 'Where was APRA?' 'Where were the auditors?' I do not think the answer is, 'Hey, they were doing their jobs. There was compliance with investment policy.' If two years ago the investment policy had been, 'Let's move into the dot com tech sector,' your super fund would now be bereft and you would have financial statements showing that they were bereft, yet you would have met all the compliance rules. People would say, 'There was an auditor, though. The accounts showed correctly that the fund was going out backwards. You had complied. Who was responsible for the investment decisions?' I do not want the auditor hung with that one.

Having said that—and I come from an audit background—I believe that we need to raise the bar of auditing for superannuation funds. There is detailed guidance from the Audit and Insurance Standards Board. I would like to see, as the committee mentioned in its first report, a board of superannuation auditors. I believe that is a sensible proposal. I have no problem with smaller accounting firms doing superannuation audits if that is what they are good at. I would hate to be a general practitioner accountant doing some tax returns, the audit of a super fund, and something else. I believe we need to be focusing on how we can improve the level of auditing of superannuation funds. We need to tighten the standards and be much more rigorous in auditors of superannuation funds meeting the experience qualification.

CHAIR—Given the issues you have raised, I think there is a real danger in there being too big a gap in not meeting community expectations. Ms Helen Martin, it might be appropriate if we hear from you next in terms of the position from which you come as an actuary, because actuaries essentially look into the future.

Ms MARTIN—I had not expected you to call on me to make an opening comment. However, I am happy to make one. I met with Brian Gray from APRA this morning and I was talking about some of the concepts that I think are relevant to today in terms of the structure of the regulation of superannuation as it is at the moment and how that could be improved going forward. I think one of the issues—and John Shanahan has also alluded to this—is that the auditing and compliance monitoring approach at the moment is very much backward looking, involving ticking boxes and seeing if people have complied with all these minute details in the SIS legislation.

Looking forward from here, ideally we would like to see some sort of process put in place, with a better risk management framework around the regulation of superannuation funds—something that requires superannuation trustees to have a proper risk management approach in place that identifies all the key risks that the funds face and that seeks advice on those key risks and how they can be mitigated—

CHAIR—Could you outline those risks?

Ms MARTIN—Things like investment risks. Rather than just saying that the trustee has to consider and formulate an investment policy, they need to more specifically require the trustee to identify particular investment risks and have in place a strategy that actually deals with those risks. Perhaps there even needs to be a requirement for the trustee to take professional advice on investment strategy and, if they choose not to follow that professional advice, to place some whistleblowing responsibility on the professional who provides that advice. So I think there is a need for some sort of forward looking risk management framework to try and deal with some of the issues that have emerged through the committee process.

CHAIR—Mr Rassi, do you have a comment?

Mr RASSI—I am going to talk a little bit about the auditing profession and then make comment on some of the other participants and stakeholders in superannuation, because I think it is relevant to talk about the relationships between the key stakeholders. There is no doubt that the auditing profession has been under attack in recent times, but it is really important that politicians, the public and regulators do not generalise the findings of certain cases and apply those findings or concerns to the audit profession overall. If you have a look at the track record, it has not been that bad—considering the number of audit opinions that have been issued since the SIS legislation first came in. Very few auditors have been successfully accused and tried for negligence or indeed struck off as not being suitable to act as approved auditors.

The superannuation audit profession has been doing a lot of positive things, and it is important to examine those things to see where we are ending up and whether in fact we are working towards improving the overall standard. For example, at the moment a new accounting standard has been released in exposure draft form for comment which attempts to improve the quality of external financial reporting and at the same time get some balance between the cost and the benefit of financial reporting. The profession is in the process of updating the auditing guidance statements that are applicable to auditors of super funds. It continues to provide courses to practitioners and they are constantly under review and being improved upon. The profession has also been quite busy considering issues of independence, and this is an exercise that has been undertaken by the profession overall.

It is important in superannuation to remember that there are a number of different stakeholders. Some of those key stakeholders are obviously the trustees, the professional administrators of super funds, the investment managers, the professional advisers that hang around the fund and the regulator. Each has a role to play. Unfortunately, if one of those parties fails to perform adequately, the other stakeholders tend to get dragged down. If something goes wrong, it then tends to attract criticism for all stakeholders. There is no doubt that there is scope for improvement in the auditing profession, but there is also scope for improvement in the roles of some of the other stakeholders.

I would hope that a forum such as this would identify areas for improvement and ways in which the stakeholders can work better together—for example, expanding the roles of auditors by statute so that we can better support the role of APRA. One of those examples might be to include a mandatory cyclical prudential review of the larger funds, which is something that has been recommended by APRA anyway but, of course, when it comes to getting the clients to undertake those reviews, cost comes in the way. The fact that it is not statutorily required discourages people from doing those types of exercises which I think are quite critical in the superannuation industry, particularly when you look at the model that exists at the larger end of the industry, which is that a lot of the duties and functions are outsourced to external service providers.

Another example would be helping the profession develop appropriate competency models. We have the concept of registration—Registered Company Auditor being the appropriate qualification for auditors to undertake the audits of APRA supervised funds. But what needs to be developed there is obviously a competency model to translate some meaning into that qualification. Another example is the regulator helping to manage the profession with the expectation gap and communicating the roles of auditors in helping to manage that expectation gap. Another example of how the stakeholders can work together is the question of prudential supervision of fund administrators, which is an area that I have raised a number of times in various circles.

CHAIR—I will now open it up very briefly for some general comment, but I am quite interested in the innovative idea put forward by Ms Helen Martin that, from time to time, trustees should have to sit down with a properly independent person about investment strategy appropriate to the future needs of their members. This is a forward looking approach which, for me, really has some attraction at the moment. I would like anybody's views.

Senator ALLISON—Before we move in on that, I am interested as well in democratising that process with members. If anyone has anything to say about that, I would appreciate it.

Mr MALKIN—I would like to pick up on a couple of points that have been made by the previous speakers and emphasise that, in our opinion, the existing legislation and the framework of the existing legislation are very robust. For example, Helen mentioned the desirability of having a forward looking framework of legislation. It already is forward looking. Within the legislation itself, specifically section 129 of SIS, it gives the auditor the ability to pick up on where they think a breach may occur in the future and agree with the trustees how to strengthen that area of potential breach.

CHAIR—There is a big difference between breach and investment risk, though, isn't there?

Mr MALKIN—Yes, there is, but—

CHAIR—We have to bring the two together.

Mr MALKIN—Yes. Within the framework of SIS, under section 52—the covenants applicable to the trustees of the various superannuation funds—exists the need to have an investment strategy. The strategy in fact outlines four key areas: risk, diversification, the ability of the fund to meet its cash flow requirements and the ability to pay out benefits when and if they fall due. The trustees have a mandated responsibility to review all of their investments in line with their investment strategy.

Of the 220,000-plus superannuation funds in Australia, I would imagine—in fact, I will not imagine; I am fairly certain—that most of them are adhering very strictly to the legislation. Most people are now becoming very attuned to their own savings agendas and retirement requirements and are quite passionate about driving their dollars further through their superannuation fund. I think the public perception is incorrect in assuming that most funds are not in fact robust and not complying with the legislation.

CHAIR—In the last five years, superannuation funds have been showing a net return on average of about eight per cent real, which is a good return. Today we are not really looking so much at the performance of the funds in terms of their returns as at their focus, adequacy and security and how to make that even more secure.

Senator HOGG—Chair, could I just take you back to your opening statement. I think this really sums up the purpose of the afternoon. As a committee, we want to continue to ensure that the bar for trustees, fund managers, administrators and auditors is raised to a level where the community can have confidence in the safety of their superannuation savings and their retirement incomes. That is our concern. I do not think we are questioning so much that there is a major problem in terms of the perception of people as to whether or not the funds are robust. I think most people believe that their funds are robust, as the chair has indicated, and are delivering a reasonable return to give them a reasonable income in their retirement.

However, the committee has now been faced on a number of occasions with inquiries—we are like doctors in the sense that they do not see well people; we only see the people who have been the subject of fund failures and fund difficulties. That brought into focus for us the issue of the role of auditors. We are now dealing with a system whereby people are compulsorily having their funds put into a superannuation fund for their retirement somewhere down the track. So it is not something that is voluntary; it is compulsory.

I think that compulsion changes the way in which they view their perception of their retirement benefit and the safety of that benefit. I think that lifts the bar more so than anything else. I think that really is the nub of what we are trying to get at when the first question posed is: what are the community expectations of auditors? Most people in the community in my view would not have had one iota of an idea of what an auditor was, what an auditor did, or what they were expected to do over a period of time. Now they would be becoming familiar with the role of what an auditor might do, but they may well have an expectation that outstrips what even the people around this table may see as being the role and the function of an auditor. Are auditors doing enough to meet those expectations? Could we come back to that? I am not saying

that the rest of this discussion is not useful, but to us that really is getting to the nub of things this afternoon.

CHAIR—Could we have one last contribution before we come to Professor Tony Harris on the adequacy of auditing standard in terms of the comments by the three opening speakers? We are now on the adequacy of auditing and accounting standards. If anyone feels that they would have liked to have spoken, please put in a submission on the issue, because we are restricted by time. We would be very happy to receive a submission if you feel that you have not had the opportunity to make an oral presentation on a particular point.

Prof. HARRIS—Although I am appearing in a personal capacity, I should note that I used to audit what was, I think, the largest superannuation fund in Australia at the time—the New South Wales Pooled Fund—so I would like to draw on that experience in my discussion. There is indeed an expectation gap, and everyone around this table is aware that this is an issue which has concerned the accounting and auditing profession for some considerable time. The profession tries to address the expectation gap by telling the community the very limited role that auditors play today in the financial and superannuation services as well as in the broader commercial sector. I appreciate the concern that this committee has that it may be that another solution is to expand the role of auditors to better meet a part of that expectation gap.

That has also been a matter for discussion within the industry and there is some scope for auditors to comment, for example, where there are systems failures within managers of superannuation funds. Even though those systems failures do not adversely affect the financial statements, they may adversely affect the way funds are either administered or distributed between members. Perhaps there is also some scope to contemplate that auditors could comment publicly on whether trustees do have—in the view of the auditors—a non-capricious view about the investment processes that they are following.

I hasten to add that in the New South Wales pooled fund the trustees were entirely professional in the way they approached the investment of funds. But you can suggest that from time to time, and it has happened in the past, when trustees are been induced to invest in firms—take the Mirror case in the United Kingdom, where the funds were invested rather more aggressively in the Mirror shares than they ought to have been—you can have an auditor playing a role about capricious investment. You can have an auditor playing a role about systems failures—something which today they have resisted doing, but something which they would be able to do if the legislation required.

As for other issues to do with auditing—I will limit myself to two more comments—we should not base our approach to the future on the fact that we have had a very benign and helpful investment regime in the recent past. The failures of the auditing profession that occurred in the past have occurred when there has been a downturn in the economy and when the sins of auditors and the sins of the corporations emerged—when they floated to the surface. The next time we have a downturn we will see many more failures which will be attributed to auditors' failings as well as trustees' failings, and I think we should be careful about that.

Having said that, the accounting standards applicable in this area are significantly better than the accounting standards in the commercial area, which are characterised by ambiguity and flexibility, to put it mildly. In the commercial sector the auditees appoint the auditors—and I see

that as imposing a very considerable burden on auditors. The same thing happens in this arena: the trustees appoint the auditors, so the auditees appoint the auditors. That is a considerable burden on the auditors should the trustees wish to remonstrate with the auditors about the way the audit is going. To date, it has been a lesser problem in this area than in the broader commercial area.

CHAIR—Why is the lesser problem with superannuation in the commercial world?

Prof. HARRIS—Probably because trustees are under a very significant obligation—as are directors of firms—which so far they have tended to treat more seriously than directors of corporations, in my experience. In my auditing, I had fewer problems with auditing the several diverse funds as well as the large pooled fund, fewer problems dealing with trustees because the seriousness of the issues were far more apparent to them than they were to the directors of government boards. Having said that, there is room to improve the role of audits and there is probably a community expectation that that role be improved. Thank you.

CHAIR—I now invite people from the roundtable to debate the issue of adequacy of auditing and accounting standards. Are there any questions or contributions?

Mr REILLY—I am from the Institute of Chartered Accountants in Australia. I must admit that I smiled when, first of all, John Shanahan talked about expectation gaps and Tony Harris has now picked that up as well. I was at a seminar this morning with a learned QC and a well-known liquidator, and the same issues were raised in terms of the corporate area, looking particularly at three recent corporate collapses: Harris Scarfe, HIH and One.Tel. It is not a new issue and I would tend to agree with Tony that we cannot guarantee, either in the corporate area or even in the superannuation area, that there will be loss in value of assets over a period of time.

I think the royal commission into HIH will end up with a higher expectation and a greater assurance that companies that operate in the insurance area, superannuation funds and banks do not go broke. There will never be an absolute guarantee, but there should be appropriate safeguards in place to ensure that there is reasonable assurance that the investors and those who deal with those companies do not lose value over a period of time. But we have to also be a little bit realistic. A superannuation fund is no different from any other investment vehicle, and if it has put a proportion—not the total lot—of its investments in, let us say, the dot com industry two years ago, then it might lose out on that if the dot coms go down in value. On the other hand, if it put part of its investment portfolio in other areas such as perhaps US futures, they would have gone up over a period of time.

It is important to make sure that the investment strategy is balanced. I would concur with the earlier statement that John Shanahan made, that if he was a member of a superannuation fund and the investment strategy was purely dot coms he would be pretty unhappy today, and one would argue that the trustees would have a great deal of difficulty in being able to justify that the investment strategy they followed was a reasonable one. I think this morning it was said that it is no defence to say you are a reasonable lunatic being on a board, and there would be no difference in the superannuation area.

It is worth referring to a research study that the Institute of Chartered Accountants in Australia and the Australian Society of CPAs did on the audit expectation gap, which goes back to 1993, and a follow-up which was called *Beyond the Gap*, which looked at the 100-odd recommendations that were made on that expectation gap in June 1996. There are lessons to be learnt out of that, and I would be happy to provide the committee with a copy of both documents.

CHAIR—Could you table that?

Mr REILLY—Yes.

CHAIR—Thank you. I invite people to address the issue raised in Professor Harris's comments that any downturns in the world economy are likely to put some pressure on auditors, returns, et cetera, because it is very pertinent in terms of trying to secure investment in this big pool of \$500 billion.

Mr EDGE—The comment I would like to make addresses what you have just asked and also what Senator Hogg has referred to about the fact that superannuation funds are slightly different in that superannuation is compulsory and people want assurance. But most of what our speakers have said—and I bring this to the table—applies to audits of all entities. I would like us to focus on the comments you have made about the impact of a recession and whether it is going to impact on all entities. I do not mean to be trite, but we as we go through that discussion we should concentrate on what is peculiar to superannuation funds. The sort of document that Mr Reilly has put on the table shows that there is a huge range of issues applicable to all audits.

CHAIR—Yes, acknowledged.

Session 2—The adequacy of reporting requirements under the SI(S) Act

Mr BROWN—As participants know, trustees are obliged to engage an approved auditor to give a report in the approved form on the operations of a superannuation fund each year. Because the requirement is for a report to be in the approved form, APRA has a capacity to define what should be included in the report so long as that is within the contemplation of the SIS legislation. The structure and content of the approved form has been negotiated with the audit profession over the years primarily through the mechanism of the superannuation national audit consultative committee, which APRA convenes and to which it invites representatives of each of the professional bodies from which superannuation auditors may be drawn as well as the Auditing and Assurance Standards Board, the Australian Accounting Standards Board, ASIC and the ATO. This group meets approximately twice yearly. The most recent such meeting was in April of this year. The approved form has been designed to eliminate duplication so that it serves both as the auditor's report to the trustees, and through the trustees to members, and also to APRA.

APRA needs to be able to rely on the superannuation fund accounts and on the audit comments on compliance. Our expectations of auditors are set out in circular IV4. Those include that the auditor must be independent, that there should be a letter of engagement from the trustee and that there should be a management letter issued by the auditor, irrespective of whether there have been negative findings arising from the audit. For funds which invest in

derivatives, whether directly or through a collective investment scheme, the trustee is required to attest annually that a risk management statement is in place that covers those investments, that the risk management statement is consistent with guidelines which have been issued by the regulator and that the procedures set out in that risk management statement have been followed. An external auditor must be engaged to audit the accuracy of that attestation.

Under section 129 of SIS, auditors also have an obligation to report to trustees whenever in the course of auditing a fund they identify a breach of the SIS legislation, or if they form the view that the fund is, or is about to be, in an unsatisfactory financial position. That report must be in writing. The auditor is protected from any recourse by the trustee or others if the auditor at the same time advises APRA. If they do not advise APRA of that finding, they must specify a period within which the trustee must respond to the identified concerns. If there is not a response, or if the response is not to the satisfaction of the auditor, the auditor must advise the regulator. In the course of general audit reporting materiality is a consideration, but in the case of a section 129 report there is no such consideration.

Reports to APRA under section 129 have been very rare. On a brief review of our files, I have been able to identify only two. By contrast, approximately one fund in eight—excluding the small APRA funds—has a qualified audit report attached to its annual return. Admittedly, approximately 80 per cent of those qualifications relate solely to the late lodgment of the annual return. The first question is: are the obligations imposed on auditors under the SI(S) Act adequate? We need primarily to bear in mind the first order responsibility of trustees rather than auditors, and also bear in mind a desire not to see any blurring of that responsibility.

Should the auditor's obligation extend to reporting directly to the regulator? The ordinary annual report by the auditor does come to the regulator; it is provided by the trustee, and we see no difficulty with that process. Where there is potential scope for greater reporting directly from the auditor is in respect of contraventions of SIS or the potential for an unsatisfactory financial position. At the moment that is optional for the auditor at the time of first identification of a compliance breach. In the previous regimes where there were approximately 220—

CHAIR—It is 'may' rather than 'must' at the moment, isn't it?

Mr BROWN—Yes. We see now that there is a potential advantage for auditors to report directly to us at the same time as they report to the trustee that they have identified a compliance breach or a potentially unsatisfactory financial position. That is not mandated. It is possible at the present time; it would be open to the professional bodies to commend that to their members. If it were the community's desire for that to be mandated, that would require an amendment to the SIS legislation.

CHAIR—What is your view? You have to be frank today.

Mr BROWN—I see now there being an advantage in that.

CHAIR—In making it a 'must'?

Mr BROWN—Yes. While in my experience the bulk of auditors are good auditors and would be happy to accede to such a request—particularly if it is promoted by their professional

bodies—I see, like you, more funds at the bottom end of the market which are encountering difficulties, and frequently the auditors of those funds would be less willing to comply with a voluntary request.

The issue of auditor independence has been raised by APRA with the accounting bodies in the past. We are aware that there are developments in terms of the definition of independence and provision of guidance on independence arising out of the international audit and accounting bodies. We have seen instances of severe lack of independence and we have on occasion disqualified auditors primarily for that reason. In a survey amongst our supervisory staff, they identified that as an issue in perhaps two to five per cent of the funds which we review. So it is not, in audit parlance, a material issue in terms of frequency, but certainly in those funds where it is an issue it does represent, in my view, a risk to members.

The argument is frequently made that one accounting firm can both prepare the accounts of an entity and audit it, and the argument is put that Chinese Walls within the firm can ensure that there is independence. That position is certainly arguable, but perhaps particularly in smaller practices it can come under legitimate question. There is not, in our view, an easy answer to that. At the extreme you would say that no entity could simultaneously prepare the accounts of a body and also audit it. That would require, in our view, significant restructuring within the accounting and audit profession.

CHAIR—Mr Phelps, do you have anything to add?

Mr PHELPS—No. As Mr Brown said, we think that having auditors report in all instances to APRA would now be feasible, given that the number of funds we are responsible for is nowhere near as large as it used to be.

Senator HOGG—Mr Brown, you mentioned that there were only two reports under section 129.

Mr BROWN—Yes.

Senator HOGG—I took it from your body language that you were a bit surprised that there were not more. Were those reports lodged in more recent times or in earlier times? Can you give us some indication of that and of the nature of the reports?

Mr BROWN—I do not have the details, I am afraid. They were two to three years ago—they are not recent.

Senator HOGG—So there is nothing in recent times. Why do you think there were only two reports in that period of time? Is it the difficulties associated with the reports being filed, or that it causes embarrassment?

Mr BROWN—I think some auditors take a more liberal view of what may constitute a satisfactory response from a trustee than I would be inclined to.

Mrs EAST—We are new in our role as regulator of self-managed superannuation funds, so we have different issues arising when it comes to the question of should the report should come

directly to us. We do not require the audit report to be lodged with the tax return. That is something that we are trying. We require the qualifications to be put on the return itself and then if we need to see the audit report we could call for it. This is because there are over 200,000 of these funds and we think many of these reports would not be necessary. If we think that we need them in future, then we would change that arrangement. If it came to the audit report coming directly to the tax office, we do not think it is such an issue for self-managed funds at this stage.

CHAIR—This question of independence has been hotly debated overseas. What is the view here? Should the auditor of the super fund also be the corporate auditor? Can we ensure that there are Chinese Walls, particularly at the small end of town?

Mr REILLY—I might take up that point first. I perhaps should have said earlier on that the standards we require in Australia in auditing, and our corporate accounting standards generally, despite some concerns about the adequacy of Australian Accounting Standards Board standards, are broadly consistent with international requirements. In relation to auditing—and my colleagues here from the Auditing and Assurance Standards Board will give you further detail—we are part of the International Auditing Practices Committee—the international auditing standards board, for want of a better term—and any updates on auditing standards, exposure drafts, draft standards and that type of thing are automatically issued here as Australian documents. So the audit issues that have been raised today are really no different from those that are being debated internationally.

In terms of audit independence, we are doing much the same sort of thing. There was quite a debate last year in the United States looking only at listed companies—the big end of town rather than the small end. After a fairly exhaustive and media intensive debate, the Securities and Exchange Commission, which argues that it is the toughest regulator around the globe, came to the view that there was benefit in auditors providing other services, providing the other services were such that the auditor was not placed in a position of auditing his or her own work.

In terms of providing accounting expertise, particularly at the smaller end of the market, I would agree with Roger that there are certainly cost issues involved there, particularly when you are looking at the very small auditors. I think Leslie would probably agree there, too. The auditor is probably best placed to be able to assist the superannuation fund, the trustees, in providing accounting expertise. But at the end of the day it is the trustees that have to take responsibility for those statements and have to make the decisions. If that is the case, then internationally and certainly in Australia, we have yet to see any evidence to say that the auditor is lacking independence and therefore that has caused a failure in terms of the audit work being done and that in turn has led to some sort of diminution in the superannuation fund. I think we need to be relatively careful there.

If there is evidence to suggest that an auditor has become too close to the trustees and effectively is not independent, the three professional bodies that are represented around this table have more than adequate disciplinary processes to take fairly immediate action. Coming out of some of the earlier submissions from APRA and submissions that we and others have made, what there needs to be is that, if APRA or any regulator sees deficiencies there, then we are more than happy to act fairly quickly. If Senator Hogg wanted to ask me how many referrals we had had from APRA—which no doubt he is about to do—I would say it is a very small

number, and I suspect my colleagues from CPA Australia and the NIA would say the same thing.

Senator HOGG—Why?

Mr REILLY—Why have we had so few?

Senator HOGG—What is your view?

Mr REILLY—In some cases, I suspect that APRA has been able to act quickly and resolve issues without referring them back to the accounting bodies. In other cases, I suspect it may well be—and this is a test for me, I guess, that it has not been so much my members who have been acting as auditors of particular funds where there have been problems. We are going to address the issue later on of just who can do the audit of a superannuation fund. The view of the Institute of Chartered Accountants in Australia and CPA Australia is that the listing is perhaps a little bit too wide today and perhaps we should go back to looking at audit competency rather than just being a member of a particular professional organisation.

CHAIR—When the funds finally fall over, ASIC comes in. Can we have your comment about the adequacy of reporting, Mr Mackintosh?

Mr MACKINTOSH—In relation to superannuation funds, we have a very small role.

CHAIR—Yes, but what about when they fall over and there is a problem there?

Mr MACKINTOSH—It can be referenced through us to the CALDB. I do not think we have had many of those either. I do not know, but it would be quite small, I think. But that is another course of action.

CHAIR—Could we have the disciplinary board acronym for the *Hansard* record?

Mr MACKINTOSH—CALDB stands for Companies Auditors and Liquidators Disciplinary Board. It is a board that we use quite often in the bigger sense, over and above just superannuation funds, but we have not had a lot of experience of referrals from APRA. I think that is correct.

Mr SHANAHAN—It seems to me that APRA has had two section 129 reports, and Mr Reilly says that very few references come from APRA through to the institute's disciplinary bodies. From what I have seen of the regulatory processes of the professional bodies, I do not think they pin a lot of auditors' hides to the wall. Sitting here, I could almost think: is there a problem? Because nobody is picking up the miscreants.

CHAIR—We ran into exactly the same problem when we looked at—

Mr SHANAHAN—I am concerned about something that Mr Brown said. Yes, I believe a mandatory reporting requirement in SIS and section 129 would be very beneficial, and I think it would require a great degree of care in drafting. In the Corporations Law, an auditor can report

to ASIC if he has a problem. There have been various formulations if he suspected a contravention or became satisfied, and lawyers would kill you saying, 'You can't be satisfied,' or, 'I have an opinion that says you are wrong, so you can't suspect it.' That is a real drafting problem.

On the matter of independence, I share some of Prof. Harris's concerns that you are appointed by the person you are auditing. I have not seen this as a problem in the large superannuation funds. I have not seen any corporates saying, 'You can be the auditor of the company and, by the way, you can also audit the super fund.' I tend to see the super funds being treated separately in tender terms, but also my experience has been with regard to independence that in the Corporations Law you cannot be sacked unless ASIC says, 'Yes, you may be removed,' and the audits I have seen done most thoroughly are those where ASIC has refused permission for an auditor to be replaced. When an auditor knows that he is in the job and he cannot be fired is when you tend to see a much more thorough audit.

CHAIR—I think we have to be very careful in finding comfort in the fact that there have been very few referrals for disciplinary action. I refer you to our experience in Hobart in relation to the solicitors' mortgage board. One of the major problems was with evaluation, and the evaluation board people came to us and said, 'No problems. Nobody has referred anybody to us for disciplinary action.' One of the major difficulties was the question of valuations of a lot of the properties. So, just because they have not been reported does not mean to say that it is not a problem. We really have to somehow get behind the scenes to ask, 'What are the reasons for this occurring?'

Mr EDGE—That is exactly the point I would like to speak to. Senator Hogg said earlier that, like a doctor, you only see sick people. I think that is the issue. I think we ought to look at what issues we have had and whether they were a result of an independence issue or a failure to report or whatever. I am talking with a slightly defensive mode because I believe we have accounting and auditing standards of the highest quality, and I have had no-one on—

CHAIR—I have to commend you on your book list. They are quite good.

Mr EDGE—I have had no examples put to me that have indicated that the cause of a problem with a super fund or any entity has been independence or the lack of a Chinese Wall or the failure to report. If you can put to us examples of that then we might be able to address it, rather than simply saying what we think is an appropriate thing at the time.

Mr VENKATRAMANI—The issue of why we have not, in some of the issues, gone back to the accounting bodies or to the auditors is a very practical one. I was quite intrigued when Mr Rassi talked about the various stakeholders. Of the various stakeholders he mentioned, he forgot one stakeholder—that stakeholder is called member. In a superannuation fund, when you review them and when you find problems, our primary objective is to make sure that the interests of the members are protected and, as Roger Brown pointed out, the primary responsibility under SIS for protecting members' interests rests with the trustees, rather than with the second order quantity, the auditor. Therefore, in those instances where we have found problems, our immediate priority has been to pursue with the trustee the issues and hopefully get them addressed. Only when they reach such a magnitude that they go to the work of the auditor have we decided that we should make a reference to the auditors. Sometimes it might have been

resolved in a perfectly amicable way, and the auditor says, ‘Yes, I agree. I will cease working in this field,’ then goes away and the problem is solved. It is an important issue that, from our point of view, we try and address what the immediate proximate causes are which could cause members’ interests to be adversely affected.

Prof. HARRIS—I was a little surprised at the comment that there has been no identification of independence problems with auditors in the past. I would argue that the audit of Tricontinental and the audit by Deloitte of AWA were marred by lack of independence. I am sure that the SEC will say that the audit of Sunbeam was marred by lack of independence. I am sure that we will see with HIH that there will be problems with independence, as there will be with the audit of Harris Scarfe. The trouble with these is that we always see them after all the damage is done, and no-one has sat down to work out whether there is a systemic problem in the independence relationships under our standards, even those that are being developed.

Mr EDGE—May I respond to that? I agree with you, Professor Harris, but your last comment is the one I am trying to get at. Is it a systemic problem? We have come up with isolated instances of failure, and failure is going to happen in every industry, superannuation fund or other. All I am saying is that when there is a failure let us determine whether it is a systemic problem or an isolated instance.

Prof. HARRIS—The audit expectations gap paper that Mr Reilly spoke about was the first time I had ever seen the industry in Australia address this issue. They tentatively started discussing who should appoint the auditor and that it may not be in the best interests of auditors or society to have, in effect, managers appointing the auditors as occurs now in the corporate world. The first time I saw that discussion was in 1993, and it has not been pursued since. Finally, I should say that the UK version of the Audit and Assurance Standards Board is significantly much more outspoken about this problem in the United Kingdom than I see in Australia.

CHAIR—Thank you, Professor Harris.

Senator ALLISON—I wonder whether we could look at one of those as a case study and perhaps ask whether the peak accountancy body has looked into it and what the results were. Perhaps not HIH or Harris Scarfe since they are a bit fresh, but what about one of the other instances? It seems to me that there is a problem if you wait until APRA tells you there is a problem, and I do not know how else you can keep check on this lack of independence.

CHAIR—Actually, under Harris Scarfe, the problem was also with the accountants, who altered the figures at the request of the management. Have the accountancy bodies taken appropriate disciplinary action or asked to show due cause?

Mr REILLY—In terms of Harris Scarfe, I was in Adelaide a couple of weeks ago, so I am reasonably well acquainted with Harris Scarfe. In my bag at the back I have a number of press clippings where the former managing director became very religious and swore on a stack of 10 Bibles that he had never, ever told his chief financial officer to rig the books, and then went to 20 Bibles when he was asked another question. The chief financial officer was not a member of the institute, but if that chief financial officer had been a member of the institute we would have started disciplinary action.

CHAIR—Or his deputy?

Mr REILLY—The difficulty in answering Senator Allison's question is that we have the same problem that everybody else has that once there is civil action before the courts and once you have ASIC or APRA taking action, then our hands are to some extent tied. I would have to take on notice what action we took on the auditor of AWA, which I think was mentioned earlier on, or the auditor of Adelaide Steamship. In both cases I believe we have taken disciplinary action but well after other people had stepped in.

If we bring it back to superannuation, because I think that is more the relevance of this subcommittee today, we are not looking at where there is civil action. What we are looking at is that if we find that one of our members has been cautioned by APRA, we want to know as well so we can take appropriate action. It may well require some re-education or we may well take action where we simply exclude the member and make that very prominent and public.

We get quite a lot of inquiries, and not just from the regulator. In fact, we have one going through at the moment, which I cannot discuss, where the member is being excluded because a number of our own members complained about an auditor who was not doing the right thing. We had a quality review—that auditor was well down towards the end of our quality review program—that said that the particular member had not complied with our rules, and that member has been excluded.

Senator HOGG—How many members have been excluded in the last two years?

Mr REILLY—I will have to take that on notice. It would not be a huge number. The results of our quality control review—CPA Australia and the institute are running separate reviews but we are towards the end of the five-year cycle—indicate, and they are only rough statistics, that some 70 per cent of audit practices are doing the right thing and there is not a problem whatsoever. We have another 10 to 12 per cent where the work has been done appropriately but has not been appropriately documented in terms of the standard. We have asked those practices to go back and to confirm to us that they are now complying with the documentation. We have about eight per cent—but I would have to get back to you on that—where we have asked for a further review because there have been more serious problems. In a very small number of cases we have excluded our members. The numbers are quite small, and that reinforces Bill Edge's comment that it is a very small proportion of our members. I cannot speak on behalf of CPA Australia, but I suspect the numbers are not dissimilar.

Mrs ORCHARD—I was also going to raise the quality review process. Also, in respect of the only two section 129 notices, Roger noted that one in eight of the reports are qualified, and I would like to think that the auditors, in qualifying those reports, felt that that was an appropriate notification to the regulator in that the regulator sees that report during the annual reporting process.

Mr BROWN—I am sorry; I missed the question.

Mrs ORCHARD—In response to the fact that only two notifications were made under section 129, the auditors may feel that the qualification of an audit report—of which you have

said one in eight has been qualified—was an appropriate disclosure to APRA of concerns that they may have had about compliance issues within the fund.

Mr BROWN—Because it would not and has not been specifically identified as being a notification under section 129. That would reveal an expectation gap between the auditor and us.

Mr MALKIN—I would like to address Senator Hogg's query in respect of the lack of section 129 notices going to APRA, and in so doing put into perspective the range of superannuation funds in Australia. There are, roughly, in excess of 220,000 funds, most of which—probably close to 215,000 or more—are self-managed funds which are regulated by the ATO. APRA and the ATO see only the sick people. We auditors see those people as they are becoming sick and, under section 129, we have the ability to negotiate with the trustees a way of rectifying either actual breaches or potential breaches. By so doing we can assist the trustees in repairing and making healthy the funds before they get to the stage of having to be reported to APRA or the ATO as being badly breaching funds, if you like. I am not suggesting that there is materiality in breaches; there is not. But the audit process under SIS gives auditors the chance to help recover a fund that might be going down the wrong track with the trustees. In 90 per cent of cases—in fact, probably 99 per cent of cases—the trustees are very happy to listen to us and rectify the problems that they have got themselves into, perhaps inadvertently, before it even gets to the regulator. By so doing we are in fact the eyes of the regulator and we are taking a lot of pressure off the regulator by providing our competency in helping to rectify these funds.

Senator HOGG—In such cases, how many funds would you repair or make healthy in that sense?

Mr MALKIN—I audit about 1,400 funds. There are some very large funds but it is mainly small funds. In our audit program we have a mandatory management letter. We applaud a well-run fund just as much as we will raise a section 129 notice to the trustee to suggest rectification of a fund that is going down the wrong path. I would think that probably in excess of 95 per cent of the funds I audit would be complying in all respects with the legislation.

Senator ALLISON—I think Mr Phelps suggested at an earlier hearing that, since the problem with auditors would appear to be with the 200 small funds, in order to reduce the number of auditors practising in so many funds so that you get more expert, more experienced and better auditors, there be some form of certificate specifically for auditing small superannuation funds, just to be sure that they know the laws and the like. This is not a question of qualification; it is a separate certification. Mr Phelps, you might remember the conversation about the idea that it would be a smaller group.

Mr PHELPS—Yes. It was the question of what was required under the legislation and then there was the question of what the accounting bodies overlaid on the legislative requirements. I made the comment that if that was not considered satisfactory, then the only thing I could think of would be to move to a situation where there was some sort of certificate that people had to gain, and I guess that is not a long way from some of the thoughts—

Senator ALLISON—Perhaps the ATO might want to comment on that idea.

Mrs EAST—It is a little early for us to comment. We are just receiving our first returns now with the audit reports. Until we actually analyse those and see what the qualifications are on those and what the auditors are doing, we really cannot comment. But we would be happy to look at that and come back to the committee at a later stage.

Senator HOGG—When would an analysis be available? Would it be midway through next year, or at the end of this year?

Mrs EAST—It is a difficult year for us in that a lot of these tax returns and regulatory returns are late, because people have been doing things other than lodging their returns, so I would not really like to put a date on it.

Senator HOGG—I am not trying to hold you to a fixed date, but just to give us as a committee some idea whether it is something that we can—

Mrs EAST—At the end of this year we should be in a better position to have a look at that.

Senator HOGG—That is fine.

Mrs EAST—We have loaded the data that we have got. We are analysing what the issues are that people are qualifying and trying to categorise that so that we can target the people we need to target.

Mr REILLY—In answer to Senator Allison's question, one of the challenges at the moment is that there are a number of different organisations that are allowed to do audit work. For the APRA funds you have the registered company auditor structure in place; for the smaller funds you do not. One of the difficulties that we have had is with the registered company auditor structure. We have a 1997 working party report which recommended that ASIC as the regulator move away from, effectively, a fixed number of hours as a default way of assessing whether you should become a registered company auditor, moving to an audit competency model. Minister Hockey last December agreed that the recommendations of that working party should be introduced without delay.

What I believe would help would be where you are doing an audit you are required to be able to demonstrate audit competency. For a member of any of the three professional bodies here—and my colleagues at the NIA can come in if I am stealing their thunder a bit—we have basic rules. Rule No. 1 is: do not go round doing work unless you are competent to do so. In the institute, CPA Australia and the NIA you are required to comply with auditing standards. I think what we are looking for is some evidence—so I will be very interested to see the ATO's survey—at the smaller end of the self-managed funds whether there are instances of people who are doing audits who are not competent to do so.

Certainly in our quality review program we have found very isolated instances of that. Where we have raised the issue with the practitioner, the member has said, 'I have been uncomfortable doing audits for some period of time because I am no longer involved in audit work. Thank you very much. I will now go back to my client and say, "I can give you all sorts of advice and do accounting and tax work but I am not an auditor so go see someone else."' We have been very much at that level. We have been also involved in continuing education courses because once

you have your ticket or audit competency it does not stop there. It does not stop there whatever you do these days. So that is an important part as well.

I perhaps would like to explore a little later on, after I give my colleagues from the NIA an opportunity, to have a look at where we could head to down the path in terms of who is allowed to do an audit. I am a little loath to follow the view that we should have a specialised superannuation auditor ticket. I do not want to increase administrative costs unless there is a clear benefit in doing that. But from my members' perspective and from all of the bodies' perspectives we would argue that our members are not allowed to go around and do audits if they are not competent to do so. I believe that we should move to adopting the audit competency model that is in the 1997 working party's report. I am hopeful that the minister perhaps not in this session of parliament but certainly in the next government will be able to implement that as a matter of priority.

CHAIR—We are jumping to our last topic. If we do not structure this properly we will be all over the place.

Senator HOGG—I was going to put Mr Reilly on notice. Further down the track could you address that issue of education, because I think that is a very important issue that we will come to? I do not want that to get lost this afternoon.

Mr REILLY—Yes.

Session 3—The nature of audit reports

CHAIR—We now move to the nature of audit reports. Should audit reports include a risk assessment? Should they be prepared more frequently? Should they include ancillary reports such as actuarial reports? I would ask Mr Malkin from CPA Australia to lead off with Ms Helen Martin to follow.

Mr MALKIN—Thank you, Senator. The auditor's report, which is in an approved format, addresses two specific areas. First, there is the statement by the auditor that the audit is deemed prepared in accordance with Australian auditing standards, comprising the fact that the financial statements of the superannuation fund give a true and fair view of the affairs of the fund. That involves the concept of materiality in accordance with the auditing standards. The second statement is whether the fund complies with the Superannuation Industry (Supervision) Act 1993 and its regulations. The concept of materiality is not applied there. In other words, it is either a breach or not a breach. As I mentioned earlier, there is provision in the act to have the auditor help rectify that breach with the trustee with an agreed time frame.

There are areas in respect of risk assessment where the auditor will have to have appraised and assessed the risk in respect of the amount of testing that he will be doing in auditing that fund. That is also in accordance with Australian auditing standards. An area which CPA Australia and the Institute of Chartered Accountants in Australia are giving some attention to is the probable improvement in reporting of super funds that could be better attuned for fund members' needs and, in particular, the development of more explicit standards for explaining the risk management strategies adopted by the trustees. That is really something which has to be

part of the prescribed reports, not necessarily the auditor's report. We are auditing and recognising the assessment of risk because that is what audit is about.

The other area which the profession is giving much more attention to is the area of prudential management of the fund, looking at prudential controls, background controls of the administration of the fund, the way trustees conduct their business relative to the fund, minutes—all of those types of things, particularly the potential controls looking at the administration of cash, the accounting for cash and the dissemination of duties within the administration procedures et cetera.

There is much more emphasis being put towards the prudential controls related to the administration of the funds rather than just the green ticking of the financial statements and the assessment of compliance with the legislation. The profession—certainly the two main accounting bodies—is very conscious of raising the standards. We are actively pursuing ways by which we can raise the standards in respect of prudential management and control.

I do not think audit reports should occur more than once a year. They are costly and we have to be very mindful of the fact that every time a trustee spends money on administering a fund, it is reducing the amount of retirement benefit that the members are going to enjoy when they are able to get that retirement benefit. We also have to be very mindful of containing costs where possible. In so doing, while also being mindful of increasing standards, we have to make sure that what we do is done in a better, more productive way. We are addressing that continuously.

Senator HOGG—Following on from that, I want to get qualification on something you just said, that audit reports should be once per year. I understand that, and I think it is quite reasonable, but what about in that small percentage where there are difficulties? Would you care to address that momentarily?

Mr MALKIN—Just simply, in accordance with section 129, which looks at potential breaches or breaches that may have occurred, the auditor has the ability to agree on a time frame for the rectification of the breach, depending on how serious it is. That means that, for example, if I came across something which was going to be a potential breach and I agreed with the trustee to have that rectified within, say, three months—and it might be an in-house asset breach which requires a building to be sold or whatever—I would not just go back 12 months later to make sure that it has been rectified. I would be looking at auditing that at the end of three months or during that three-month period to make sure that everyone is on track. In that respect, the auditor is looking progressively during the year.

Senator HOGG—I understood that would be the case, but I needed that on the record.

CHAIR—It is quite attractive to me that, where there is a qualified auditor report, there is certainly a case for at least two audit reports in the subsequent year. Not just one, if there is an qualified audit report in the previous year.

Mr RASSI—Could you clarify that?

CHAIR—If a qualified audit report has gone in, I am attracted to the idea that in the subsequent year—instead of waiting another 12 months for a report to the members or somebody else—there should be an interim report to the membership. I know it is costly.

Mr MALKIN—An area that we are conscious of in the profession is the communication of the auditor's report to the members. The auditor's report is the auditor reporting to the trustees and members of the superannuation fund.

CHAIR—That is right.

Mr MALKIN—In most cases, the audit report stays with the trustee because it is not necessarily the most scintillating piece of reading.

CHAIR—Are you saying that the audit report does not get through to the members?

Mr MALKIN—It does not have to be sent to the members on an annual basis.

CHAIR—We will soon fix that up.

Mr MALKIN—The members have a right of access to the report under the legislation and, if it is a fund which sends out its annual reports and so on, it will mention who the auditor is, et cetera. So there are prescribed methods of reporting.

CHAIR—Thanks very much for that information. Ms Martin?

Ms MARTIN—I agree with the comments by Mr Malkin that, in a number of instances now, auditors are identifying risk management issues in their annual audit reports on funds. However, the issue remains that—except in the cases where there is a potential breach of SIS—there is no onus on the trustees to necessarily act on those risks that are identified. I advocate that that might be an area of regulation that could be improved along the lines of my comments in my opening statement.

I think we do need to be conscious in this about imposing additional costs on funds without there being any material benefit as a result. The materiality of issues would become very important, and that is always an area for judgment. One of the questions framed in the terms of reference for today is: should they include ancillary reports such as actuarial reports? I am not quite sure what the committee had in mind there. There is a requirement for regular actuarial reports on certain superannuation funds and that is clearly appropriate, particularly for defined benefit funds. I would be interested in the views of the committee as to, if there were additional actuarial reports that they thought might be appropriate, what those might be.

CHAIR—You spoke earlier about the need for trustees to take an independent assessment of their investment strategy. Is that right? How often should that assessment take place, every three years? Every 12 months would be a bit too often, wouldn't it?

Ms MARTIN—Yes. I used investment strategies as an example. There are a number of risks that funds face. Investment, fraud and all sorts of other things are potential risks. There are

different professionals appropriately placed to advise the trustees on those different types of risks. In the case of investment strategy that would normally only be reviewed to any great extent every three years or so, but there would be more regular monitoring and fine tuning of investment arrangements in that intervening period.

Mr RASSI—I just want to make something very clear: the role of the external audit is twofold: firstly, to form an opinion on the truth and fairness of the financial statements; and, secondly, to make a limited statement about the compliance of the fund with the prescribed requirements of SIS. It is not a reliable vehicle for the reporting of prudential management issues. This is why this concept of prudential reviews or risk assessment reviews—call them what you like—has evolved. Under these reviews a body of audit work is being done outside that statutory audit role. I have raised this issue a few times and I am a firm believer that having a process of prudential review, particularly at the larger end of the industry, is an extremely healthy exercise which would complement the external audit.

In the annual APRA return the trustees are asked the question: have you had a prudential review conducted? I myself as a practitioner have conducted a number of these over the years and they have been an assessment of the risk assessment systems, an assessment of whether their corporate governance structure is right, and all those other issues—it is quite a broad based review. I think that needs to be looked at and I think there needs to be some sort of mandatory requirement conducted around that type of work.

Senator HOGG—Conducted by a different auditor or the same auditor? Or doesn't it matter?

Mr RASSI—It could be conducted by the same auditor. I have found that where I have been asked to do that it has helped me in my role as external auditor because I was more aware of some of the risks that I had delved into. Also it is usually cost-effective for the same auditor to expand his external audit role to cover those other areas.

CHAIR—There almost needs to be two audits, doesn't there? There needs to be a compliance audit and a financial audit. Are auditors always in the best position to conduct compliance audits of the corporate governance and those sorts of things?

Mr MALKIN—The audit report format, SIS and the regulators prescribe what needs to be done.

CHAIR—Just be a little bit careful. I do not want to keep going back to what SIS requires; I want to go back to make sure whether we should be looking at bigger issues. I am very conscious that we are getting very defensive and the whole purpose of today's exercise is to open the issue a little bit rather than just go back to the defences, 'We are good and we have to prove to you that we are good.' We really do have to open the horizons a little bit.

Senator HOGG—Let your hair down. Be warm and relaxed. That is what the chair is trying to say.

Mr RASSI—I can address that issue. Lawyers are well placed to conduct compliance work. Obviously it revolves around legislation and checking for compliance with legislation, but the advantage that auditors have is that auditors are well placed to deal with the issue of materiality

with compliance reporting. It is not an easy concept to get your mind around and we have put quite a bit of work as a profession into defining materiality in the context of SIS compliance. It is also very cost-effective to conduct compliance work at the same time as the financial statement work is conducted. For example, if the auditor is looking at auditing the benefit payments in the accounts of a super fund, it is quite effective also to look at the relevant SIS requirements that come into play with benefit payments. So most auditors would conduct that work in a very integrated way. I think that is the most cost-effective way of conducting that work.

Session 4—The reliability of audit reports

CHAIR—Mrs East, would you like to lead off?

Mrs EAST—I am going to be quite brief. As far as early warning is concerned, I am not sure how early we mean here, but for self-managed funds the audit report is prepared within nine months of the end of the financial year. It is tied to the lodgment of the returns for self-managed funds. That would be earlier than the ATO could possibly go out and look at 200,000 funds. But as far as self-managed funds are concerned, we do not think that the early warning is so critical because, from the financial side, the members are the trustees and they are looking after their own financial affairs. We do think that the audit report on compliance is important but we do not think that that is necessarily so time critical. From our experience we think that some of the compliance breaches can be fixed later without the money going out of the fund. They may have nothing to do with the financial side.

Mr VENKATRAMANI—I want to go back to this issue of risk management statements. In regard to your comment about going beyond what is currently prescribed under SIS, when we look at some of the better practices in the industry we find that people, institutions and funds do have those practices. They try and divide up the various risks to which the fund is subject. Investment risk is one to which the defined benefit fund is certainly subject and liability risk where actuarial involvement is mandatory. Then you have operational risk, which is the single largest risk which superannuation funds face. We do ask what kind of risk management framework the trustees have. As Roger pointed out earlier, auditors come only at the second level. The trustees who are responsible are expected, during our reviews, to have processes. Very recently ASFA has started a campaign, if you like, of asking large super funds and medium super funds to have business plans and as part of that to have risk management statements. So if you are trying to migrate good practice from other sectors of the industry which we supervise, I do believe that there is a good case for maybe making risk management statements not merely good practice but perhaps mandatory for trustees. Then auditors and others who are involved can express an opinion on the adequacy and effectiveness of those practices.

Mr NIVEN—It is true to say that our role in the regulation of super funds is limited not to the self-managed funds but to the larger ones. Our focus is on consumer issues, consumerism and financial services. Therefore, the ability to rely on audit reports to provide early warnings of potential fund failure is really something that falls more under APRA's, rather than ASIC's, side of regulation. So this is not an area in which we have particular experience of what is going on. Unless Mr Mackintosh wants to add anything, I think this is probably an area of the industry where we do not have the experience to be able to comment.

CHAIR—Mr Shanahan, have you, as a forensic accountant, got any comments on the reliability of audit reports?

Mr SHANAHAN—I take the point I think Mrs East made that the audit reports that the ATO are getting are nine months after the event. Mr Brown's comment that 80 per cent of the qualifications they get are for late lodgment. It seems to me that from a regulatory viewpoint the audit process is happening fairly slowly and, if we are trying to use this to get some input into how we should prudentially regulate, I am not sure it will work.

I have worked on bank audits, where an audit report is provided by bank auditors to the prudential regulator. They are a much more detailed form of audit report. Some of the bank's shareholders would be mortified if they saw the report that went to the prudential regulator. It is much more detailed and picks many more holes. There are only a limited number of banks. I do not believe you could have a much more detailed report on prudential management issues. You do it perhaps with the large or the medium super funds, but to look at this for the entire population of 220,000 I think would be fairly difficult.

I am not convinced that the audit report in its present format is going to help here unless we have a particular prudential direction to the audit function. Every auditor at the moment says, 'APRA has set out what we will put in the audit report. We will all follow that. We cannot depart from that.' I worry that our audit reports are so pro forma that you would all almost have to have a qualification in flashing neon lights and say, 'Look in this additional paragraph. Something is wrong,' before it gets noticed, and it is not going to the members. Very rarely will a report get through to the members.

CHAIR—Should the reports be more prescriptive in terms of what has got to be ticked off?

Mr SHANAHAN—I can appreciate that the format of the report is useful so that we can tick off a whole lot of compliance boxes. Because the report is so prescriptive it then becomes difficult for any real issue you want to raise to stand out. If you took that argument to its logical extreme, you could say, 'Well, you just say it is all right in a very simple report and then anything you write beyond that means there is a problem,' but that is fairly dramatic and novel. I can let my hair down, but I think that is going a bit too far.

Prof. HARRIS—In auditing the State Bank we saw much of the Reserve Bank than we did of ASIC and APRA when we were auditing superannuation, but that is very much a function of the number of banks, I think, and the resources of the Reserve Bank compared with the resources of APRA. But there is some possibility there that, although auditors hate open questions, APRA can make more use of a directed questionnaire of auditors. There may be some advantage in that. As I say, auditors hate open questions, though; they like to audit to standards and to statements that others have made.

Mr BROWN—In that respect I have two comments. The form of the audit report, as I said earlier, was negotiated with the accounting professional bodies and thus is in a form which they were willing to sign off on. It quite carefully includes a statement that there is a capacity to add to that statement as long as any additions do not detract from the positive statements which the form is required to make. I would also say that, even at a quite mechanistic level of clerical staff

accepting very large numbers of reports from auditors, simply the fact of an additional paragraph does stand out as if in neon lights and has been noted.

The other comment I wish to make in regard to the reliability of audit reports is this: as a general observation we do find the financials reliable, but one area of lesser reliability from our point of view has been in relation to the valuation of assets where those are not frequently traded on an open market and, most particularly, where they may be investments in a unit trust where that unit trust has perhaps a common trustee together with the superannuation fund. That is not to say that such valuations are universally poorly done, but it does say that the incidence of unreliability is higher in that sort of category.

CHAIR—We have not heard from the Auditor-General, on whom parliament relies very heavily.

Mr McKEAN—I would like to make a couple of comments on this issue. One issue is that the traditional audit model of the moment is backward looking. It looks at the past, not at early warnings. That raises the question of looking at some real time type auditing and ‘auditing at the moment’ rather than in the past. I do not offer the answers here today, but that is an issue for consideration. The second point is that if you are looking at fund failure, you tend to look at solvency type issues—the extreme—and one of the dangers from an audit perspective is that if you express a concern about solvency you may in fact create the failure itself. A model that allowed for a ‘gale warning’ type system where you may have a warning range from, say, one to five, may help with that. You could start to flag a concern, but not necessarily the absolute concern that the fund is insolvent. They are just thoughts for consideration.

Mr MALKIN—I would like to make a point for clarity. The time frame for the issuance of the auditor’s reports—for example, nine months after year end or four months for a small APRAX fund or non self-managed fund—is not a function necessarily of the audit; it is a function of the reliance on all the financial information coming from the various fund administrators and the myriad of people who are contributing to a superannuation fund—service providers and so on. It does take some time and is very complicated. The financial institutions that are managing the investments and placing investments and so on are always very hard pressed to get everything done close to the end of the financial year because of the complexity of what they do. The time frame is really just waiting for the information to be able compile the accounts rather than a desire to delay the process.

Mr PHELPS—There have been several references to banks, and Mr Venkatramani mentioned that our intention is to try to migrate best practice from across all the sectors that we supervise—to try to pick the best out of each different thing—but at all times we are constrained by the fact that there are only 50 banks and 3,000 corporate super funds and another 10,000. What is possible in one area, while it may give ideas, may not be practical in another area. The system is that there is an annual meeting between the auditor, the supervisor, and the bank to discuss any audit issues. I do not think that would be practical with the number of superannuation funds.

The onus to put the risk management systems together is on the management and the board of the institution, so they produce the risk management systems. After many years of discussions with auditors, we came to the conclusion that we would get the chief executive of the

institution, with the endorsement of the board, to testify that those risk management systems were being followed and they were adequate and current. Following the quote of Mr Thompson earlier on, when you try to get auditors to say that these risk management systems are adequate, people say, 'Adequate for what? What do you mean by adequate?' We eventually gave up on that and said, 'We'll get the chief executive and the board to put their names to this.'

Those sorts of experiences would say that to expand the trustees' responsibility to having an investment strategy, for example, you would have to turn three or four lines of an investment strategy into five or six pages of analysis of what your members' likely leaving patterns are, what the needs for liquidity of the fund are and what the risks of these sorts of assets might be over a five-year horizon and a three-year horizon. That is what would be needed to turn the need for an investment strategy into a full blown risk assessment of the portfolio that has been selected.

CHAIR—Should the trustees' risk management strategy be sent to members incorporated in the annual report?

Mr PHELPS—I would think so, Senator, yes. Whatever information has been put together by the trustees ought to be made available to the members.

Mr MALKIN—Again, if we can make a distinction between self-managed funds and the ones regulated by APRA, in self-managed funds all of the members are in fact trustees, so they are party to the decision making process for the investments.

Senator HOGG—Could I ask a question that might be now going outside the square? Is the technology available or are there models available that in some way can be utilised to test the reliability of audit reports? Is this the path that you are going down? I see computers do absolutely marvellous things these days. They seem to be able to do everything, even make a person's heart beat such as that. Is that where we are going in the future?

Mr RASSI—Mr Chairman, I might be able to comment on that. I will speak from my firm's perspective. In terms of our audit methodology there is a calculated assurance model in place which attempts to measure the reliability of the reports in a statistical fashion. An audit report is not going to be correct 100 per cent of the time, but I would like to think that most firms are working towards a 90 per cent or 95 per cent reliability model and that is the way the statistics fall out. But unfortunately it is a fact of life that five out of 100 reports could, in fact, arrive at the wrong conclusion and that is reflecting the nature of the audit process. I think you will find that most practitioners can measure that reliability risk.

CHAIR—In the report to members, how would it be if it was included in the usual information that the auditors were satisfied that there was an appropriate risk management strategy that they have sighted and it was last prepared on a certain date? I agree that it does come back to the trustees rather than the auditors, but I do think the auditors have a role to tick it off in some way.

Mr RASSI—Sighting an investment strategy or a risk management strategy is not necessarily going to add value in reporting that to the members. It depends on what the auditor does in relation to that risk management strategy.

We have also got to be very careful that when we talk about risk management we are not just focusing on investments. Risk management is a lot broader than that. If you are talking about the whole risk management processes and systems, it is not just investments; you are looking at the whole operation. Which part are we talking about?

CHAIR—Should we specify risk management and other risk assessments? Because investment risk is where most of the funds are falling over at the moment, aren't they, because they have had to narrow—at arm's length and all that sort of thing?

Mr MALKIN—If we go down that path, we also have to look at the education of members of funds, so they know what to ask for and understand what they are going to get.

CHAIR—Agreed.

Mrs ORCHARD—In our earlier submission, we made the comment that auditors would be willing to do a wider review of the risk management systems assessments of the fund but we would need some guidelines within which to work—for what is expected within that—so that an opinion could be formed. We cannot just say that the risk assessment is appropriate. That leaves the auditor quite wide open and does not give us a scope within which to work.

CHAIR—That is why you are here this afternoon. We are seeking your views.

Mrs ORCHARD—I guess we are going back and saying that APRA has a risk management process that they review too, and the profession has indicated that they would be willing to undertake that on behalf of APRA—be it reporting to APRA or to the trustees as appropriate, but bearing in mind that there are costs involved in that and that a clear scope and a clear guideline of what is actually being reported on needs to be made available. It cannot just be an open-ended statement, an open question.

CHAIR—Are the regulators interested in developing some guidelines in this area for us before we complete our report?

Mr PHELPS—There is a trustee circular on investment strategy, for example, which is there and which would be one of the things which would have to be taken as a model and beefed up to provide the sort of structure—

CHAIR—How long would it take you to beef it up and come back to us?

Mr PHELPS—A few months, I would think.

CHAIR—We might have to put that as one of the recommendations that you should undertake.

Mr EDGE—I think the discussion has been fruitful to this stage and I concur with some of the earlier comments that, as auditors, we tend to require a framework or some criteria or something against which to report and, if APRA are able to do something, I am sure that the

idea has merit. It has been done, as we have said, with the banks. It needs to be done carefully, with due diligence, and I just want to give some credibility to the idea.

Session 5—The role of professional bodies

Mr REILLY—Quite a lot of what I was about to say has really been covered today. Certainly, the accounting bodies represented here today are supportive of the committee's wish to ensure that there is assurance that audit work that has been done is of the necessary standard. I would make the point again that the auditor cannot guarantee there will not be losses made in superannuation funds over a period of time, but the audit assurance is important because it is independent assurance. The auditor is an independent entity giving an opinion that the financial statements are true and fair and there has been compliance with the various statutory requirements that are there. I support my colleague Bill Edge from the Auditing and Assurance Standards Board to say that, certainly as far as the larger funds are concerned, the regulator indeed can get greater value out of the auditor, but the auditor has to move from simply reporting on the financial results. I think that in the last supplementary submission we gave to the committee, we gave cautious support for APRA's proposal to extend the auditor's responsibilities that are currently placed with the banks to superannuation funds and insurance companies.

That is tempered with, 'What is the cost of doing that?' and, while I do not think that would be appropriate in smaller funds, it certainly would be in some of the larger funds. I think that has our general support. I would suggest that APRA, as the regulator, continue to work with the Auditing and Assurance Standards Board to ensure that there is a framework that auditors can realistically report against. Auditors are very loath to sign off saying, 'We're not aware of anything else that perhaps the regulator might be aware of some way down the track.' That is an unrealistic reporting requirement. Certainly, in terms of the work that has been done with the banks, it has worked, and I believe APRA have got some value out of that.

Senator HOGG—Can I stop you before you proceed?

Mr REILLY—Sure.

Senator HOGG—Do you have an idea of the cost of the extension?

Mr RASSI—As a practitioner, I have probably conducted 20 prudential-type reviews of large funds, and you are looking at \$30,000, \$40,000 or \$50,000 to conduct such a review of their risk management systems. For their total audit fees, you might be looking at \$20,000, \$30,000 or \$40,000. A prudential review, as you can see, is quite an extension of the traditional financial statement audit.

Mr REILLY—What would the surplus from that fund be—the profit for the year for that fund—in trying to work out the audit fee in terms of the assets under management?

Mr RASSI—Minuscule. Those sorts of fees are in the context of funds that have \$300 million, \$400 million, \$500 million or \$600 million sitting on their balance sheets. That is why I am a firm supporter of having that type of extension to the traditional financial statement audit—because I think it is very limited. Those prudential reviews are—

Senator HOGG—Sorry to interrupt you there.

Mr REILLY—That is fine. We have already talked about standards. I believe the standards are internationally comparable. I think, in terms of independence, while Professor Harris and I may well debate audit independence and whether auditors can provide other services, by and large in the superannuation area we have not seen systematic evidence that audit independence has created major problems. Where there have been failures in the superannuation area, it is a matter of looking at the individual cases. However, as I would say to Professor Harris, we always have an open mind and are prepared to look at it further.

In terms of the quality control review—and I think this is particularly important for the smaller funds and for the ATO funds, where the cost of Mr Rassi doing a fabulous review would probably kill most of the funds in total—I believe that you should be able to have some reliance on both the institute and CPA Australia. I will leave the NIA to comment separately on our own quality review cycles. We have come almost to the end of the first cycle in the last six months. I suspect that we may uncover a number of instances right towards the end, as reviews have been delayed. We will wait and see on that.

If our reviews are worth while, and there is a significant cost on the practitioner—there is a cost of \$1,000 to \$1,500 per review—then you should be able to place some reliance on it. We certainly do, and we are certainly promoting it to our members, who are getting value out of having an experienced practitioner come through, examine the files—particularly the audit files—and say, ‘Yes, the practice and the audit are in accordance with the auditing standards,’ or, if it is not, see that action is taken straight away to ensure that those audits are conducted effectively.

Again, we have a number of examples where auditors have said, ‘We’re not really doing enough auditing; we are not sure we are able to maintain our competencies because of the costs involved. We’ll get out of it and let someone else do it.’ I think that is important. You should place some reliance on that. I would again implore you and the other regulator, APRA, to notify us if you do come across evidence. We accounting bodies do take our responsibilities serious there. We are self-regulatory. If we fail that, one has to question why we are here. In terms of discipline, it goes without saying that disciplinary process is there. We certainly have not had a great many examples of disciplinary issues. We take a bit of heart from that but we also realise that a number of issues will not come to us because they have been resolved in other ways.

I think education is an important area. Again, the requirements of the accounting bodies are that they are only allowed to do audit work that they are competent to do, and there is a professional requirement that they are required to keep up to date each year—that is 120 hours over a three-year period—and there is structured and unstructured education. In terms of our quality review process, the reality is that we have not uncovered too many instances where those requirements have not been exceeded many times over. Simply, because of the changes in the legislation over a period of time, you eat up your 120 hours over three years very quickly. We have run a number of specific courses, again in conjunction with APRA and also working with the ATO. My colleague Susan Orchard might like to take over and talk about the education area, which picks up your earlier comment.

CHAIR—Before we do that, I think it might be handy to quote from a report that we put down on Monday. I quote from page 21, paragraph 3.16. We received a report from Mr Richard Rassi from Deloitte entitled *Top 10 audit issues from 1999*. The top 10 issues for 1999 were as follows:

- lack of meetings held by trustee boards;
- review of risk management statements not conducted on regular basis;
- outdated bank and investment signatories;
- lack of procedures to ensure trustees are not disqualified persons;
- incorrect calculation of benefit payments to members;
- member reporting not within the timeframe specified by the SIS Act;
- member contributions not remitted within 28 days of month end and employer
- contributions within 28 days of balance date;
- reconciliation of assets, key profit and loss items and membership not conducted on a regular basis;
- trustee equal representation requirements not satisfied; and
- financial statements not completed within the timeframe specified by the SIS Act.

Not surprisingly, as members of parliament, we have asked you to come before us today to help us improve the audit function, because all those things are very serious issues—to say, in this electronic age, ‘Yes, we do it nine months after it’s all fallen to pieces.’ We really have to have some more early warning signals and we have to pick up on some of those things that Mr Rassi issued. In the last few minutes, could we look to some proactive measures to try and lift the standard? Although we are ticking things off, getting a submission like that is very worrying to us.

Mr MALKIN—The profession—certainly CPA Australia and the institute—is constantly revising the training and education programs for auditors of super funds. In fact, I remember welcoming you, as a member of CPA Australia, to an audit of super funds course some years ago in Hobart. Those types of programs are being continuously updated and strengthened. We are recognising all the types of error messages that Mr Rassi has included in this report, and they are being addressed through the education process. Susan might like to add what the institute is doing in respect of educating their members.

Mrs ORCHARD—Education takes a number of forms. It includes face-to-face education, communication with members on what is happening in super—which we conduct with our superannuation and financial planning practitioners on a weekly basis—as well as education through magazines and other forums that we have to communicate with members. I think we are seeing an improvement in the audit process. The areas that we have highlighted are highlighted back to trustees and, hopefully, we should then see these issues being resolved by the trustees as they become better educated. Many of the issues that are being highlighted by auditors as lacking within funds really come out of the education of trustees, which I think the industry as a whole has been committed to, certainly over the last two years through APRA, ASFA and a number of other bodies, including us.

Mr AGLAND—I think it is also very important for us, as the accounting bodies, to work with APRA. Being honest, there have been some communication problems at times between APRA and the accounting bodies. It is nothing personal. We have a pretty good relationship with the ATO in relation to the sharing of information, and I guess this comes across in relation to the disciplining of our members. I have only seen one report from APRA about a member. It was a very good report, and it had a lot of information that was very useful. But for us to look at what our members are doing, we need as many sources of information as possible, and APRA is a very good source of that information. Maybe they do not have the resources—but they need to inform us about those issues and about certain members. We would be quite happy to then look into those members and to take appropriate action.

Senator HOGG—I ask APRA the question: do you have the resources to fulfil what Mr Agland has just been speaking about, or is that stretching your resources?

Mr BROWN—There is an element of priority that we apply in using our resources. As Mr Venkatramani said earlier, when we encounter a fund which is in some difficulty, our first priority is working with the trustee—if that is a viable option—in order to protect member interests. If it is not possible to work with that trustee, then it would be to replace the trustee or to take action against the trustee, and we will review how many super funds the auditor is engaged with in deciding how much effort we put into addressing the shortcomings of that auditor. If the answer is few, it may be that we would call the person in and encourage them to expend their energies in ways other than auditing super funds. That is reasonably effective, because in most instances where that happens the person involved audits very few super funds.

Senator HOGG—But what about your capacity to do it? What about your capacity to perform this role?

Mr BROWN—In order to fully address every issue that we come across, we could expand the resources that we use manifold.

Senator HOGG—That is what I suspected.

Mr REILLY—From the accounting bodies' point of view, we are not there to suddenly get the hammer out and smash hands along the way. It would be good if there was some mechanism so that you could say, 'There is a member there. The member has had some failings and they are not doing a lot of audit work,' or, 'The failings are there. Can you help the member?' A lot of our work is in fact in the education area. People are fallible; they do make mistakes along the way. They may only be small mistakes and our disciplinary area is seen as hitting people hard, but quite a lot of the time the discipline committee is saying, 'You've got it wrong. What's the answer?' and the member has said, 'Sorry. These are the things that I have put in place to make sure it's right next time around.' It would depend on the severity of the issues. So we are open to working with you and with the ATO on that basis, as well.

Mr BROWN—Keith, I need to respond to that. Because there is a formal power in the SI(S) Act for us to refer and because that can be seen as detrimental to the interests of the auditor, it is not open for us to pick up the telephone and say, 'Hey, we've got a problem with such and such an auditor.' We have to through a formal process of giving that person natural justice. We have to give them an opportunity to respond to the issues that we have with them and then the

referral has to be formal, unless it is that the auditor, of his or her own volition, is prepared to come to the professional bodies and say, 'APRA had these concerns with me and suggested I take on a certain level of training.' But, given both the secrecy provisions within the APRA Act and the formal referral provisions within the SI(S) Act, there is not the capacity for us to work at that sort of informal level.

Mr REILLY—I guess my colleagues at ASIC would make exactly the same point, but I have also made the comment that maybe if we are looking at changing the way the legislation operates there is some way of cooperating a little bit better so that it is in all of our members' interests and also in the interests of trustees and members of the super fund.

CHAIR—I have a question about the role of professional bodies. Are we expecting to produce a silk purse from a sow's ear? Is the problem really a trustee problem in that the accounts are not reconciled and balances are incorrectly calculated and not enough trustee meetings are taking place? Are the problems really further back in the system?

Mr MALKIN—Perhaps I could address that by saying that the audit process is designed to pick those sorts of things up. I also make the very strong point that both the Institute of Chartered Accountants and CPA Australia have a very strong, very healthy relationship with both the ATO and APRA. APRA and the ATO participate in the training courses which we are talking to our members about—the audit of super funds and the administration and so on of superannuation funds. So they are very proactive in that area.

CHAIR—But SIS has been in for quite a number of years now. It is a bit disturbing to have those 10 points in the report from Mr Rassi. It would be all right to take two or three years to get the act together, but people should be getting used to SIS now and what is expected of trustees. For how much longer do we keep saying, 'Yes, we've got to educate trustees better, we've got to educate auditors better'? Members are getting a bit testy. If people have \$50,000 or \$55,000 invested in a fund—which is the average balance—they want to know it is safe. These issues have to be addressed. We might have to go back further.

Mr RASSI—I should report that there have been some improvements on some of those issues in recent times. In particular, this year I think we will see a much better performance in the timely lodgment and finalisation of accounts. It is something we have been drumming into all the clients. APRA have been quite firm on this issue, and rightly so. I think we will see improvements on some of those issues. Others are still hanging around; some of those issues may not impact on the safety of members' funds but, nevertheless, they are issues that should be addressed.

CHAIR—I am concerned about ones that are not reconciled—I would be a bit worried if I was not carrying my true contributions; they might have gone off to somebody else.

Mr RASSI—Taking up your comment, some of it does have to go back to the trustees. They do need to take responsibility and take note of some of those issues.

CHAIR—How do we do that?

Mr BROWN—Steps have been taken. I think you are quite right in identifying that these are trustee issues. Some of the changes to SIS which took effect from January this year are quite helpful.

CHAIR—They are the criminal liabilities?

Mr BROWN—The shift from fault liability to strict liability. You talked about reconciling member balances. Previously, if a trustee kept the accounts in a shoebox and they were a total shambles, to launch a prosecution it had to be proven that that failure to maintain the records properly was reckless or deliberate. Now it is sufficient to simply prove the fact of failure, although there are statutory defences. We have not yet launched a prosecution under those strict liability provisions, but we have already seen, very strongly, that the change in the legislation has focused trustee attention remarkably. When we go and talk with trustees and we have difficulties with a particular fund, we see that the willingness of the trustees to respond promptly and effectively has been very much enhanced. Even before we have implemented the powers that we have been given, their beneficial effect is being seen.

CHAIR—That is good to hear.

Mr VENKATRAMANI—One of the additional tools in our armoury is the ability we have now to accept enforceable undertakings, as has been the case with ASIC for quite some time. While in the past we had to more or less operate on a wing and a prayer, accepting that the trustee or other associated parties with the fund who said that they would rectify issues would do so, and then if necessary going back, now—having got the past track record—if we do not have confidence we are able to accept an enforceable undertaking. This effectively ties down a particular person to do what they agreed to do. That is an additional thing which we are taking on board.

I would also like to respond on the issue of communications. I would agree with Mr Malkin that APRA and other bodies tend to maximise communications on relevant issues, but sometimes due to various changes et cetera those communications do not take place. I would like to refer to the superannuation national audit committee which, as Roger said in his remarks, we try to hold once in six months to talk about issues of common interest. The accounting bodies plus ASRB are included. At the last meeting in April we did not have a single accounting body there. We only had the two research bodies, and I had to write to them to ask whether they really thought this forum was useful to them. We thought that it was useful. I wrote to ASIC and the ATO as well. They all came back and said that, yes, it is useful. Communication takes two people to communicate. If we offer communication channels and if people do not take them, sometimes it makes it very difficult. We cannot mandate people to communicate.

CHAIR—Why didn't the bodies attend?

Mrs ORCHARD—The accountant bodies didn't respond on that occasion as we had recently changed chairperson. The invitation went to the previous chairperson, who had also changed firm in between times so the email went into the ether. That was a communication breakdown, as sometimes occurs when bodies change people who are organising things.

CHAIR—What about the other bodies?

Mr VENKATRAMANI—CPA offered apologies. Brad Pragnell had just moved to ASFA. There was an issue, so we accepted it.

Mr MALKIN—And I was representing CPA Australia, and unfortunately I was ill at the time.

Mr REILLY—Mr Chairman, we will take action to ensure that does not happen again.

CHAIR—And the national institute?

Mr AGLAND—I am not aware that we had a member on that discussion.

Mr VENKATRAMANI—Renate.

CHAIR—They have a member?

Mr VENKATRAMANI—Yes, she is Renate Tonks.

CHAIR—I see.

Mr VENKATRAMANI—We have written to them and they have communicated now that they would revive this relationship so that we can communicate.

CHAIR—It is unfortunate, isn't it?

Senator HOGG—We will have to hold these meetings more often so that people can find out what is going on!

Session 6—The qualifications and experience required for auditors

CHAIR—We move to our last issue—the qualifications and experience for auditors. Should they be licensed? Should we have a level 1 or a level 2 licence for, say, the ATO type funds, or a different level for the APRA funds?

Mr AGLAND—As it currently stands with the SI(S) Act, all that is required is that the person is registered under the Corporations Law and is either a member of a specified professional organisation or an approved auditor. There is no actual specification in that in relation to qualifications or experience. However, that does not mean that there are not requirements there for experience and qualifications. They do that, in effect, by adopting the requirements that we as the accounting bodies set. We have set standards as to the qualifications of members at different levels. We have requirements in relation to ethics and in relation to codes of conduct. We have means to investigate members. We also have requirements in relation to continued professional education. The way the legislation sits, it is taking our rules and our regulations and, in effect, applying those. That puts the pressure onto us as the

accounting bodies to ensure that those members out there are appropriate to do these types of audits.

As far as the NIA is concerned, we have various levels of membership. The bottom level is the associate membership. All that requires is that someone have an Advanced Diploma in Business Accounting, which is a two-year course. However, such a person would not be able to conduct these types of audits because we do not believe they have either the experience or the qualifications to do so.

The next level up for us is the member level. That requires that they have either a degree or the graduate certificate in professional accounting from the University of Southern Queensland, which also includes courses on business ethics. They are also required to have a minimum of three years experience in the field before they can reach that member level.

We have recently introduced a new level called professional national accountant. That will involve the member undertaking either a university degree or the Bachelor of Financial Administration which we have created in conjunction with the University of Southern Queensland. This is a full, three-year tertiary level qualification comprising 24 units. Twelve of them are core, there are another seven that relate to a particular major such as public practice, and there are five elective subjects.

On top of that, for a member to do these types of audits, they would need to be in public practice, which requires a public practice certificate under which they are forced to take a program that teaches them how to run a practice and those sorts of issues. They also have a high degree of educational requirements and there are greater requirements as far as their ethics and codes of conduct are concerned.

CHAIR—With all these qualifications do you think all of your members would be qualified to do a superannuation audit for an APRA fund?

Mr AGLAND—We would prefer those at the top level, the PNA level, to be the ones to undertake these sorts of audits. It is not so much the qualification that they take at the beginning; almost as important is their experience level. We think they should have the basics they learn in university or under a course, then they should have certain years out in practice, and then after that take a course that is more specific to superannuation funds.

CHAIR—If I am, say, an employer with between 50 and 100 employees and I am aware of one of your members who might be a friend of mine and I know he has these qualifications and I say, ‘We’ve got this big superannuation fund. We’ve got \$200 million in it. It’s growing rapidly,’ would he be able to say, ‘Yes. I’ll accept the audit of this rapidly growing fund for 50 to 100 members.’

Mr AGLAND—As Keith has already indicated, we would require that the member in themselves know that they are capable of doing that audit. If the member is not capable then they should not do it. If they did, we would take action against such a member. Our members do not tend to deal with the larger superannuation funds; they tend to deal more with the small superannuation funds because that is where they have their expertise.

CHAIR—Young people are always very confident in their own abilities, aren't they, when they come out of university?

Mr AGLAND—Yes.

CHAIR—It would be hard to turn that offer down.

Mr AGLAND—That is why we think experience is probably as important as, if not more important than, their initial education.

CHAIR—Do you think they should be licensed?

Mr AGLAND—Licensing creates problems in and of itself, I think. The registered company auditor is a clear example of something that was a great idea but the specifications to become an RCA are such that there are very few registered company auditors out there, which forces them to do a lot of work that people of their experience and their skill probably do not need to undertake. There are other people who could undertake a lot of that work. We would not want to see a licensing arrangement that cut off the majority of accountants who would be able to undertake small superannuation funds. If you want to say that those sorts of people cannot undertake audits of large funds then that is fine but I think, in reality, the large funds would go to the big accounting firms anyway.

CHAIR—Do you have to be a registered company auditor to audit an APRA fund?

Mr BROWN—Yes.

CHAIR—Your members would not come into that area?

Mr AGLAND—We do have some members who are RCAs.

CHAIR—That solves that problem.

Mr BROWN—Yes.

CHAIR—What about the standards for the smaller funds?

Mrs EAST—It is not a question I can answer, I am sorry. I thought that the qualifications were set out in the schedule 1AAA to SIS, which says that they need to be a member of these particular associations. It is a roundabout way—it does not say what the qualifications have to be as such, but it says that they have to be a member of a particular association which in itself requires certain qualifications.

Mr BROWN—That is correct, Senator.

CHAIR—What are those bodies? You have to be a member of a body such as?

Mrs EAST—CPA Australia and ICAA. They are listed in the back.

CHAIR—The National Institute of Accountants?

Mr AGLAND—The National Institute of Accountants and the—

Mr VENKATRAMANI—ATMA.

Mrs EAST—They are actually listed in the back.

CHAIR—Are you happy with that arrangement?

Mrs EAST—Yes.

Mr REILLY—I am not too sure that the Institute of Chartered Accountants or CPA Australia are that happy about those requirements. I guess I would go back to the comment that was made earlier by Mr Agland: merely saying that if you are a member of a particular organisation you are then able to do an audit places quite a lot of reliance back on that particular individual and that individual's professional organisation to ensure that they actually comply with the rules. So, whilst I am not about to say that chartered accountants, CPA or NIA members are breaching those requirements, I think the fact that at the APRA level you require a registered company auditor to do APRA funds is appropriate, because at least the registered company auditor structure ensures that that person has met a minimum level of competence over a period of time. I am by no means a supporter of the way that the registered company auditor structure is operating today—and my colleagues at ASIC can nod, because they are not happy with it either. We have made—

CHAIR—How does it need improvement?

Mr REILLY—A government working party issued a report back in September 1997 which suggested that we move away from a strict hours based approach and move to an audit competency approach. We believe, as I said earlier on, that the government has given a commitment to implement that working party report and we are hopeful that—given the legislative timetable this year—the new government, of whichever political persuasion, will implement the recommendations of that bipartisan group.

CHAIR—Can you give some more information on that?

Senator HOGG—Where is that report?

Mr REILLY—The report would have been referred to the minister back in 1997, so it might have gone back to Senator Ian Campbell—in fact, I think it went to the Treasurer with the recommendation that legislative amendments be made.

CHAIR—Do we have a copy of that?

Mr REILLY—Yes. The Treasurer would certainly have a copy of that, as would my colleagues from Treasury, and I am sure Mr Pascoe would be able to furnish the committee with a copy of that report. That is just in terms of the APRA funds—

Senator HOGG—I would like to ask one question: what follow-up have you done in the wake of that report to see in its implementation if there was an undertaking that legislation would take place? Have you done any work on it?

Mr REILLY—We certainly wrote to the minister—it would have been the Treasurer—after that report was issued. We have written fairly constantly to the Minister for Financial Services and Regulation. We have had a number of meetings with Treasury. We have had a number of meetings with our colleagues at ASIC and we have further developed the audit competency model. The working party approved moving to an audit competency model, subject to that model being developed and getting support from key constituents. We have had that now for some two years or longer and it has just been a matter of getting it through the legislative logjam. But the minister, in December 2000, did say that he would give priority to that report being introduced into legislation. That will overcome some of the concerns that my colleagues from the NIA have raised and also the frustration that my own members and CPA members have in becoming registered company auditors.

One of the issues that the working party report highlighted was the fact that, once you got your ticket, you effectively had it for life. Of the 7,000 registered company auditors that were actually on the ASIC register, there might have been only 4,500 that were active auditors. It is becoming increasingly harder for a professional to become a registered company auditor because of the change in the way that the requirements have been administered. So I think that is good. I would then suggest—if you are looking for a leap of faith, Mr Chairman—something regarding the smaller funds, the ATO's funds. The institute and CPA Australia are uncomfortable with the fact that there are some other organisations—and I am not necessarily referring to the NIA, so don't jump up and down—where mere membership does not give any indication of audit competence. I would argue that mere membership of the institute or CPA Australia by itself does not necessarily mean you are a competent auditor—further requirements and training are involved.

We would like to think that this committee—once we have an audit competency regime in place—can look at utilising that rather than just mere membership of a professional body in terms of doing the audit of any superannuation fund. We take the view that an audit is an audit and therefore it has to be done effectively and properly. The benefits of doing an audit more than outweigh the costs. We have concerns with some of the anecdotal evidence coming back—prior to the ATO becoming involved in the smaller funds—at the ISC level and of course via APRA, that some of the smaller funds are not being audited appropriately. Our quality review program has tended to suggest that that is a fairly minor area for our members, but we are tarred with the same brush. As soon as a regulator says, 'There has been an audit failing,' we automatically say, 'Well, was it us? Or was it them? Or was it some other group along the way?'

Senator HOGG—Whilst this is the industry's view, what will this do for consumer confidence? How will it change the public perception of what you do? Because I think that is important.

Mr RASSI—I think if it is communicated and explained, it could add confidence.

Senator HOGG—That is the answer I wanted to hear—'if it is communicated and explained'. That, then, raises a whole set of issues in itself. Who bears the responsibility of the

communication and the explanation, and how does that information get out there into the broader world? We are here this afternoon conducting this inquiry because consumers have expressed to us a lack of faith—whether it be correct or incorrect—in auditors or some auditors. Taking Mr Reilly's point, you just cannot label all auditors as failing because one fails. That is why I am asking that question. It cannot just be seen from an introspective point of view, as far as the audit industry might be concerned. It goes beyond that. I was interested in your communication of what might take place as far as change goes and how you will give effect to it.

CHAIR—It is competency. Is that by examination initially plus experience?

Mr REILLY—No, the model that we have worked on is a logbook type structure where you gain experience on particular audits and then work under the direction of a registered company auditor, who is the mentor. The registered company auditor signs off once the particular person has met and demonstrated that degree of competence. It is a much better way than it simply being a matter of hours. The problem with the hours approach is that if you come from a small practice you simply are not going to get the number of hours that you would have from a larger practice, or if you come from a major practice you may spend quite a lot of your time doing other work than audit work. You can spend a lot of hours and still be pretty incompetent. That is not directed at anyone—it is anecdotal evidence. Present company excepted. We think it is a far better approach and it is the approach that the major accounting organisations are using. They are saying that before you are promoted from being an audit senior to an audit supervisor to an audit manager to an audit partner, you have to demonstrate that you have reached appropriate competency levels, otherwise you do not go any further. Competency has certainly been supported over the last 10 years in a whole range of different training areas.

CHAIR—Are there any final comments? Professor Harris, you started it off.

Prof. HARRIS—I am a little surprised that there has been no response to the concerns that APRA have raised very early on that an auditor may be able to audit their own statements. Some auditors have made allegations that because of Chinese Walls they are able to audit financial statements about superannuation that have prepared elsewhere in the firm. From my understanding of the auditing and assurance standards, I would have thought that was not permitted. If it is permitted, then I will be surprised.

Mr SHANAHAN—I find myself somewhat at odds with some of the comments.

CHAIR—That is why you are here.

Mr SHANAHAN—Being a registered company auditor I think is a great qualification. I do not think just membership of any organisation is going to get you there. The SIS regulations say you are an RCA, a registered company auditor, and you are also a member. I believe that a competency requirement is essential. I would like to see this assessed somehow or other rather more than just by a logbook. We have all got enough experience with the logbooks for motor vehicles to know that that is a really good system!

I still believe that if we have got a competency assessment, I would like to see a separate licence or a separate chapter of superannuation auditors. If you look at the problem which Mr

Rassi identified, it is a lack of experience and knowledge of the legislation. The legislation is complex. We keep amending acts. The regulations keep changing. APRA bring out guidance every two years, an addendum in between, and then toss in derivatives as well.

It is complex. You need specialist knowledge. I have no problem saying, 'I would like to see specialist people there.' I do worry if we say, 'Great news to the rest of the world: we now have better superannuation auditors.' Audit is not one of these sexy products you can sell easily, and if you say, 'We have got better auditors,' there will be a loud yawn. People will say, 'Well, so what?' I think we have identified a problem: what do the members of the funds get from their funds? Most fund members will have trouble understanding the financial statements. My super fund sends me things, and I do not even know which sort of investment portfolio I have got. I look at them all and think, 'I hope one of them there is mine,' and I then see an audit statement saying 'it complies'. Does it comply with a risk management statement I have not seen? Does it comply with all the SIS regulations? Ask any of our members whether they know what is in the SI(S) Act and what this compliance statement is with.

If you look at Mr Rassi's 10 audit problems, a number of them were: 'Our reports run late.' The ATO says, 'We get the report nine months after year end.' APRA says, 'Eighty per cent of qualifications are for late lodgment.' Of course, funds are always better if they are reporting on time, but the fact that they are running late because parliament has imposed GST reporting, BAS, IAS, quarterly statements—we are all busy. Of those 10 issues, there were outdated bank investment signatories. You forget to change the bank signatories. Is that going to really affect the prudential ability to survive? They are compliance issues, but I keep thinking: are these the sort of compliance issues which go to the very fabric of whether my funds will be safe? The incorrect calculations benefit payments to members worries me. I can be a member.

CHAIR—In isolation they may not be, but if you have got two or three of these things added together then I would be a bit concerned if I were a member.

Mr SHANAHAN—I agree. When you investigate defaulting auditors, the more straws in the wind you see the more you think, 'He is not doing a reasonable job.' If I could make one comment in passing, my experience is that I have a great degree of confidence in the staff that do the audits. I believe the people we recruit into the auditing profession from universities with our in-house training do a great job. They find everything that needs to be found. It is in the audit management, the audit supervision and partner clearance level where people make the decision: 'Oh, we have seen that; we can live with it.' I have got a great belief in the ability of our audit staff; I do worry about some of our audit management.

CHAIR—Could you elaborate just a little bit more? It sounds most intriguing.

Senator HOGG—I would love to share your confidence.

Mr SHANAHAN—In audit files I examine in investigatory work, I find that everything that needs to be found is documented in the files. You then have to ask the question: why was it not raised in an audit report or the issue resolved with the client?

CHAIR—Right.

Mr SHANAHAN—That may be because of a lack of independence or because if we rocked the boat we could lose a client. They are real issues which are of concern to auditors.

CHAIR—That is a bit of a worry.

Mr SHANAHAN—It does concern me. I am intrigued by the comment just made from someone down here, ‘But not super fund auditors.’ And I do take some confidence in the fact that I do not see the super fund audit being something that goes along the tail end if you win a major corporate audit client.

CHAIR—How do we overcome the sorts of problems that you have just thrown into the basket? The youngsters do a great job.

Mr SHANAHAN—I am concerned about the regulation of auditors. I believe that ASIC has some of the problems that APRA has. If an audit failure is identified by a regulator you have to follow a due process at law and immediately they bring in lawyers and the whole thing slows down. I do not believe that the self-regulation practised by the professional bodies is as speedy or as efficient as some would have us believe. I think our self-regulation needs strengthening.

CHAIR—What is the next step then?

Mr SHANAHAN—I think we need to tighten up our self-regulation. If people get disciplined by the CALDB then they are reported to the institute or CPA Australia and quite often they say, ‘You’ve been dealt with. We won’t do anything more than that. You can’t have double jeopardy.’

CHAIR—You are saying that there are problems after all the spadework, the hard work, the compliance and the ticking off has been done—that somehow these things do not get reported.

Mr SHANAHAN—I believe the regulatory process for bringing the small minority of defaulting or deficient auditors to heel takes a long time to work through. At the firm I was a partner with, we resolved one audit issue with the regulator only 11 years after the audit had been concluded. I have an expert’s report into a litigation matter that may occur next year—may occur next year—on a 1988 audit. That will only be 14 years after the event! Mr Mackintosh cannot look at that auditor until after the civil action has finished. Let us add two years for the action, take out some appeals, and 20 years down the track the regulator might look at it.

Mr REILLY—I would like to do a little reality check. I think we have had a couple of examples. You can pick any one of a small number in terms of the high profile corporate collapses. The reality is that, when I look at the superannuation area, I am not aware that the particular instances that Mr Shanahan has raised are systematic at all. We will have some failings along the way but if it was more than a couple of isolated instances—

CHAIR—He is an adviser to ASIC, though.

Mr SHANAHAN—I get briefs from ASIC. I do not advise ASIC. Senator, I am sure Mr Reilly can produce the figures and I am sure that we have all wasted our time—there is no problem with audits. APRA has not ruled out anybody, the ATO has not ruled out anybody—and they both have the ability. ASIC, I believe, has not ruled out any super fund auditors

d they both have the ability. ASIC, I believe, has not ruled out any super fund auditors through CALDB action, and Mr Reilly is going to tell me that professional bodies have not ruled out any auditors of super funds. So I do not know what we are worried about. Clearly there cannot be a problem!

Mr BROWN—Mr Shanahan, we have disqualified in the order of 20 auditors over a period of time.

CHAIR—You have wiped out 2,100 trustees too, haven't you?

Mr PHELPS—That includes the 1,600 small funds that we could not locate. In the transfer to the tax office and after three letters and five phone calls we had no option but to replace the trustees.

CHAIR—When I mentioned that figure on air the commentators could not believe it. They really thought you were doing your job, wiping out 2,100. Just two last questions, Mr Mackintosh.

Mr MACKINTOSH—I just want to respond to a couple of things that John Shanahan said. Sometimes the process is cumbersome, but I think APRA raised the point before, quite rightly, that there are principles of natural justice when you get into these areas that do have to be followed. Sometimes that takes a bit of time and effort, but there are two sides to every case and the process has to be gone through in a lot of cases.

On industry specific regulation, which is something he quickly touched on, I note that we have not gone down that route on any other industries—in ASIC anyway; we may have got a little bit in insurance with APRA—but we do not have specific qualification for mining auditors or for retail auditors or for auditors of financial advisory services. I would caution you to look carefully before you went down that track for one particular situation. I think there would have to be very special circumstances.

CHAIR—I think there are special circumstances, because it is a long-term investment over a lot of years and it affects a lot of people's futures.

Senator HOGG—And it is compulsory.

CHAIR—It is different from a mining industry.

Mr MACKINTOSH—We keep coming back all the time to safety. But it seems that there is a relationship between safety and return. The balance that always has to be struck is what sort of return you want to earn and then you take a risk. If you really want safety, you would go back to putting all the money into cash.

Mr BARTLEY—Listening today, one of the concerns I have is that, as a lot of small funds have been put over to the ATO and with a lot of the legislation that we pass—and I do not have a problem with lifting standards—I am concerned that we do not drive the smaller funds out of existence by raising the standard too high in certain areas so that they cannot afford the cost of compliance. There are 200,000 small superannuation funds—mum and dad funds. As a firm, we

are quite heavily involved in small mum and dad funds. The cost of compliance keeps going up. Maybe some consideration needs to be given to a split system where the APRA regulated funds adopt a particular procedure, but those funds that are regulated by the ATO have a lower cost frame. That has already been done with the fees, and certainly most small funds welcomed the fact that instead of paying \$200 they pay \$30, but maybe some other criterion needs to be in existence because they are managing their own money at the end of the day, and really it is compliance that is the issue. The basic attitude of the NIA is that we would like our members to be able to audit small funds. They are already doing the tax returns.

CHAIR—If anybody would like to add anything further, please put in a supplementary submission. We would be pleased to receive it. Thank you very much for appearing before the committee today. On behalf of the committee, I thank everyone who has given evidence and participated. It has been most useful—and a report will follow.

Senator HOGG—Thanks very much.

Subcommittee adjourned at 6.38 p.m.