THE UNIVERSITY OF SYDNEY

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Mr Adam Cunningham,
C/- Joint Committee Public Accounts and Audit
Parliament House,
Canberra, ACT 2600

Dear Adam,

Attached to this letter is the "Opening Statement" that Committee Chairman Bob Charles, MP indicated we could provide as part of our submission. My recollection is that you said it would be received as a "Supplementary Submission". Please confirm receipt of this material.

Also provided as an attachment is a copy of the galleys of a forthcoming article detailing an alternate group accounting mechanism which was requested by the Committee. It is written by Professor Clarke, Professor Dean and Dr Erne Houghton.

The weekend's revelations that XEROX overstated revenues by several billions over the last five years highlight the importance of your Committee's deliberations. Coupled to the earlier sagas there is clear evidence that there are many issues related to accounting and auditing practices that need reforming. It is our hope that Stephen Bartholomeusz's concerns expressed in "Over-inflated bubble portent of trouble", S*MH* Saturday 29th (p. 48), that 'vested interests against real reform [by regulators, boards and investors related to governance structures] are substantial and remain greedy', are unfounded. Time will be the arbiter.

Yours sincerely,

Professor Graeme Dean, on behalf of Professors Clarke and Wolnizer and himself.

Joint Committee of Public Accounts and Audit Hearings, Canberra, 28 June 2002

“Opening Statement”

Professor Frank Clarke, Professor Peter Wolnizer and I thank the Committee for the opportunity to talk to our submission.

The primary themes in our submission are:

- Additional layers of regulation are unnecessary – in any event they will have little impact if the present financial reporting framework continues.
- A clean audit report ought to mean that the financials truly reflect the financial performance and financial position of a company – they do not! Absent of fraud, they mean that the Accounting Standards have been complied with.
- Complying with the Accounting Standards ought to mean that the wealth and progress of a company are shown in the financials – typically under the present financial reporting regime it does not!
- A clean audit report ought to indicate that the audited data can be used to determine reliably the salient financial characteristics of a company – rate of return, earnings per share, interest times cover, solvency, debt to equity, asset backing, and the like – typically it does not! Currently, it is not a warrant of quality.
- None of the proposed remedies for the current state of play will improve the quality and serviceability of the data in published financial statements – none address that issue – none appear to recognize it.
- Our proposal is a much simpler approach to implement than many in the submissions before this Committee.
- Were a comprehensive mark-to-market accounting system to be instituted and the true and fair criterion reinstated in its pre 1992-override format, auditors would potentially have recourse to externally-generated, publicly-transparent, evidence; financial statements would contain data that are fit, *serviceable*, for the uses ordinarily made of them to assess and evaluate the financial state of companies; and, likely as not, most of the mechanisms being proposed to improve the quality of auditing would not be required.
- Contrary to what is implied in many submissions to this Committee it is not failures *per se* that is critical but rather the *unexpected nature* of them. And that is a problem relating to what is to be gleaned from the financial data relating to the company’s performance and position.
- Quite rightly independence has been in focus in many submissions. But, in both its historical and contemporary settings, *Auditor Independence* properly refers to an auditor having an independent mental attitude when forming his opinion on the *truth and fairness* of the financial representations in the *Statement of Performance* and the *Statement of Financial Position.*
- Thus, the notion of independence that has occupied so many in the wake of HIH, One.Tel and Harris Scarfe, and fuelled by the Enron and WorldCom affairs, has diverted attention from the main problem – that the current system of accounting produces data without the recourse to corroborable externally-generated evidence (as required everywhere else when the truth of matters is sought) - that is evidence outside of that provided by those preparing a reporting entity’s financials. This facilitates both accidental misstatement and deliberate financial finagling.
- Data prepared in compliance with the current package of Australian Accounting Standards are not conducive to representing a company’s financial performance, its financial position or

crucial assessments of solvency and firm flexibility in a way remotely consistent with the understanding of those terms in every other setting in which financial calculation and assessment is made.

- As long as the true and fair criterion is deemed subservient to compliance with the Accounting Standards, and deemed to be satisfied by that compliance, the general run of companies' financial statements will be misleading, and the data therein will not be serviceable in the assessments and evaluations ordinarily made with them. Auditors' opinions will not be the product of an independent state of mind and their reports will continue to be largely irrelevant to an assessment of the wealth and progress of companies.

In sum, we draw to the Committee's attention simple, innovative solutions to redress the incidence of *unexpected* corporate collapses, with their concomitant loss of confidence in the integrity of the market system, individual losses, and the repeated public bemoaning of the lack of the professional ethos of accountants (and others, such as lawyers and valuers) – so aptly captured by the recent *SMH* caption, "things are crook … investors are worried by terror and whether accountants tell the truth" What is described above is totally consistent with the recommendation of CLERP 1, namely that conventional Historical Cost-based accounting be replaced by "market value" (or what we called mark-to-market) accounting whereby physical assets are reported at their market selling prices and liabilities at their settlement prices.

Professor G W Dean
Professor P W Wolnizer
Professor F L Clarke