

Our Ref: 4258

Mr Adam Cunningham
Inquiry Secretary
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Dear Mr Cunningham

REVIEW OF INDEPENDENT AUDITING BY REGISTERED COMPANY AUDITORS

Thank you for your letter dated April 12, 2002 and for the opportunity to provide a submission to the Committee's review.

While I have joined with my colleague, the Auditor General for Victoria, in supporting his comprehensive submission, I offer the following complementary comments for consideration by the Committee:

Auditing is Different

Auditing is a professional service of trust carrying with it an exacting obligation to apply professional skills on behalf of arms length third parties. This needs to be, and for it to be seen to be, provided in a manner comparable to which trust account accounting requires a higher level of professional care of companies than does routine accounting.

Further, auditing represents a form of delegated regulation in that auditors are required to be registered by the Australian Securities and Investments Commission under the Corporations Act 2001.

Clear Separation Removes Uncertainty or Doubt

Where an accounting or auditing firm carries out the external audit and simultaneously provides non-audit services to the same client, the principle of audit independence is threatened, notwithstanding that these services may be performed by separate divisions or sections within that firm. In these circumstances, there more often than not is a perception, if not a view, by users of that client's financial statements that audit independence has been compromised, which can result in a significant loss of confidence in the integrity of the external audit process.

For the investor or shareholder to have confidence in the quality of the external auditor's work, these parties must perceive the external auditor as being rigorously independent from the audit client.

Accordingly, the only effective way to ensure that external auditors are, and are seen to be, truly independent of their audit clients, is to prohibit an accounting or auditing firm, or individual from simultaneously providing external audit and non-audit services to the same client. Nothing less than this will represent “true” independence in the eyes of the average member of the general public. One cannot simply overlook this fundamental principle, because it serves to remove uncertainty or doubt.

Our Office Position

The long standing policy and practice in the public sector in Western Australia is that, where a private sector accounting or auditing firm, or individual is engaged to provide external audit services to an audit client, then that firm or individual should not undertake any other work for the client during the period these external audit services are being provided. We apply this principle where a firm or individual is engaged under contract by our Office to carry out an external audit of an agency on our behalf, by requiring that firm or individual not to undertake any other work for that agency during the term of the contract without the written consent of the Auditor General. Such consent is rarely given. The firm must not only demonstrate independence, but be seen to be completely independent of the audit client in order to avoid the perception that there is a threat to independence.

Another matter relating to these contractual arrangements that perhaps could be considered, is a requirement that the firm carrying out the external audit work should not be able to provide any non-audit services to that audit client within a defined period after the contract expires (eg. 12 months). This would provide some protection against auditors using their audit engagement to set themselves up to perform non-audit work for the same client as soon as the external audit engagement is completed.

Pricing Structure for Audits

Those criticising proposals for prohibition of simultaneous provision of external audit services and non-audit services may claim that there will be a reduction in the number of professionals willing to undertake external audit work because of the higher earnings available in carrying out non-audit services. If the ability to simultaneously provide non-audit work was removed, then the market can be expected to respond by setting a pricing structure for external audit work which would more truly reflect the nature and value of this work.

I hope our comments will be of assistance, however, should you require further information, please contact the undersigned on (08) 9222 7501.

Yours sincerely

D D R PEARSON
AUDITOR GENERAL
May 31, 2002