



CREATIVE GOVERNANCE

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The Committee Secretary
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Dear Sir/Madam,

REVIEW OF INDEPENDENT AUDITING BY REGISTERED COMPANY AUDITORS

I wish make a personal submission to the Committee under the terms of reference and the press release announcing the review by the Chairman, Mr Bob Charles MP.

The terms of reference refer to 'independent auditing' and 'registered company auditors'. The term independent is a tautology as Australian auditors are required to be independent under their professional auditing framework. There is no evidence that Australian auditors are not independent. By using the term 'registered company auditors', the scope of the enquiry is restricted to auditors who are registered with the Australian Securities and Investment Commission (ASIC). This excludes all other auditors. There is further confusion in the next sentence with the wish to explore accountability of 'both public and private sector auditing'. Under the professional accounting and auditing frameworks there is now no distinction between 'private' and 'public' sectors. Further, I was unaware that Auditors General who operate in the restricted public sector market were registered as company auditors with ASIC.

The next paragraph of the terms of reference is even more confusing. The current accounting framework in Australia is developed through a cooperative arrangement between government and the accounting profession. It not a question of 'balance' between 'external controls through government regulation' or 'freedom for industry to self regulate' but a joint approach applicable to all reporting entities. It is my

contention that the same model should be applied to the auditing framework so that the accounting and auditing frameworks are consistent.

The press release announcing the enquiry refers to the ‘recent spate of corporate collapses’ in the context of auditing. I am unaware that the level of corporate collapse or, more generally, financial failure, has been any higher recently than it has been in the past or will be in the future. Secondly, the comment “the community expects auditors to report fairly and accurately on the financial state of the companies they are auditing” implies auditors are somehow failing in their duties. Auditors follow the auditing standards as set down by the professional accounting bodies and the law to give an opinion as to whether financial statements are prepared in accordance with the accounting framework. The audit report adds credibility of these financial reports, but does not provide an assurance as to the future viability of the entity. I am unaware that auditors have recently been found not to be applying the auditing framework.

The comment that “If such failures had occurred in the public sector, the public and the Parliament would have expected the Commonwealth’s auditor, the Auditor-General, to be held to account” is not relevant. Financial failure has been and is rampant in all Australian governments. As far as I am aware, no Auditor General has ever been held accountable for such failures. The question of competence of public sector audit offices to conduct financial audits is relevant as Australian governments have only recently commenced preparing general purpose financial reports on an accrual basis. In my opinion the public sector audit offices should operate under exactly the same auditing framework as other members of the auditing profession.

The press release refers to ‘private sector’ shareholders and the public having legitimate expectations of the effectiveness of auditors which are ‘clearly not being satisfied’. I disagree entirely. Users of financial statements in Australia can expect that general purpose financial reports are prepared under the accounting framework issued by the professional accounting bodies and government through the Australian Accounting Standards Board and endorsed in the *Corporations Law*. Secondly, the users can read the audit opinion and be confident that this has been arrived at using the auditing framework and that the auditors have complied with the law. Thirdly, the users can make their own decisions as to the viability of the reporting entity. There is no evidence as to what ‘expectations’ users of financial reports have or that these are not being satisfied other than in some uninformed populist reporting. The Australian auditing framework is consistent with the international auditing framework being established through the International Federation of Accountants therefore any variation imposed by government would be against global standards.

The question of ‘balance’ between ‘government regulation’ and ‘freedom for industry to self-regulate’ in the press release and terms of reference is confusing. Does this mean government regulation alone should be used to set accounting and auditing standards? Does ‘industry’ mean the accounting profession, firms of auditors, both public and private sector auditing entities, individual members of the accounting profession or the ‘private’ sector at large? The current arrangements for developing the accounting framework appear to be working satisfactorily. In contrast, the auditing framework suffers from total confusion of responsibilities and roles mostly caused by the government not adopting the same model for auditing as they have for accounting standards. The Commonwealth government continues to use legislation,

administration and surveillance plus dependence on the accounting profession to issue auditing standards to regulate a partial sector of the auditing market, yet ignores regulation of auditing conducted in other sectors and particularly the public sector.

In my opinion the public policy issues which the Public Accounts Committee should be addressing in respect of auditing are as follows;

- What is the role of auditors of financial statements in Australia?
- Are auditors satisfactorily fulfilling this role?
- Is there a fair and competitive market for the provision of auditing services?
- Are auditors properly regulated; and,
- What should be the role of government, professional bodies and members of the accounting profession in ensuring auditing competence?

Discussion of these issues is addressed in the attached submission I have provided to the Treasury on the Ramsay Report that contains practical recommendations made for simplifying and coordinating the roles between government, the professional accounting bodies and the members of the auditing profession.

My recommendation to the Committee is that they can make a significant contribution to the continued improvement of auditing in Australia by assisting in clarifying the roles of financial auditors, the government and the accounting profession. These roles should be mutually exclusive yet coordinated to ensure the present confusion, duplication and irrelevant expectations surrounding auditing are removed.

On the broader issue of corporate governance and corporate collapses of listed public companies in Australia, the Committee could address the role of the Australian Stock Exchange Limited (ASX) in preventing loss of investor funds. For example, were listing rules used to govern the 120 odd new companies admissions in 1999 sufficiently rigorous to prevent companies with low prospects of success being listed? Has the ASX considered modifying their listing rules to undertake the regulatory role assigned to them in legislation? Does ASX surveillance and monitoring cover the financial health of public listed companies? It would appear that since demutualisation that the ASX has conflicting aims of providing a fair and reasonable market for securities while at the same time earning maximum profit for its shareholders.

A further issue for consideration by the Committee is the role of management in financial failure. In many cases the causes of corporate collapse are repeated and repeated. Argenti in his book of corporate collapse in the 1960s and 1970s points out the most frequent answer of directors following a collapse was that they were unaware of the true position of the company. In the current age of technology and instant information this should be regarded as making them even more responsible for the failure. The Committee could address the issues of management education, case studies in corporate collapse, use of technology to monitor corporate financial health and development of partnerships to promote corporate governance with professional bodies such as the Australian Directors Institute.

The issue of the apparent lack of audit independence is being given substantial attention by government. Firstly, the focus should not be on this one attribute but on the broader issue of auditor *competence*. The government can assist audit competence

by requiring the professional accounting bodies actively police the auditing sector of the profession on an *individual* basis. Secondly, the government can assist improving the audit framework by removing the current legislative requirements over auditing in the *Corporations Law* and replace it with the requirement of auditors to comply with the auditing framework. The government can then apply the model of developing the accounting framework to the auditing framework through the Auditing and Assurance Standards Board (AuASB). Thirdly, the government can deregulate the public sector auditing market and make public sector audit offices accountable in the same manner as other auditing firms.

I would be pleased to elaborate on the ideas included in this submission or on any other matter related to the enhancement of the auditing framework and corporate governance in Australia with the Committee.

Yours sincerely,

Graeme Macmillan
Managing Director

Attachment: Submission on the Ramsay Report to the Treasury.