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The Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Room SG.64
Parliament House
Canberra ACT 2600

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17 November 2003

Dear Sir

CORPORATE LAW ECONOMIC REFORM PROGRAM (AUDIT REFORM & CORPORATE DISCLOSURE) BILL

As one of the largest auditing firms in Australia, KPMG fully supports the joint submission by the two major accounting bodies, the Institute of Chartered Accountant in Australia (ICAA) and CPA Australia (CPA). A copy of that submission is attached for your reference.

The CLERP 9 draft legislation, which incorporates many of the recommendations of the HIH Royal Commission, is of major significance to the accounting profession. We recognise that there is public expectation for reform and we all need to do everything possible to help improve public perception about the capital markets, however we feel that there are likely to be significant unintended consequences if the Bill is passed without change.

In addition to our support of the joint submission, we wish to highlight three areas from that submission that are of critical importance. These are the issues raised relating to:

- the practical difficulties that may arise from application of the general auditor independence requirement as it is currently drafted (item 87);
- the unintended consequences of changes to auditors' reporting responsibilities (item 108); and
- the severely restrictive nature of the current definition of "immediate family member" (Item 68).

General definition of auditor independence

We support a general definition of auditor independence and understand the desire for such a definition to be enshrined in law; however, as currently drafted, the definition will mean that any circumstance that may appear to impair an auditor's objectivity, even to a minimal degree, could result in the company losing its auditor.

In order to achieve the Federal Government's objectives, the standard for auditor independence must be workable. To be workable, it must be objective and certain.

In our opinion, the test as drafted is not practical in its application. It:

- is not an objective test and is not capable of clear application. This will result in inconsistent determinations and lead to significant unintended consequences;
- imposes criminal liability on all partners of audit firms, even in circumstances where events occur that are outside the control or knowledge of the audit firm or the individual partners (notwithstanding the limited defences available); and
- applies a more restrictive standard than equivalent overseas regulatory regimes, including the US Sarbanes-Oxley Act and Section 8 of the International Federation of Accountants Code of Ethics, which are reflected in the Australian profession's own Professional Standard F.1, "Professional Independence".

The joint submission shows that the standard of independence proposed under Division 3 of Part 2M.4 is so restrictive that it will potentially damage the profession and the role of the auditor in the capital markets without producing corresponding benefits to users of audited financial statements. It will also severely restrict the ability of Australian business to access essential skills and resources and will add significantly to the cost of compliance.

These fundamental matters can be addressed by modifications to the general standard as described in the joint submission. We believe that the modifications proposed will maintain the independence of the audit function while avoiding unnecessary restrictions on auditors and audited bodies.

Auditors' reporting responsibilities

The expansion of the auditors' responsibilities under CLERP 9 has been introduced in response to concerns that ASIC is not receiving sufficient notification under the existing section 311 requirements. Section 311 was introduced to provide an auditor with a cause of action if the board or management was not dealing appropriately with an issue. We question whether

notification to ASIC is an appropriate measure of the effectiveness of this requirement as often there will be no need for an auditor to report to ASIC.

We consider that the proposed amendments, particularly the removal of s.311(1)(b), will damage the existing framework by:

- causing auditors to become 'policemen' for ASIC in identifying all contraventions of the Act without consideration of their relevance to the audit opinion;
- requiring disclosure to ASIC prior to an issue being appropriately considered by the board or the auditor;
- destroying the existing open dialogue between auditors and senior management on issues for fear of a section 311 disclosure event;
- hampering recruitment of graduates to professional firms for fear of criminal penalties for non-disclosure to ASIC.

The existing s.311(1)(b) qualified the auditors reporting responsibility such that it was only necessary to report to ASIC if the auditor believed a contravention had "not been adequately dealt with after bringing it to the attention of the directors". To amend the obligation such that an auditor must notify ASIC even if the contravention has already been, or will shortly be addressed, frustrates effective and proper corporate governance.

In relation to s.311(1)(b), the joint submission recommends the re-instatement of this limb in a manner that will ensure the principle of reporting responsibilities is not lost and those responsibilities will be effective. In particular, the recommended amendments will:

- require the auditor to report to ASIC if the auditor believes that the conduct giving rise to the circumstances *"has not been adequately dealt with after bringing it to the attention of the directors"*; and
- this report be made *"within a reasonable time"* after the auditor becomes aware of the circumstances.

This will allow effective and proper corporate governance processes by the board of directors to operate, while providing auditors with a means of acting where those processes fail or are likely to fail. It also ensures that the auditor's report is as timely as possible and not bound by an arbitrary, and in certain circumstances unachievable, period of time.

Immediate family member

The draft provisions extend the definition of "immediate family member" to a wider range of individuals than in other countries. It includes, for example, the parents and siblings of a person, whereas the definition adopted in overseas markets is limited to spouse and dependants. The result of this is that financial and employment restrictions will apply to a large number of individuals with no impact on the conduct of the audit and over whom the audit firm have little, or no, influence. This is unworkable in practice and has little value in protecting auditor independence.

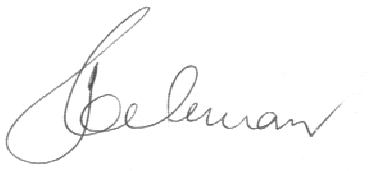
In practice, individual auditors, audit companies and audit firms and their individual partners will have no practical mechanism for monitoring and controlling the activities of "immediate family members" (as currently defined in the draft provisions) of partners, professional employees and non-audit service providers and their employees in order to prevent contravention of s.324CD(1).

Furthermore, lead auditors will be unable to provide s.307C declarations due to the impossibility of determining whether such third persons have entered into arrangements which trigger a contravention of s.324CD(1).

We recommend, therefore, replacing the definition of immediate family member with that adopted in overseas capital markets, that is spouse and dependants.

Thank you for the opportunity to submit comments on the draft Bill. We would be happy to discuss any of the issues raised in this or the ICAA/CPA response with the appropriate Government officials.

Yours faithfully



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