

**Senate Select Committee on
Superannuation and Financial Services**

**Main Inquiry
Reference (a)**

Submission No. 238

Submittor: Mr Tony Harris
3 Ellalong Road
CREMORNE NSW 2090

Sent: Friday, August 17, 2001 11:05 AM
To: Morton, Sue (SEN)
Subject: Auditing

Ms Sue Morton,
Committee Secretary,
Inquiry into Prudential Supervision, Consumer Protection for Superannuation,
Banking and Financial Services
Parliament House, Canberra

3 Ellalong Road
Cremorne 2090

Dear Ms Morton,

One of the issues that might be of interest to members of the committee is the relationship between auditees and auditors under Australia's Corporation Law. Bank auditors have special relationships with bank regulators, a relationship that is justified because of the importance of bank health for the health of the economy. And this relationship can be mirrored for superannuation fund auditors and the superannuation regulator. However, such piece-meal adjustments to the audit reporting role does not address the underlying weaknesses in auditing in Australia, nor does it help those in other parts of the economy than banking and superannuation who rely on audit opinions.

The Australian audit profession is more modest about the difficulties it suffers compared to its counterpart institute in the United Kingdom. The UK audit body, and the United States regulator, the Securities Exchange Commission, is more concerned than we have been about the conflicts that can arise between audit and non-audit work when they are undertaken by the same firm. The difficulties that this can cause were illustrated by the audit of Victoria's Tricontinental financial statements. According to evidence given to the subsequent inquiry into Tricontinental's collapse, KPMG, the external auditors of Tricontinental, refrained from auditing a crucial area of Tricontinental's accounts because management had prohibited the internal auditors, KPMG, from auditing that area.

There has been some resistance to the argument that external auditors treat the external audit commission as the foot in the door, and will price the audit task accordingly, but there is no argument that the external auditors have an advantage in winning non-audit contracts, as can be seen by the amount of non-audit work awarded to external auditors.

There is no persuasive argument against another major issue, the notion that managers, in effect the auditees, influence and indeed determine the appointment of the auditor. This can cause considerable tensions in an audit when an auditor senses that his audit contract will be terminated if the firm continues to press a point which management resists. The difficulties that arise can be seen in Andersen's audit of Sunbeam in the United States and the Deloitte audit of AWA in Australia last decade.

These tensions were addressed in a paper on expectations gap prepared on behalf of Australia's two auditing professions last decade. The authors proposed, with some hesitation, that a committee of shareholders should be tasked to appoint or recommend auditors.

Such a committee might suffer the same problems faced by directors and shareholders at annual general meetings, it would be heavily influenced by management. It would also fail to address other difficulties, such as the limited duty of care that auditors have under the general system used to appoint auditors.

Although auditors report to shareholders and have a duty of care only to shareholders and their directors, the reports of auditors are relied upon by others who have to make decisions about the allocation of resources, such as banks, employees, customers and intending shareholders. But these other persons have no recourse to auditors should their audit reports be negligently wrong.

The Commonwealth Bank, when the Victorian Division of the National Safety Council of Australia failed, was unable to sue successfully the NSC auditors, just as other banks have since failed in their attempts to hold auditors accountable for misleading audit opinions. Banks now obtain their own evidence in a costly effort to find reliable information, even though this theoretically duplicates the work of auditors.

Because auditors are effectively appointed by management, it is unsurprising that their invidious position can prejudice their work. The community is concerned about conflicts of interest in other professions, such as those that might be faced by members of the medical and pharmaceutical professions when prescribing or filling prescriptions for drugs, but such conflicts are mild compared to those faced by auditors in the private sector.

The parliament addressed these conflicts in the legislative arrangements for the appointment and dismissal of public sector auditors, there is an equally pressing need to address the same conflicts in the private sector.

Yours sincerely,

Tony Harris

August 17, 2001