

**Maintaining Confidence in Australian Capital
Markets - The PricewaterhouseCoopers Perspective
on the Audit Independence debate**



The PricewaterhouseCoopers Perspective on the Audit Independence debate

Section 2 of this submission contains a copy of the executive summary of the views of the major Accounting Firms in relation to the Ramsay Report, and the detailed commentary supporting those views. PricewaterhouseCoopers has taken a lead role in the development of these views, committing our people and resources to the task of obtaining the consensus of those firms.

PricewaterhouseCoopers in Australia has more than 35 senior staff, including 5 partners, devoted to the monitoring and continuous improvement of technical accounting and auditing standards and audit methodology. They are supported by an International network of more than 70 partners and 200 staff working in the same area.

This Section highlights the specific views of PricewaterhouseCoopers, based on the experience and quality of our people and methodology; and provides high level commentary on some of the issues we consider to be of primary importance.

PricewaterhouseCoopers strongly believes that the auditing profession in Australia, and the ethics supporting those that operate as auditors, are sound and world's best practice. This is reflected in the on-going confidence placed in Australian capital markets and the robust performance of our nation in the global economy.

However, PricewaterhouseCoopers believes well considered and defined changes to the corporate governance framework can result in further enhancement to the attractiveness of Australia's capital markets to foreign investment.

The focus should be on corporate governance as a whole

The recent high-profile examples of corporate distress in Australia and overseas have turned the spotlight onto corporate governance, and in particular audit independence.

More substantive, far-reaching changes are needed to address the concerns of the investment community, and enhance the corporate governance environment in which Australian companies operate.

PricewaterhouseCoopers welcomes the current debate and feels that as the largest accounting firm in Australia we have much to add. However, we strongly believe that a singular focus on the narrow issue of audit independence will not result in the real changes that are required to maintain the confidence in Australia's capital markets, and further improve our standing in the international arena.

A focus on audit independence alone ignores the fact that an independent poor quality audit is still a poor quality audit.



Accordingly, PricewaterhouseCoopers gives its backing to the Ramsay Report and in substance to the recommendations contained therein. We also believe that the current environment can be used as a catalyst to enable the introduction of more meaningful changes leading to Australia setting the benchmark for the world.

Sound corporate governance has long been recognised as a key element for markets wishing to attract capital. The opportunity now exists to create an enhanced environment for Australia with resulting increased appeal to foreign investors.

The Role of the Audit

PricewaterhouseCoopers believes that the right solution for the audit regime will be found in a three-level approach:

Only by critically examining the role the audit plays as part of corporate governance, and analysing this in light of the modern investment community's needs, will we be able to re-define what an audit should do in the future.

1. Ensuring the highest level of integrity of the current audit, thus maintaining confidence in the capital markets;
2. Reviewing and evolving the scope of the audit to close the current expectation gap; and
3. Introducing a system of continual review of the financial reporting and audit framework to ensure greater transparency.

The recommendations contained in the Ramsay Report will go a long way to providing the integrity required to ensure confidence and improved transparency around the audit process.

However, PricewaterhouseCoopers also believes it is imperative that the role of the audit should quickly evolve to meet the expectations of investors. The expanded role should, for example, provide commentary on those areas where shareholders seek additional assurance, such as risk management, internal controls, financial health, future risks, proper conduct, and the degree of aggressiveness or subjectivity in accounting policies.

PricewaterhouseCoopers is continually studying how our own audit reporting can be enhanced to address the needs of shareholders.

Only by critically examining the role the audit plays in corporate governance, and analysing this in light of the modern investment community's needs, will we be able to re-define what an audit should do in the future.

PricewaterhouseCoopers fully supports such an examination and is continually studying how our own audit reporting can be enhanced to address the needs of the shareholders.



The role of Legislation in Independence

PricewaterhouseCoopers fully agrees with Mr David Morgan, CEO of Westpac, who told Business Sunday (Feb 10, 2002):

“One really has to have a hard look at accounting standards that permit manipulation and permit a victory of form over substance...Because at the end of the day you can’t legislate goodness; and important as accounting standards are; and as independent auditors are; corporate governance is really a state of mind -- and it is around the integrity and values of the company and its leadership...What I think there needs to be is adherence to Best Practice...”

Therefore, our views and recommendations, and our on-going efforts, focus on how Australia might create an environment in which good corporate governance can flourish – an environment which fosters Best Behaviour.

Such an environment cannot be created if heavily regulated, and therefore we do not believe that legislation is the right vehicle to achieve best practice corporate governance, including auditor independence.

Real independence and audit quality come from adherence to the highest ethical standards.

Instead, the focus should be on the ethical standards under which all members of the accounting and auditing profession are required to operate. The ethical standards on independence in Australia are currently being updated to meet the IFAC guidelines which were developed globally and were released late last year.

PricewaterhouseCoopers believes that the key to ensuring investor confidence lies in the enforcement of existing ethical and auditing standards, and the procedures for the disciplining of individuals and firms that are shown to have departed from these standards. We acknowledge that such enforcement and disciplinary procedures have been lacking to date.

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The framework also needs to be considered by the total investor public, from small investors to large institutions, to be effective and above reproach. Membership of an oversight body should therefore include representation from all stakeholders to add real credibility to its operations.



Other services can both enhance and strengthen audit quality, and will ultimately be in the best interest of shareholders.

The provision of other services by auditors

Further, we strongly believe that the simplistic notion of barring auditors from all advisory work for their audit clients would result in poorer quality audits -- and significant additional costs for corporations. Management must not be constrained in its ability to use the best professionals, on a case by case basis, subject to the overriding constraints of independence and ethical conduct.

Strong controls and tight procedures within the audit firm itself, supported by a robust supervisory environment that punishes bad behaviour, will deliver the best solution to addressing perceptions of independence associated with an audit firm performing other services for its audit clients.

We believe that the provision of other services like tax and due diligence strengthen the quality of the audit itself. These other services can be provided alongside audit services, so long as the underlying principles of independence are adhered to and the quality of the audit itself is safeguarded.

Mandatory rotation of audit firms

PricewaterhouseCoopers does not support the mandatory rotation of audit firms.

Retention of institutional knowledge by the audit team is a key part of delivering a quality audit. We strongly believe that mandatory auditor rotation would destroy audit quality over time, and lead to increased client management disruption and distraction - and increased costs.

Importantly, a recent study commissioned by the SEC in the U.S. indicates that there are significantly more audit failures in the early years of an audit. A mandatory audit term of 5 or seven years would lead to a lessening in an auditor's understanding of the corporation's business, plus higher costs and distractions associated with an increased tendering focus. Similarly the final year can arguably be affected by the re-tendering process itself.

As a firm we are already in the process of implementing a policy requiring the mandatory rotation of the audit signing partner on our listed audit clients at least every seven years.

A quality audit can only be delivered by individuals and firms with experience, integrity and training, acting with independence and objectivity and using their knowledge of professional standards, a deep understanding of the company being audited and knowledge of the industry in which it operates. Factors such as mandatory rotation, which lessen these opportunities, run the risk of reducing the quality of the audit.



The PricewaterhouseCoopers quality audit process

The audit practice of PricewaterhouseCoopers is founded on the values of quality and excellence:

People

- Quality begins with our people, and we have rigorous procedures for recruiting, developing, promoting, assigning responsibility, then managing and overseeing their work. Our policies and procedures have been proven and continually enhanced over time, and we believe the quality and performance of our professionals is unsurpassed; and
- The highest standards of continuing education and technical training for our audit partners and staff.

Risk Management and Independence

- Strong risk management procedures to be followed before an audit client can be initially accepted, and each year thereafter. These procedures include the involvement of dedicated risk management partners, selected on the basis of their record of quality of work, experience and judgement;
- A dedicated team of 5 partners and 35 senior staff responsible for ensuring the highest level of technical advice or expertise is available to our audit partners and staff. This team of professionals has no client or revenue responsibility and also commits its time to providing input to the accounting and auditing standard setting process;
- Strict independence guidelines already in place, and a dedicated 'Independence Office' to constantly monitor adherence to policy; and
- Strict policies regarding the retention of documents needed to support our professional work for a period of not less than 7 years.

**PricewaterhouseCoopers
– Leadership in Audit
Quality is our mission.**

Review and Quality Control

- All listed audit clients use a concurring partner who has not been involved in the detailed audit work, to review the completeness and quality of the audit as well as all important or difficult issues as a mandatory requirement;



- Mandatory procedures in relation to consultation on important issues with specialist and other experienced partners who have no responsibility for revenue or client billing;
- PricewaterhouseCoopers has a strictly-adhered-to internal review and disciplinary process; and
- Our audit methodology is used uniformly across all audit engagements to ensure consistency of approach, with compliance regularly reviewed and evaluated.

Most importantly, PricewaterhouseCoopers prides itself on a culture that questions and challenges, both internally amongst our partners and staff, and externally during the performance of an audit.

No single partner or audit team is expected to 'go it alone' and we have a No Tolerance policy for behaviour that does not support our high standards.

The lessons to be learned from Enron

PricewaterhouseCoopers acknowledges the impact that the failure of Enron has had on innocent employees and shareholders and the wider ramifications on capital market confidence in the U.S.

However, we believe that to react to the failure of Enron by making knee-jerk changes in Australia ignores the differences between Australia and the U.S.

The accounting standards in Australia are based on substance over form, rather than the rule-driven principles under the generally accepted U.S. accounting principles.

Enron's treatment of various transactions as off balance sheet, thus reducing the level of debt reported by Enron in its financial statements, are evidence of significant errors of judgement and a clear lack of transparency in respect of all those involved.

Various lessons may be learned from Enron and some, if not many, of these lessons may properly lead to changes in the regulatory, financial reporting and corporate governance environments. Any changes, however, must support an environment that allows Australian corporations the flexibility to attract capital.



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However, one lesson that PricewaterhouseCoopers believes should be clear is that the failure of one audit, one auditor or one firm should not be treated as indicative of a systemic failure in the audit process or of the lack of independence of the audit profession as a whole.

PricewaterhouseCoopers supports change to the current regulatory and corporate governance environments, but change that is the result of rigorous debate that follows the contribution of all stakeholders.

Summary and Conclusion

The recent events surrounding HIH and Enron have created a great deal of confusion with resulting impact on investor and market confidence.

We endorse the Government's decision to take steps to maintain confidence in the capital markets but believe that focusing on the "audit independence" issue alone will not achieve the required outcome.

PricewaterhouseCoopers endorses in substance the recommendations contained in the Ramsay Report in the knowledge that they will help to maintain confidence in the capital markets, but believes that now is the time to be redefining the role of the modern audit in line with the current and future needs of the shareholder and market in general.

This process should include providing the highest level of safeguards to the current audit, while expanding its role to better reflect current and future market needs, and continually reviewing that role over the years to ensure maximum quality and transparency.

As the leading firm in the Australian accountancy profession we stand ready to work with Government in helping to create an environment in which good corporate governance flourishes and in which shareholders can have confidence in the health of their investments.