



Independence of Australian Company Auditors

Comments on the Consultative Document from the Association of Chartered Certified Accountants (ACCA)

1. ACCA is pleased to present its comments on the Ramsay Report, dealing with the highly topical issue of audit independence. ACCA offers this contribution from a unique global viewpoint and experience. It is the largest worldwide professional accountancy body, with nearly 300,000 members and students in 160 countries and with 32 staffed offices and 35 active centres. ACCA's members hold senior positions throughout the corporate sector and, although ACCA is strongly identified with the smaller practitioner, it also has a significant presence at partner level in the Big 5 firms around the world.
2. ACCA is recognised in the Australian Corporations legislation for the purpose of registration with the Australian Securities and Investments Commission for practising as a company auditor or liquidator. In the UK, ACCA has identical statutory recognition with the Institute of Chartered Accountants in England and Wales, the Institute of Chartered Accountants in Scotland and the Institute of Chartered Accountants in Ireland. It also has statutory recognition in a number of other countries.

General comments

3. ACCA commends the Ramsay Committee for producing an exceptionally thorough review of the topic, taking in the full range of independence issues from appointment, oversight and regulation of auditors to the role of the corporate audit committee in maintaining audit integrity.
4. While auditor independence is only a part of the debate which has intensified in the aftermath of the Enron collapse, the recommendations of the Ramsay report are very relevant to that debate. We attach to this response a copy of ACCA's own response to Enron, which contains a number of points and recommendations which are relevant to the issue of auditor independence.

5. We have a number of specific comments on issues raised in the paper which we spell out in detail below. Our principal concerns are set out below.
6. While we recognise that the remit of the Ramsay Committee related specifically to issues of auditor independence, we believe that - particularly in the climate following Enron - it is not sufficient merely to establish an Auditor Independence Supervisory Board (AISB). The scope of this Board should be extended to cover all the processes of standard setting, regulation and discipline relating to auditors and the extent to which these serve the public interest.
7. We do not agree with proposals to include, within the membership of the proposed Auditor Independence Supervisory Board (AISB), representatives of the ICAA and CPA Australia. We believe that it is critical for the Board's credibility that it should be demonstrably independent of the accounting profession and its structures. Therefore, although it is not necessary to exclude accountants from membership of such a Board, they should neither be in a majority nor represent particular professional bodies. This follows the principles adopted for the UK Review Board. It is particularly invidious to include some professional bodies but to leave other recognised audit bodies outside the independence oversight process.
8. The Report proposes that extensive independence rules should be written into the Corporations Acts. In our view, these would be better dealt with as a matter of professional ethics.
9. Since ICAA and CPA Australia are not the only bodies recognised under Australian law as eligible for appointment as company auditors, we disagree with the suggestion that the experience and professional development arrangements of these two bodies should be the benchmark for the profession as a whole.

Specific recommendations

10. We comment below on the detailed recommendations which are summarised in section 2 of the report, under the headings used in that section.

General statement of principle requiring independence

11. The "reasonable investor" test set out in the second paragraph is a complex one on which we presume that legal advice has been obtained. While we support a principles-based approach to this (in addition to a number of explicit legal prohibitions), we believe that

this is better set out in a mandatory code of professional ethics than in legislation which could expose the accounting profession to legal challenge.

12. In our opinion, it will be preferable for the annual declaration referred to in the third paragraph to come from the relevant corporate audit committee instead of (or in addition to) the auditors themselves.

List of core circumstances which create a lack of independence

13. In general, we favour an approach based on principles to one based on detailed rules. The Enron affair has highlighted the dangers of a rules based, 'cook book' approach which, driven primarily by the litigious environment in the US, can encourage companies and their auditors to go as close as possible to the limit of what is legally permitted.
14. For this reason, we are unclear as to why it is proposed to incorporate these recommendations into law when the new principles-based IFAC independence framework, to which all registered auditors in Australia must subscribe, is about to come into force. The focus on "core circumstances" is reminiscent of the original US and European approaches to this issue before the logic of the principles-based approach became clear. By contrast, a principles-based approach focuses on the areas of greatest risk and the potential safeguards which may be available in individual cases.

Employment relationships

15. It is proposed that a number of prohibited relationships should be written into the Corporations Act. For reasons already stated, we believe that many of these issues are best dealt with via the ethical codes of the professional accounting bodies.
16. The adoption of such a detailed list of prohibitions risks creating the impression that any relationship which is not explicitly prohibited is thereby acceptable. For example, the fifth prohibition relates to members of the audit team who are officers (or influential employees) of the client *at any time during the period covered by the audit report*. The parallel clause dealing with the "immediate family" (a term which is not defined) of members of the audit team uses the term "director" rather than "officer" and does not specify any period. Is it therefore acceptable for the spouse of the audit engagement partner to be the company secretary of the client company, or to be a director during a period other than that covered by the audit report? This is not merely a matter of



tightening the drafting: the problem is that, the more elaborate the prohibitions become, the more the "grey areas" between rules proliferate.

17. The prohibition on "employment by client of former auditor/employee of auditor" posits some complex continuing financial relationships between the former auditor and the audit firm. We are not aware that audit enforcement regimes elsewhere in the world have found it necessary to write independence legislation at this level of detail and to incorporate it into law. Furthermore, provided the former auditor is not in a position to influence the conduct of the audit, it is not clear why his or her financial relationship with the audit firm is relevant - it is the judgement of the auditors, not the company directors, which these sections should be designed to safeguard.

Financial relationships

18. Similar considerations arise in this section. We believe that there should be further consideration of the balance between prescriptive legislation and professional codes of ethics.

Non-audit services

19. We support the recommendation that the provision of non-audit services by audit firms to their clients should be dealt with by revised and updated professional ethics rules, by mandatory disclosure and by strengthening the role of audit committees. In particular, we support the requirement for the client Audit Committee to consider and report on the potential impact of such fees on the independence of the auditor.
20. In our view, some services (such as tax compliance) may be most economically delivered by the auditor without risk to independence. Before considering any prohibition, more evidence is needed on the circumstances when, and the extent to which, non-audit services may jeopardise independence.

Establishment of an Auditor Independence Supervisory Board (AISB)

21. In our opinion, auditor independence is too narrow a remit for a Board of this nature. Auditor independence should be integrated into, and monitored by, the regular quality assurance review processes. We recommend the establishment of a Board which is similarly constituted to the proposed AISB but which has a much wider remit; this Board should be charged with the task of overseeing, and reporting publicly on, the standard setting, quality

assurance and disciplinary systems to which the accounting profession is subject and the extent to which these serve the public interest. This should include, but not be limited to, matters of auditor independence.

22. Our remaining comments in this section apply equally to the AISB as proposed and to the wider body which we advocate.
23. Based on our experience as a key player in the development and establishment of an independent, non-statutory framework for regulation in the UK, we believe that it is critical that such a board is demonstrably free of any influence by the profession and its structures. For this reason, while accountants should not be excluded from membership by virtue of their qualifications (which may well be an advantage), they should not form the majority of the members of the board nor should they represent, or participate in the governance of, any particular accounting body.
24. If, nevertheless, it is decided to proceed with the proposal for professional body representation, we think that this should be open to all recognised auditing bodies in order to ensure that the AISB is properly representative.
25. The best way to ensure that the new board is clearly free of any influence from the profession is for it to be funded by government. If, however, this is not seen as politically achievable, we support the proposals for "no strings attached" funding, safeguarded by means of a largely non-accountant Board and fixed sum funding to which the profession is committed for a fixed period. This closely parallels arrangements recently agreed in the UK for funding the Accountancy Foundation.
26. One of the key features of the new UK arrangements is the prominent expectation that the professional bodies will normally implement the recommendations of the Review Board and, in the exceptional circumstances that they do not, will make a public statement of their reasons. This requirement does not appear to be explicit in the proposals for the AISB. Its absence serves to undermine the public interest powers of the Board, such as that to advise the professional accounting bodies on whether standards on auditor independence have been adequately implemented.

The report recommends that the AISB should "monitor the nature and adequacy of systems and processes used by Australian audit firms to deal with issues of auditor independence". It is not clear whether it is intended that this will be achieved by direct monitoring of firms or by secondary oversight of aspects of existing quality assurance processes. If the former is

intended, the statement that the AISB will have a "small professional staff" will be of concern to those with experience of monitoring audit quality, who understand the scale of staff resource required to conduct effective monitoring operations.

27. In any event, we question the logic of treating the monitoring of auditor independence issues as a separate activity, distinct from the monitoring of general audit systems and performance.
28. The report also extends to the AISB a role in monitoring companies' compliance with the auditor independence regime, the teaching of professional and business ethics as they relate to issues of auditor independence and the adequacy of the profession's investigation and disciplinary processes. The last of these functions, is not limited to auditor independence, as the others are, and we wonder whether this is deliberate. We support the wider interpretation, but only in the context of a board concerned with the wider general remit which we advocate above.

Audit committees

29. The contents of the proposed Guidance Note are very comprehensive. We consider, however, that such guidance would be more appropriate within a formal Code of Corporate Governance along the lines of the UK Combined Code rather than being described simply as a guidance note supporting the listing rule.
30. We question the legality and feasibility of the proposal that the Audit Committee should review the compensation of individuals employed by the auditor and the nature of their internal contracts.

Other issues considered during the review

31. We remind you that ICAA and CPA Australia are not the only bodies recognised under Australian law as eligible for appointment as company auditors. In the light of this, the proposals that the experience and professional development arrangements of these two bodies should be the benchmark for the profession as a whole are not reasonable.