

**SUBMISSION BY CORRS CHAMBERS WESTGARTH**

**TO**

**SENATOR THE HON IAN CAMPBELL, PARLIAMENTARY SECRETARY  
TO THE TREASURER MANAGER OF GOVERNMENT BUSINESS IN THE SENATE  
ON THE REPORT OF PROFESSOR IAN RAMSAY INTO INDEPENDENCE OF  
AUSTRALIAN COMPANY AUDITORS**

**The General Manager,  
Corporate Governance and Accounting Policy Division,  
The Treasury,  
Langton Place, PARKES, ACT, 2600.**

**1 Introduction**

Corrs Chambers Westgarth welcomes the opportunity to provide the Commonwealth Government with feedback regarding the Report of Professor Ian Ramsay into Independence of Australian Company Auditors (**Report**).

**1.1 Summary**

While broadly supportive of the recommendations and analysis contained in the Report, Corrs believes that several of the Report's recommendations could be refined to provide a better regulatory environment.

As a general principle Corrs supports the view that "The markets and their participants have gained quality information and investors' trust through vigilant and active corporate governance. Quality information is the life-blood of markets; corporate governance ensures the flow of that information is not severed."<sup>1</sup>

Corrs believes the substance of the Report needs to be examined from a corporate governance perspective and not as an accounting issue.

Specifically Corrs encourages the Government to:

- amend the Corporations Act to include a specific statement of intent that the auditor is required to be and remain independent and a general statement that independence requires the auditor to ensure that the auditor is able to exercise objective and impartial judgement on all issues encompassed within the auditors engagement;

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<sup>1</sup> Lynne Turner (SEC's then Chief Accountant) February 21, 2001 speech "Audit Committees: A Call to Action".

- amend the Corporations Act to reflect the “core circumstances” when an audit is to be regarded as not being independent, these provisions should reflect international rules and should be subject to ongoing review by the Financial Reporting Council (FRC), the Companies and Securities Advisory Committee (CASAC) or similar (see below);
- review and reconsider the administration of the proposed Auditor Independence Supervisory Board (AISB). While Corrs is generally supportive of the Report’s recommendations regarding the provision of non-audit services by audit firms to their clients we are concerned that the proposed AISB does not easily fit within the existing scheme of audit regulation and that the AISB ought to be more closely associated with the Companies Auditors and Liquidators Disciplinary Board, the FRC and/or the role of the Australian Securities and Investments Commission (ASIC). The criticism of the proposed administrative arrangements should not be regarded as a rejection of the need for continued supervision and monitoring of audit independence merely of the need to ensure the issue of independence meshes with the overall regulation of audit conduct; and
- implement the Audit Review Working Party’s recommendations as identified in the Report.

Corrs would welcome the opportunity to discuss with the Government the matters raised in this submission. The contact on this matter is:

Andrew Lumsden, Partner  
Corrs Chambers Westgarth  
Level 33, Governor Phillip Tower  
1 Farrer Place  
Sydney NSW 2000

Phone: (02) 9210 6385  
Mobile: 0418 110 665  
Email: Andrew\_Lumsden@corrs.com.au

## **2 Detailed submission**

### **2.1 General comments**

Corrs has reviewed the report in detail and considered the recommendations in the context of the recent failures of Enron, HIH, Harris Scarf, One.Tel and others. We appreciate that the current environment for the regulation of auditors is highly fluid and is the subject of intense review around the world by a number of legislators, regulators and supervisory bodies.

We acknowledge that Australia is a small part of the global securities market and that a number of companies regulated by Australian laws are also regulated in one or more other jurisdictions around the world. Australia must ensure it adopts a scheme of regulation that preserves the integrity of our local markets, recognises our autonomy but that pays proper regard to the fact that we are part of a global environment.

Corrs support the views of David Knott the Chairman of ASIC “...that community expectations of audit need to be examined from a broad perspective, not by assuming that independence is the only – or necessarily the most important – issue at stake. It is logical to assume that lack of independence may lead to a bad audit. But it is a non-sequitur to deduce that an independent audit will be a good audit. We need to question just how rigorous and investigative we want our audits to be; what we are prepared to pay for them; and how strictly we will hold the accounting profession to account for

failing to detect and report when financial statements do not reflect a true and fair view of the enterprise.”<sup>2</sup>

We generally support the focus of the Report on the role of the audit committee. Corrs believes that the primary custodians of companies are and should be the elected directors. Investors should expect their directors to critically examine any matter that might have an adverse impact on the integrity of the company's financial information.

Given the complexities of today's corporate environment we doubt whether you can draft with precision every circumstance where an auditor is confronted with difficulties regarding audit independence or whether she or he is compromised in undertaking the company's audit. It should be the board and not the regulator alone that must accept primary responsibility for the proper presentation of financial information to investors.

This is not to say that we should not strive to improve the regulatory framework for the regulation and supervision of auditors merely that we need to see the issue in a matrix of regulation, supervision and investigation by legislators, regulators, professional accounting bodies and companies. If we ignore the whole we risk the criticism that the approach is piecemeal and fails to address all the complexities of the issue.

## **2.2 Changes to the Corporations Act**

Corrs is generally supportive of the proposed changes to the Corporations Act recommended in Part 5 of the Report. We do not propose to comment in detail on the drafting of these provisions particularly the proposed amendments to s324 of the Corporations Act. Naturally we would welcome the opportunity to comment on the specific drafting when the language has been settled.

Corrs supports the proposed inclusion in the Corporations Law of a general statement of principle requiring independence. We wonder whether it would be useful to supplement this proposal with a clear statement about the duty that auditors owe to the company. Having regard to this suggestion perhaps it would be more useful if rather than a declaration to the directors there was a positive obligation on the auditor to include in the audit certificate (included in the annual report) a statement that the auditor has maintained its independence in accordance with the Corporations Act and the rules of their professional accounting body.

Corrs supports a 2 year quarantine period for auditors becoming directors. Corrs agrees that strong personal ties such as this may well compromise the independence of the audit, this is an issue that ought to be the subject of ongoing surveillance by the audit committee, not just at auditor/director level.

Corrs supports the inclusion of a safe harbour for inadvertent breaches of the independence rules provided the suggested conditions are met.

## **2.3 Provision of non-audit services**

Subject to the comments below Corrs supports the recommendations of the Report regarding the provision of non-audit services by audit firms to their clients. We support the move towards full disclosure of the dollar amount and type of service provided by the audit firm to the client.

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<sup>2</sup> August 2001 Monash Law School Foundation Lecture.

Corrs also supports the requirement for the annual report to separately confirm that the directors and/or audit committee believe that the provision of non-audit services by the audit firm is compatible with maintaining the auditor's independence.

#### **2.4 Measures to enhance audit independence**

Evidence seems to suggest that the current co-regulatory model is appropriate for the regulation of auditors. Corrs agrees that self-regulation can be more flexible and less costly for both business and consumers than direct government involvement.<sup>3</sup> ASIC must however have the power, resources and skill base to ensure that it adequately monitors the professional bodies to ensure minimum acceptable standards are met, similarly self-regulation must have vigorous and active accountability mechanisms.<sup>4</sup> The Audit Review Working Party (Working Party) recommendations<sup>5</sup> (below) seem sensible and broadly consistent with the philosophy contained elsewhere in the Corporations Act eg the FSA licensing regime.

*The conditions set out in the Law would provide that the ASC must be satisfied that each authorised accounting body has and will continue to maintain:*

- (a) sufficient resources to enable the delegated functions to be performed in an efficient and effective manner;*
- (b) a comprehensive and mandatory code of ethics and other rules dealing with the conduct of members who provide auditing services;*
- (c) mandatory requirements for the continuing professional development of its members and for professional indemnity insurance for those members in public practice;*
- (d) a comprehensive program for the periodic review of the work of members who provide auditing services;*
- (e) appropriate disciplinary procedures for dealing with complaints and other matters concerning members who provide auditing services; and*
- (f) adequate indemnity insurance arrangements in respect of its performance of the delegated functions.*

Corrs suggests that the above recommendation of the Working Party (together with such ancillary provisions as seem desirable) be immediately drafted into legislation and that it be subject to public consultation for not less than 2 months. We think it would be helpful if the explanatory material issued with such legislation include a complementary ASIC draft practice note or similar. We believe it would be useful for the public understand ASIC's reading of the administration of the provisions. Clearly, in this case ASIC's implementation of the policy is central to the effectiveness of the provision and maintaining market confidence in the robustness of the model.

#### **2.5 The Auditor Independence Supervisory Board**

Corrs supports the broad thrust of the philosophy behind the establishment of the AISB. There is a need for an independent, well resourced and focused body to review, counsel and monitor the necessarily fine edges of maintaining independence. Today's business environment is a sometimes surprisingly interconnected and a body like the AISB will substantially assist auditors and audit committees with difficult questions of judgement.

<sup>3</sup> Jillian Segal "Institutional self-regulation: what should be the role of the regulator?" 8 November 2001.

<sup>4</sup> *Report of the Taskforce on Industry Self-Regulation in Consumer Markets* August 2000.

<sup>5</sup> Recommendation 4.2 of the Audit Review Working Party Dealing With Requirements for the Registration and Regulation of Company Auditors – *Ramsay Report* Appendix C.

The AISB will also be well positioned to consider the results of Paul Volker's committee of the International Accounting Standards Board (IASB) to recommend reforms to independence standards and similar.<sup>6</sup>

Corrs suggests that one feature of the AISB should be a positive obligation on the body to counsel and educate auditors and the public. A specific requirement for confidential counsel ought to be included so auditors and audit committee members) can have a one-on-one confidential, non-binding counselling about concerns regarding their ability to express their independent opinion.

While we support the idea and function of the AISB we believe it could be more effectively accommodated within the existing structures for the regulation of accounting. Treasury will no doubt advise whether the AISB could be accommodated within an invigorated CALDB or as part of the FRC or elsewhere. It seems sensible to invigorate our existing structures rather than creating a proliferation of bodies that are too economically insignificant to satisfy the communities' expectations.

## **2.6 Audit Committees**

We believe that a well functioning audit committee is an important element of good large company corporate governance. Accurate financial information is the lifeblood of markets, markets will punish poor financial information (by reducing support for our market), values will fall and prosperity will decline. As a consequence of this, investors are entitled to high quality financial information.

A cost of participating in public financial markets is the cost of establishing resourcing and supervising an audit committee in all but the most exceptional circumstances. The ASX ought to be encouraged to consider the recommendations of the Report and circulate a draft listing rule and guidance note for public consultation as soon as possible.

We support the recent statements by the FSA that it is appropriate to look to the audit committee if there is an audit failure. Clearly this will mean an increased commitment from companies and committee members to the work of audit committees.

## **2.7 Appointment of auditors**

Corrs does not support calls for the company's auditor to be chosen by a regulator such as ASIC. Corrs is in favour of the Listing Rules including a requirement for the audit committee to have primary carriage for the appointment (including the terms of the retainer and remuneration) of the auditor.

## **2.8 Mandatory rotation of auditors**

The Report recommends the mandatory rotation of audit partners responsible for the audit of listed companies. Corrs agrees that the rules governing the professional associations regulating auditors ought to require, at a minimum, that rotation of audit take place at least each 7 years. Corrs agrees there ought to be a quarantine of the partner (irrespective of the firm) for at least 2 years.

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<sup>6</sup> *The Economist* 7/2/2002 "When the numbers don't add up".

## 2.9 Competency requirements for audit committee members

The Report recommends that audit committees be mandated and that they be comprised of suitably qualified individuals. The Report recommends that each member of the audit committee be financially literate, the Reports states "financial literacy is an essential skill for audit committee members." We are supportive of this recommendation and particularly of the board of directors (as opposed to any third party) being charged with responsibility for determining financial literacy according to their business judgement.

## 3 Conclusion

In addition to the above Corrs supports the calls for CASAC or similar to begin a well informed debate about audit reform more generally. There is a need for a debate about audit reform that focuses on the broader perspective (perhaps encompassing the independent expert, ensuring consistency between these two similar threads in the Corporations Act). The Government needs to look not only at audit independence but also the community's understanding of and expectations from, the auditing profession.<sup>7</sup> There is a growing need to address the twin issues of the expectation gap and the readability of accounts. The focus of the process needs to be about providing investors with information not avoiding liability, Corrs notes with interest recent calls from Mr Harvey Pitt, the chairman of the Securities and Exchange Commission for auditors to identify the 5 assumptions that make the biggest difference and to show how the numbers would look if different assumptions were made.

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<sup>7</sup> See Segal and Knott op cit