SUBMISSION

TO

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

REVIEW OF INDEPENDENT AUDITING BY REGISTERED COMPANY AUDITORS

JOHN HAMMOND
SUITE 275, 236 HYPERDOME
CNR PACIFIC HIGHWAY & BRYANTS ROAD,
LOGANHOLME, QLD 4129.

PH: (07) 3209-7673
FAX: (07) 3209-7673
E-mail: jhammond@netspace.net.au

The Joint Committee of Public Accounts and Audit is conducting a review into independent auditing by registered company auditors.

Much attention has been directed towards the role of the external auditor in the wake of the spate of recent corporate collapses and this focus has been long over due.

Corporate collapse has been around for many many years. One just has to go through the list of well known corporate names going back 40 years which collapsed suddenly. Names like Ariadne, the Adsteam group (involving Adelaide Steamship Company, David Jones, Tooth & Co, Petersville Sleigh, Clark Rubber and other associated companies), Tricontinental, Pyramid Building Society, Budget, Quintex, Estate Mortgage, Bond (together with Waltons Stores), Rothwells, Bank of Victoria, the National Safety Council of Australia, the Girvan building empire, Mainline, Cambridge Credit, Gollins Holdings and Hooker. Businessmen who have been burned by their involvement in corporate collapses include Alan Bond, Laurie Connell, Ron Brierley, John Spalvins, Bob Ansett, George Herscu, and the late Christopher Skase.

Recent headlines drawing attention to corporate collapses include HIH, Ansett, One.Tel and United Medical Protection (UMP). High-flyers behind these companies include Rodney Adler, John David (Jodee) Rich, Rich's wife and sister. The reputations of Lachlan Murdock and James Packer might have been tarnished along with that of Air New Zealand.

Some corporations have narrowly escaped collapse. These include Fosters Brewing, BHP, and several TV and radio stations. Mergers have helped Coles and Myer.

But why all the attention towards external auditors? They are just one aspect of a myriad of factors which have a bearing on the financial well-being or otherwise of an entity. Consider the following analogy.

A bus full of passengers crashes en route to Canberra from Brisbane. All are killed and no-one survived to tell the story of the events just prior to the crash. The public wants to know exactly what caused the accident and so take steps to ensure the fate will not be repeated. People want to know what and/or who is to blame for the crash.

First one might ask whether it is the designers of the bus – the Board of Directors of the collapsed company?
Was it the driver of the bus who was to blame – the CEO of the failed company?
Was it the builders of the individual components of the bus:

- the engine - the Sales Department?
- the brakes - the audit committee?
- the transmission - product and design department?
- the electricals and onboard computer - the accounting department?
- the interior fit out - the HRM department?

Was it the overall exterior of the bus – the Profit & Loss Statement?
Was it the colour of the bus – the Balance Sheet?
Was it the chassis which caused the crash – the internal systems?
Could it have been caused by the road conditions – the economy?
Could it have been caused by the speed limit – ASIC?
Could it have been caused by speed bumps – the ATO?
Could it have been caused by running out of petrol – ASX?
Could it have been caused by the passengers – the shareholders?
Could it have been caused by the QA inspectors – external auditors?
Could it have been caused by the weather conditions – world events?
Could it have been caused by design standards – accounting standards?
Could it have been caused by ……. and the list goes on to include the role of the Police, Motor Registration Board for registration of the bus and the driver, Road Traffic Authority for setting the speed limit, the road construction company, the tyre manufacturer, the service station attendant for incorrect tyre pressure, local farmers for stray livestock on the road, etc, etc. Similarly the corporate side of the analogy could include the accounting profession, auditor registration standards, company secretary registrations board, Accounting Standards Review Board, etc, etc.

The Joint Committee of Public Accounts and Audit has expressed concern that steps should or must be taken in an attempt to stem the flow of corporate collapses. No-one wants to see another HIH, One.Tel, Ansett or UMP collapse. But Australia is not alone here. It has not been long since the American giant Enron collapsed owing reportedly the largest level of debt in history.

But can external auditors be singled out to accept the blame? The obvious answer to the uninformed public might be Yes but to an accountant, the answer is No. Why then is there a difference here? The answer is perception.

Members of the accounting profession are all too well aware of the intricacies of the financial side of a large company but not many fully understand and comprehend these intricacies – the breadth and depth of all these aspects are just far too great for one person to master.

Counting or Accounting has its origins in the days before the abacus. It has been many centuries since double entry bookkeeping was introduced. Taxes have been around long before Caesar. The doctrines of Accounting have been well established for many centuries. Profit and Loss Statements were easy to read and Balance Sheets told the whole story. The Audit Report gave the "true and fair" approval. But as the adage goes: the times are a changing!

No-one can ignore the fact that our lives have become very different over the past 15 years or so. Many people have seized the opportunities created by the computer and are now travelling on the information super highway – the world wide web.

But has accounting kept pace with change? In some respects, the accounting profession has kept pace with technological change – the accounting function has been computerized and information is on-line. However an agreed position on many new accounting concepts has not been set in concrete yet.

Going back to our analogy, the role of the external auditor is similar to that of Quality Assurance Inspectors. Change has also affected our bus over the past 15 years.

Instead of the tradition steel chassis, manufacturers have developed alternatives – alloys. Stress tests have been conducted on these alloys and they have been approved as an alternative. Does the QA Inspector of the bus accept these test results or conduct new tests? In the early stages of the production run of the bus manufacture, QA might perform independent tests on a sample bus – no problems and that aspect gets the tick. However, over time, the composition of the alloy changes. The alloy could be a mixture of any metals from a list – steel, copper, brass, bronze or new non-metals including aluminium, carbon or titanium. To the QA Inspector, all looks and feels fine and presents no overt problem until a crash happens and the chassis is examined. Should the QA Inspector be held accountable for the inferior quality of the alloy composition when a test was performed many months ago?

Earlier I mentioned perception. I believe the public at large has the perception that an external auditor should be attesting to the accuracy of the financial statements of a company *in toto*. The profit as disclosed in the annual Profit and Loss Statement is the absolute correct profit as determined by the preparers of the Statements. The external auditor has examined all entries and transactions and verified them as being absolutely correct. The Audit Report as published in the company's Annual Report says that the Statements and true and correct. The Audit Report is seen as the QA Inspector's checklist of ticked boxes. How wrong most people are.

The role and responsibility of the external auditor is misunderstood. It would be an impossible task for an external auditor or a team of external auditors to examine every record and every transaction entered into by the company during the financial year. If it takes say 10 accounting staff full time, then it would take an equal number to check every aspect of their work. The added problem of this misconception is the time constraint. The full time accounting staff have the full 12 months to carryout their work – the external auditors only have about 6 months from the end of the financial year to the publication of the Annual Report.

The role of the external auditor, I believe, is to ensure that the entity has adequate controls and systems in place to ensure correct preparation of accounting records.

Included in this examination would be adherence to Accounting Standards and good corporate governance.

Corporate governance was espoused some 10 years ago in the UK. The Cadbury Report was published in the UK in 1992 and dealt with Corporate Governance. The report also highlighted deficiencies in the Audit Report and made several recommendations. The Cadbury Committee was formed in May 1991 because of a concern by the London Stock Exchange for the perceived low level of confidence both in financial reporting and in the ability of auditors to provide safeguards which the users of company reports sought and expected. Although the report dealt with a concern within the UK, this concern equally applies in Australia.

In the 10 years that have passed, has this concern been lessened? The obvious answer as it applies to Australia must be in the negative otherwise this Joint Committee would not have been convened.

Chapter 5 of the Cadbury Report was entirely devoted to the topic of Auditing. According to the Cadbury Report: "the audit provides an external and objective check on the way in which the financial statements have been prepared and presented."[1] However the Report suggested that the work of the auditor was difficult and cited a number of reasons as follows:

(a) Accounting Standards were not rigid and provided scope for differing interpretations by directors;
(b) Shareholders formally voted on the appointment of auditors as put forth by the board of directors. Once appointed, the auditors never make contact with any shareholders;
(c) Audit firms compete on price and professional standing; and
(d) Companies do not have unlimited funds for an audit. Accordingly the company therefore gets what it pays for.

At least the Cadbury Report started the ball rolling in the right direction.

[1] Report of the Committee on the Financial Aspects of Corporate Governance, 1 December 1992, para 5.1, page 36.

The accounting profession worldwide has attempted to address some of the concerns raised by Cadbury. However I believe the Australian accounting profession has been slow to arrive at an agreed position on some accounting aspects. For example it took many years before the Standard dealing with leases was published yet leases have been a normal business decision and activity for many years. Furthermore, there still exists ambiguity of the term "material asset" in AAS29 as the term is not defined. The valuation and recognition of intellectual property has not been properly addressed yet proprietary rights are discussed every day. Another aspect is the broad concept of "control" which has a huge bearing on consolidations and joint ventures. A flick through the index of The Australian Accountant journal highlights the breadth of the many accounting aspects still unresolved.

The treatment of certain items by the accounting profession and found in Accounting Standards differs from the treatment required under the Income Tax Assessment Act. A classic case here is the accounting accruals method and the cash method adopted by STS taxpayers. The methodology for the treatment of income and depreciation differs between accounting and taxation based purely on level of turnover of the entity. In effect two sets of records are needed. Also there is a continuity problem when a business expands to the extent that a new level of annual turnover exceeds the $1M threshold. In addition it is now impossible to compare the financial position of a company with an annual turnover of say $750,000 with that of a company with an annual turnover of $1,200,000 because the playing field is not level. The former reports on a cash basis whilst the latter reports on an accruals basis.

Many have taken the lead championed by Cadbury. These include Professor Ray Chambers, Henry Bosch and more recently Professor Ian Ramsey. David Knott has added the weight of ASIC to protecting the investor by regulation and audit. In his speech at the 2002 CPA Congress, Knott matched President Bush's 10-point plan for accounting and audit reform with 10 points of his own. Most points were not new and most were "warm and fuzzy" statements. Knott did suggest the compulsory attendance of auditors at AGMs. I support this suggestion which should have been implemented as part of corporate governance many years ago.

Professor Ramsey presented his report to Government last year. He enquired into the independence of the external auditor after the HIH collapse. Ramsey reiterated similar recommendations to those put forth by Cadbury and others in the USA. The main focus of literature in recent times has been directed towards accounting standards and auditor independence.

Concentrating on the latter ie auditor independence, many articles on the topic suggest common themes as follows:

(i) a demarcation between the provision of audit work and consultation to reduce audit gaps,

(ii) a restriction in ownership of corporate share by the audit firm and/or audit firm superannuation fund,

(iii) a ban on appointment of external audit personnel to the corporate audit committee, and

(iv) rotation of the company's auditor.

Whilst I agree with these recommendations, I am not going to reiterate what has already been written in reports and articles but concentrate on the bigger picture. More must be done and I propose to outline to the Committee exactly how all four themes above can be accomplished. In his report, Professor Ramsey listed a number of recommendations but stressed that it was not a menu but a case of all or nothing. I agree. The four recommendations above will not assist in minimizing the level and magnitude of corporate collapses. Like the bus analogy, fixing one aspect will not put an end to the likelihood of future bus crashes. It involves a combination of aspects all working together.

Australia is not alone in addressing corporate collapses. A few months ago in America, a new piece of legislation was tabled. This legislation "Corporate and Auditing Accountability, Responsibility, and Transparency Act (CAARTA) was in response to the Enron collapse and the bankruptcy of Global Crossing. "In brief, the legislation would ensure auditor independence through new firewalls and a public oversight board for accounting of publicly traded companies. Companies would have

to provide more public information about their financial health in real time. The legislation would beef up the Securities and Exchange Commission (SEC) budget by almost half to enable it to perform more oversight, and it would be directed to set up audit reviews of large companies."[2]

Cadbury and Ramsey made mention of accounting standards. Presently accounting standards are developed in UK, USA, Canada, Australia and many other countries. There is a slow move towards international accounting standards mainly being pushed by globalisation of groups. It is extremely difficult for a parent of an international corporation with operations in many countries to produce consolidated financial statements when subsidiaries use different accounting standards and principles.

Accounting standards are slow in addressing current issues. These include derivatives, e-commerce, commodity hedging and synthetic financial arrangements. I have already mentioned intellectual property and proprietary rights.

Earlier I drew attention to the mismatch in accounting treatment and tax treatment for STS and non-STS taxpayers. There are many other areas which cause concern to accountants. The following list, though not exhaustive, includes:

- tax deduction for expenditure incurred regardless of when paid,
- some prepayments being deductible under s82KZL but apportioned for accounting,
- GST adjusted cost base compared with pure accounting gain on disposal,
- tax value of natural increase of livestock,
- obsolete stock valuation and write-offs,
- valuation of goodwill,
- valuation of mining reserves,
- goods own use,
- stock items used in promotional presentations,

[2] 2-13-02, Press Release – U.S. House of Representatives. Michael G. Oxley, Chairman, Committee on Financial Services: Oxley, Baker to Introduce Corporate and Auditing Accountability, Responsibility, and Transparency Act.

- GST on in-kind transactions, and
- joint ventures.

As an example, I wish to discuss the last two points. The introduction of GST has highlighted a few “gray” areas in the business world – in-kind transactions and joint ventures. For an in-kind transaction, for example free use of research facility in exchange for the final research report, there is no accounting transaction but there exists a transaction for GST purposes depending on whether either or both of the parties to the transaction are registered for GST. However despite the introduction of GST from 1 July 2000, I am not aware of any Accounting Standard dealing with this matter.

Joint ventures are an interesting concept. Apart from the more usual large construction or mining joint ventures, many research undertakings are by way of joint ventures. Many of the research agreements between bodies like CSIRO or RIRDC and scientists are now formal GST joint ventures. However the broader definition to include “the sharing of profits” in the GST legislation has lead to many more joint ventures or partnerships.

Some managed investment schemes may be considered joint ventures for tax purposes because under the management agreement, each grower shares the pooled harvest. The Commissioner of Taxation has had great difficulty in this area. An examination of some of the recent Product Rulings highlights this difficulty. In some Rulings, the Commissioner has determined that although a joint venture agreement exists which limits liability, the Commissioner has determined that it is in fact a partnership for income purposes because each grower has a share of the pooled produce. A partnership under partnership law has joint and several liability which is specifically written out of the joint venture agreements. Furthermore, the expenses paid by each “partner” are considered a deduction in his/her own right as it is considered by the Commissioner that the grower is carrying on a business in his/her own right. The consequence of this incongruent treatment is that every time a “partner” dies or abandons his/her farm in the managed investment scheme, the partnership is dissolved and a new partnership is constituted. I would not like to guess at the possible number

of partnership registrations required for say 1,000 growers during a 15 year managed investment scheme.

The Ralph Report to government recommended a change in the method of calculating taxable income. There was general in principle support of the tax value method (TVM) by both the Commissioner of Taxation and the accounting profession. However with the release of “Option 2”, the accounting profession is now reconsidering its support as it appears the difficulties in measurement outweigh the benefits.

In the past few years, much attention has been given to the “whole of government” approach and the “one entry point” for new business. A more recent example of a co-ordinated approach was contained in the Commonwealth Budget. The government intends to simplify procedures for company registration by combining the ASIC’s company registration process with the Australian Business Number (ABN) application process managed by the ATO. The government believes this approach will reduce red tape and save businesses time and money by removing duplication.

Another area for improvement is in reporting requirements. Currently a listed company has to provide financial reports to ASIC, ATO and ASX. This is considered another example of bureaucratic duplication. With recent focus on whole of government, it would be more prudent to reduce the financial reporting to just one arm of government. To facilitate this requires a major redirection which is possible. Basically this redirection requires a merger of some parts of the ATO, ASIC and ASX into a new co-ordinated arm of government. The remaining areas of ASIC and ASX may also be integrated into the one body.

Already the ATO has separate and distinct business lines being:

- individuals and non-business,
- business, and
- large and international taxpayers.

The transition to a whole of government reporting simply requires the renaming of the last business line into “listed entities and groups”. The current Small Business line

would be split into “non-listed companies” and “other business (eg partnerships and sole traders)”.

ASIC again requires a split into segments being:

- listed entities and groups,
- non-listed companies, and
- others including bodies corporate and managed investment schemes.

ASX requires a split in function between:

- listed entities and group financial reporting and compliance, and
- other ASX functions.

The end result would be as follows:
ATO:

LE Business Line -	listed entities and group financial reporting and compliance
NLC Business Line -	non-listed company financial reporting and compliance
Other Business -	other business financial reporting and compliance

ASIC/ASX: (merged to become a new “Corporate Regulatory Board”) and include some areas currently under State administration to remove State anomalies and therefore permit national uniformity. Functions include but not limited to:

- Registration of company auditors, liquidators, Australian Financial Services Licence holders, authorized representatives and tax agents,
- Fund raising prospectuses and offer document vetting,
- Corporations Act & FSRA matters,
- Registration of schemes – MIS, strata title, timeshare, film, derivatives, etc
- Not for profit organizations – charities, etc
- Bodies corporate,
- Unincorporated associations,
- Stock exchange maintenance

Exchange of information between these sectors would be permitted within strict guidelines.

Currently a listed company could be subject to an income tax audit from the ATO, an audit from ASIC, and a show cause from ASX. As seen from the above, all reporting and compliance is performed in one area thus reducing uncoordinated exposure from government, reducing compliance costs and above all reducing duplication.

[As an aside, trusts have not been discussed here. I my view, a trust should be a company in all respects. The one exception is a deceased estate under administration.]

If the above is not adopted, then the current time frame for lodgment of financial reports should be streamlined. Currently, the ASX requires quarterly financial statements, whilst ASIC requires half yearly financial statements. With the introduction of GST, companies now lodge either a monthly or quarterly Business Activity Statement (BAS), together with an annual income tax return. If listed companies are currently lodging quarterly financials to the ASX, then why not impose the same requirement to lodge these financials with the ATO.

Furthermore with the wide use of computerized accounting packages, lodgment and publication of financial statements should be more timely. Many large companies operate in a "real time" environment providing instantaneous information and data exchange. Currently ASIC require lodgment of half yearly results within 75 days of the end of the half year period and within 3 months of the end of the financial year. Lodgment of the Annual Return to ASIC and the annual tax return to the ATO is required by 31 January each year for those entities which balance on 30 June. With increased use and performance of computers within the corporate and financial spheres, these lodgment dates could be drastically reduced except for audited financial statements. This last point will be explained later.

Regarding the Annual Report, too much emphasis is placed on this document. The Annual Report is a requirement placed on the company by ASIC to present to shareholders. However the document is prepared by accountants who have completed tertiary studies but read by many non-accountants ie persons who have no intimate knowledge and understanding of accounting concepts and principles. The document

by its very nature contains detailed "technical" data. The report is similar to giving 100 people a crystal radio instructions manual and ask each to understand it without any basic knowledge of electronics.

Further to the Annual Report, attention should be directed to meaningful information to investors. The Annual Report should provide the tool to compare oranges with oranges. To facilitate this, users of Annual Report need to be informed as to the industry the reporting entity is in. The use of ANZSI Codes for the main business of the reporting entity would assist users. Thus Annual Reports could be categorized into the broad ANZSIC divisions eg construction, manufacturing, wholesale trade, retail trade, banking and finance, services, etc. In that way, an investor (with adequate education) could compare 2 companies within the same ANZSIC division. Listed companies should include key ratios comparing their performance with that of the industry as a whole eg references to market leader or above average performance compared with the industry, could be disclosed. Key ratios for all listed companies should include the following:

- ratios to assess earnings capacity:
    - (i) gross profit ratio,
    - (ii) net profit ratio,
    - (iii) net profit to total equity,
    - (iv) net profit to total assets, and
    - (v) rate of stock turnover.
- ratios to assess financial stability:
    - (i) working capital ratio or current ratio,
    - (ii) quick asset ratio or liquid ratio,
    - (iii) debt ratio, and
    - (iv) equity ratio.

These last four ratios could assist the Directors to form the opinion that there are reasonable grounds to believe that the company will be able to pay its debts as and when they fall due.

A comment regarding educational qualifications and registration of auditors is needed.

A person appointed as a company auditor must be registered with ASIC. Once appointed as the company auditor for a particular company, then that appointment stands unless otherwise terminated in certain circumstances. However in recent times there has been more emphasis on a tendering process for an audit.

To become registered with ASIC as a company auditor, the applicant must be a member of a prescribed accounting body, hold educational qualifications in accounting or commerce for 3 years or 2 years respectively, have satisfactory practical experience, be capable of performing the duties of an auditor, and be a fit and proper person.

However the same educational qualifications may not be prescribed for a person occupying an audit position in a government department. With the revocation of the old regulation 33 (Public Service Act) qualifications barrier, it is possible for an income tax auditor employed by the ATO to posses no accounting or commerce qualifications. Many GST field staff do not have relevant accounting or commerce qualifications.

A similar position exists within ASIC. Investigators may possess either an accounting degree or a law degree. Thus if a document is examined by a law graduate, then it may be possible for that person not to understand the accounting ramifications when dealing with, for example, a forgiven debt.

Taking the notion of education one step further, attention must be directed towards educating those entering the auditing profession that ethics should never be compromised. The external auditor must not only be independent but also seen to be independent. If the external auditor feels that he/she may be seen to cross this independence line, then he/she should resign from the external audit position.

Another aspect, which impinges on the role and responsibility of the external auditor, is the identification of the appropriate contact person within the company. The suggestion being put forth is that the external auditor should report to a person who may be independent of the Board and not at Board level ie the chief financial officer.

I am very wary of this suggestion and I am not certain whether such a person can ethically exist. Surely as long as any person continues to be paid, then he/she is not independent. I suppose the ideal situation is for the external auditor to report to a committee comprising a mix of board members, non-executive directors, chief financial officer, and a number of unrelated shareholders not associated in any dealings with the company or any subsidiary. The number of shareholders must be greater than all other positions combined. The reason for this is that in fact the shareholders vote and agree on the appointment of the external auditor and thereafter have no contact with the external auditor. My proposal corrects that anomaly.

The last aspect which should be addressed is the matter of employment packages offered to senior executives. The problem is two fold. Firstly the extent of base salary to CEOs has ballooned to outrageous proportions. To curb this trend, the tax scales should impose an extra 10% loading for salaries in excess of $1M. The second part of the problem is the payment of bonuses based on performance. For the unscrupulous, an inflated performance level means a greater bonus, so why not use some creative accounting – overstate this, revalue that, a better bottom line and therefore a bigger bonus. As these people are in the driving seat and aware of a possible collapse, it is the same people who sell their shares and bonus shares just prior to the crash thus reaping maximum rewards before all other shareholders or before the dealing in shares is suspended. As outlined above, a quarterly lodgment of financial statements could highlight such activities earlier thus preventing the Board members from dumping their shares just prior to the collapse.

Corporate collapse of major public companies always makes the headlines. But these are usually the tip of the iceberg. Over the past 3 years in Australia, there have been over 26,000 companies that entered external administration. This represents about 2.2% (or 1 in 45 companies) of all registered companies.

A concerted effort must be made to reduce the incidence of corporate crashes. Whilst I recognise the fact that there will never be a year in which there may be no bankruptcies, the number, extent and impact can be limited.

SUMMARY and RECOMMENDATIONS

If the government is serious about the accountability surrounding corporate collapses, then appropriate action must be taken in this regard and taken now.

I am suggesting a number of changes to be made over the next 5 years. In addition I am suggesting a redirection in the sphere of external audits and external auditors. The present environment is not conducive to auditor accountability. Presently an unworkable situation exists. To put it crudely, external auditors are engaged to confirm the annual reports of the company. If there are any problems which result in a qualified statement by the external auditor, then it is highly unlikely that the auditor will be engaged next year. The position is similar to a convicted prisoner being a juror, or a thief being a shop assistant.

For the public to have confidence in the roles and responsibilities of external auditors a complete change in direction and attitude is required. The following points are listed in no particular order of preference.

- No auditor should ever be a member of any corporate audit committee.
- All persons in the government sector with a title of "auditor" or "audit manager" must possess relevant accounting or commerce tertiary qualifications.
- Persons employed as field staff in the GST business line of the ATO will conduct reviews (as opposed to audits).
- Prior to registration as a company auditor (external auditor) the applicant must have had a minimum of 2 years experience as an internal auditor.
- After a transition period of 5 years, all external auditors to come under the domain of an independent office titled "Corporate Audit Office." This office will consist of external auditors together with appropriate administration and support staff. External auditors will undertake audit work exclusively. These external auditors would sever all ties with their former employer. Copies of each auditor's report once submitted to the client would also be lodged with the Annual Report of the client with the ATO and the new Australian Regulatory Board. Michael Coleman could head this office and table a report to Parliament in similar fashion to that by the Auditor General.

- The new “Corporate Audit Office” (as proposed above) would self-fund after the first year of operation. Listed companies will engage external auditors from the Corporate Audit Office (CAO) under a contract for services. The contract will permit loading to cover administration, support costs and a flat fee per audit towards development of international accounting and auditing standards. The CAO will set a standard contract rate per day for audit work undertaken. The CAO will maintain a permanent file for each client, and all supporting documentation from audits will be kept for 5 years.
- Registered external auditors employed in the CAO would be free from liability and lawsuit regarding the Audit Report only. Civil action could be taken by the company against an external auditor for negligence and other breaches of professional conduct in addition to any action taken by the accounting body to which the auditor is a member.
- The external auditor must attend the client’s AGM and be prepared to answer questions from shareholders in addition to questions put on notice from the Board.
- The external auditor is to report to an audit committee comprising a mix of board members, non-executive directors, chief financial officer, and a number of unrelated competent shareholders not associated in any dealings with the company or any subsidiary. The number of shareholders must be greater than all other positions combined ie the majority rests with the shareholders.
- Integration of the functions of the ATO, ASIC and ASX to facilitate a single reporting and audit regime. The establishment of a redefined “Listed Entity” business line (replacing the existing LB&I business line) and enhanced SB business line within the ATO. The amalgamation of ASIC and ASX into a new “Corporate Regulatory Board” is strongly recommended in order to reduce duplication.
- A specific format to be developed for all Annual Reports incorporating key financial ratios and comparison with industry average ratios.
- Quarterly financial reporting solely to the ATO within a new lodgment period (less than the current 75 days). Annual Reports lodged with the ATO and the new Corporate Regulatory Board.

Financial reporting is a tangled web of many facets. It is the external auditor who has to check on the way in which the financial statements have been prepared and presented. This is an increasingly difficult task for the external auditor.

Although the Joint Committee is reviewing the aspect of independent auditing by registered company auditors, it should not be dealt with in isolation. Therefore I am willing to work under the auspice of the Independent Auditor – Mr Michael Coleman in the development of the aspects presented above.

Some of my suggestions appear radical but Australia must be proactive in ensuring external auditors can hold their heads up high.

By the very ethical nature of the auditing function, one should not need to be reminded about independence. Nothing should compromise this independence. The external auditor must not only be independent but seen to be independent. This must be at the forefront of every external auditor.

I look forward to appearing before the Joint Committee to further explain my approach.

John Hammond.