



13 April 2004  
4 Loddon Court  
Clayton South 3169

Dear Dr Dermody,

This supplementary submission is intended to deal with matters that were raised in the February 27 Bulletin of the Financial Reporting Council regarding the manner in which the FRC has moved to deal with the reconstitution of the domestic auditing standard setter. I am concerned the council is cutting corners and that Federal Treasury has ignored basic transparency – a typical abrogation of their responsibility to act in the public interest – in their haste to make decisions as to how the new structure ought to operate.

According to the FRC Bulletin detailing deliberations during their February 27 meeting, the council has tentatively agreed it would reappoint the existing Auditing & Assurance Standards Board for another 12 months. On the surface this would appear to have no real problems to those without a sophisticated understanding of the issue of independence and the attainment of confidence in the regulatory system. What the model currently being contemplated by the council creates is a situation where the community is not being sent a message that the new regime is anything but the rise of the old guard without even the notion that Treasury would call of expressions of interest in audit board membership.

One of the first and easiest matters to address is the independence of the chair. In the model that is the Australian Accounting Standards Board structure the chair – currently David Boymal – has no other affiliation nor any other job other than to be the chair of the accounting standards board. That is all he does and he cannot be accused of pursuing the agenda of another employer or a client because there is no such thing. The audit board that operates under the FRC once the legislation becomes effective should have the same opportunity. This means the Treasury should as a matter of urgency place an advertisement asking for an expression of interest from people that would be prepared to serve as an independent chair of the Auditing & Assurance Standards Board. That advertisement should specify the job description and have a fairly tight deadline by which applications should be submitted. A name or names to be placed before the Treasurer should be drawn from those applicants and a subsequent appointment made by that means.

It would be nonsensical to have a lower threshold of independence for the audit board – a body that is ostensibly set up the draft and promulgate sets of rules for a specific body of professionals. They regulate what these professionals do day to day therefore it is probably more critical that the head of this standard setter be an

independent person and not somebody that would serve on the board in that role as a practitioner. The community deserves a structure that prizes and gives greater emphasis to independence and that is important where auditing standards themselves are concerned.

The rest of the audit board should be rolled over for at least three months to buy the FRC time to get expressions of interest from people that are prepared to serve on the board in a part time capacity. A reconstituted board should be derived from the names that come forward with the clear objective of having good strong technical minds on the board as well as some lateral thinkers that sit outside the auditing fraternity. Having the appointment process take place in a more formal manner means that the community will see clearly that a board is being appointed in a transparent and open and public manner. This will do much to enhance community confidence in the system. Any final selection of the board should have at least some of the existing board members in order to preserve some semblance of continuity.

Another issue that can be brought up in this context is the need to ensure the board is seen to be doing its job in the public interest. It is in my view necessary to ensure the chair is independent of any major stakeholder in order to give the community that assurance. Standard setting is too important a task to end up being characterised as captured by four major accounting firms. Any new structure should ensure such a perception is discouraged by appointing as a first step an independent chair.

One of the concerns I have with the present state of play is that the appointment process and the manner of reconstituting the audit standard setter has been effectively played behind closed doors with Federal Treasury playing its usual games rather than the FRC taking the initiative and imposing an appointment process very early on to get a properly reconstituted board. One definition of the word 'reconstitute' is 'to build, to constitute again or differently' but it appears Treasury has forgotten the English language comes with the unfortunate baggage that these words actually mean something. For Federal Treasury to have involved itself in dealing with the issues in a very backroom manner without a proper public process is an absolute disgrace. I sincerely hope the US authorities wake up to this nonsensical, Keystone cop-style exercise and continue to impose their own regulatory investigations into Australia. That is the only thing that will make the bureaucrats sit up and take notice. US regulatory intervention should not be encouraged but it might be necessary if they are to take comfort in the way our companies deal with governance and independence issues if the independence of the structure is not assured. There is an increased focus in this country on the work of the Public Companies Accounting Oversight Board, which sets the auditing standards for the US profession. We should be aiming to win the confidence of the US regulators by emulating where possible their take on independent standard setting. A lesson may be learnt from the US Financial Accounting Standards Board, for example. It has seven members that serve in a full-time capacity and they are all independent. All they do is set standards. They do not work for any other master. This is similar to the model adopted by the International Accounting Standards Board. I mention these bodies so that you can factor them into your analysis of what might be a suitable model for standard setting in

this country generically as you reconsider the structure of standard setting at their key milestone in the development of the corporate law governing this area.

I am equally concerned with some of the political noises I am hearing from various players in the corporate community on the adoption of international financial reporting standards. The Group of 100 – a body that has historically funded international standard setting prior to the restructure of the IASB – has come out to oppose the recent decision of the Financial Reporting Council on the adoption of international financial reporting standards by January 2005. This seems odd to me coming from a group that has been quite active in the past both in arguing for the adoption of international accounting standards and also throwing dollars at that body in order to help it thrive. They are not known for providing funds to the Australian Accounting Standards Board and I am aware from background briefings with various individuals that no amount of pressure would have made them to put funds into the domestic process in a generic sense. Money was given by the Group of 100 through the Australian Stock Exchange for the international harmonisation project back over 1996-97. The fact funding was only forthcoming on the proviso accounting standards would be brought into line with the then available accounting literature issued by the old International Accounting Standards Committee is an indication of the political environment in which standard setters find themselves. I firmly believe the present objective should be to seek as speedy transition to international financial reporting standards. The corporate sector's opposition tends to be heavily daubed in self-interest and should not be taken seriously by any politician in receipt of letters lobbying them to propose motions of disallowance.

Our structure of legislating standards – auditing or accounting - should also be re-examined and parliamentary input should occur at an earlier stage in the process, which could be facilitated via a subcommittee of a larger parliamentary committee to deal with exposure drafts and other documents. We need as many voices as possible from this country engaged in the debate while it is still a live issue. Our present structure is inefficient and results in disallowance occurring at the end of a process that has already unfolded both internationally and domestically. We should consider adopting the Canadian model of legislating standards that effectively places the standards in the law as an entire package just by reference alone. I would argue this is an eminently more sensible way in which to deal with auditing standards, for example, rather than have a massive redrafting exercise that some people believe is necessary as a result of a wish to embed auditing standards in the law. It is in any case an issue that needs to be revisited as we look to incorporate is regarded as standard practice in accounting and auditing globally.

I look forward to meeting with you and other committee members on April 14. Feel free to call anytime if you wish to discuss this submission further.

Kind Regards

Tom Ravlic