

3. COMPANY AUDITING IN AUSTRALIA

301. This chapter provides an overview of the institutional arrangements for the registration and regulation of company auditors in Australia. The chapter also provides an outline of the types of auditing work that the Law and other legislation provides must be undertaken by RCAs.

REGISTRATION OF COMPANY AUDITORS

302. The rationale for registering company auditors is to ensure that there is, within the accounting profession, a group of readily identifiable people who have the experience and specialist skills needed for undertaking company audits. This, in turn, assists in maintaining public confidence in the capital markets.

303. The first Australian requirement for the registration of company auditors appeared in the Victorian Companies Act of 1896. During the early 1890s the standard of company auditing in Victoria was apparently of a poor standard, with allegations of auditors lacking appropriate qualifications, not being independent of the companies they were appointed to audit and failing to perform the duties of auditor in an appropriate manner. The then Victorian Attorney-General, Mr (later Sir) Isaac Isaacs, made the following observations about the standard of company auditing during the debate on the Bill that ultimately became the Companies Act 1896:

The system of auditing accounts of public companies at the present time, as honourable members know, is by no means satisfactory. Auditors are called in who are selected in the first instance, perhaps, not by reason of any particular competence they may possess, but because they are personal friends or, it may be, relatives of the directors or of the manager, whose accounts they have to overlook and certify to; and we have known instances in this colony where men of by no means unblemished character, but whose sole recommendation was their relationship to the directors or to the manager, have been called in to certify the correctness of the accounts...Honourable members will at once admit that auditors have been far too slovenly in their work in the past. I am not speaking of all auditors, of course, because we have notable exceptions to the general rule, but in many institutions the auditors have evidently thought that their chief duties

were fulfilled by a perfunctory examination of the books, and after all they merely certified that the accounts were correct according to the books...¹

304. The Act contained a number of provisions dealing with the audit of companies, including one for the establishment of a three-member Companies Auditors Board which had the power to licence persons to act as auditors of companies where the Board was satisfied with their general conduct and character and had the appropriate qualifications. The qualifications that were needed by a person to obtain a licence included:

- (a) holding a certificate of competency granted by the Municipal Auditors' Board pursuant to the Local Government Act;
- (b) membership of accounting bodies such as the Incorporated Institute of Accountants Victoria or the Australian Institute of Incorporated Accountants;
- (c) having, within five years before the commencement of the Act, practised in Victoria for at least three years as an auditor or accountant; or
- (d) having, upon examination, satisfied the Board that he had a thorough knowledge of accounts and auditing and the provisions of the Companies Act.

305. Subsequently, the other States (as the Colonies had become) followed the Victorian lead and introduced requirements for the registration of company auditors. Research suggests that Tasmania followed in 1920, South Australia in 1934, Queensland in 1942, Western Australia in 1943 and New South Wales in 1945.

306. The Working Party notes that the need for the Law to establish a mechanism for the regulation and supervision of company auditors in particular is largely a reflection of the fact that Australia does not have a legislative regime for the registration of all individuals who provide accountancy services to the public.² Although proposals for the enactment of such legislation have been put forward by the accounting profession from time to time, with the twin objectives of preventing unqualified persons from holding out to the public that they have accounting skills and to bring accountants into line with other professions such as legal practitioners, doctors and dentists, all of the proposals have ultimately lapsed.

307. The absence of a legislation-based regime for the registration of public accountants has created problems for many State and Territory Acts that impose audit

¹ Victorian Parliament (House of Assembly) Hansard, 11 June 1895, pp. 224-225.

² There were formerly Public Accountants Registration Boards in New South Wales and Queensland.

requirements. As one means of overcoming these problems, some State and Territory Acts provide that any audits required under these Acts must be undertaken by RCAs, notwithstanding the fact that the subject matter of the Acts may not directly relate to the administration of companies.

THE LEGISLATIVE FRAMEWORK

308. The legislative provisions dealing with the registration and regulation of company auditors are located in the following Parts or Divisions of the Law and the ASC Act:

- Division 1 of Part 3.7 of the Law, which deals with the appointment and removal of auditors and the independence of auditors;
- Part 9.2 of the Law, which sets out the pre-requisites for registration as an auditor, the supervisory requirements in respect of auditors and the cancellation or suspension of an auditor's registration by the CALDB; and
- Part 11 of the ASC Act, which deals with the establishment of the CALDB and the manner in which it conducts hearings.

309. In addition, some requirements are set out in regulations made for the purposes of the Parts and Divisions referred to in the last paragraph.

310. A detailed description of the provisions listed above is set out in the chapters dealing with the topics to which the provisions relate.

ROLES OF ASC AND CALDB

311. The registration of company auditors is the responsibility of the ASC, which performs the function in accordance with its enabling legislation, the Law and the Corporations Regulations (the Regulations). The Law provides that the ASC will not register a person as a company auditor unless it is satisfied that the person is a fit and proper person to be so registered and that the person has satisfied the minimum educational qualifications and attained the level of practical experience that are required for registration.

312. Individuals who have been registered as company auditors are subject to an ongoing obligation to advise the ASC of changes in details such as their name, their address and the name or style under which they practise. They are also required, once every three years, to lodge a statement updating the personal particulars contained in the application for registration and any previous statements and provide particulars of up to ten company audits conducted during the period covered by the statement.

313. RCAs are also subject to the ASC's ongoing auditors' surveillance program, which aims to ensure that they perform their duties in accordance with the Law, other statutory requirements, the general law and auditing standards.

314. Where an RCA fails to lodge a triennial statement, ceases to reside in Australia or, in the opinion of the ASC, is incompetent, negligent or otherwise not a fit and proper person to remain registered as a company auditor, the ASC may refer the matter to the CALDB for disciplinary action, including possible deregistration. A decision of the CALDB may be the subject of an appeal to the Administrative Appeals Tribunal (AAT).

ROLE OF ACCOUNTING BODIES

315. Australia's accounting bodies have developed comprehensive requirements for entry to membership, the supervision of members and, where necessary, the disciplining of members which apply to all members of the bodies, including those who are RCAs. As many of these requirements exceed the legislative requirements and ASC procedures for the registration and supervision of company auditors, the Working Party believes that an overview of the requirements of the accounting bodies will be of assistance to readers when they are considering the Working Party proposals set out in the following chapters. This overview is in Appendix B.

316. In addition, the ICAA and the ASCPA have had a significant influence in raising audit standards, particularly through their education and continuing education programs and the work of the Auditing Standards Board, which is jointly funded by those bodies.

NUMBER AND DISTRIBUTION OF RCAS

317. As at 2 April 1997, 8,404 RCAs were registered under the Law. The distribution of these auditors by State and Territory is set out in Table 3.1.

318. Table 3.1 also shows the distribution of Australian companies by State and Territory. It will be noted from the table that there is a close correlation between the number of companies in a jurisdiction and the number of RCAs in that jurisdiction.

Table 3.1: Number of Registered Company Auditors and the Number of Companies in each Jurisdiction

State or Territory	No. of RCAs as at 2/4/97	Percentage of total	No. of companies as at 22/5/97	Percentage of total
New South Wales	3,588	42.69	362,521	35.53

Victoria	2,186	26.01	307,860	30.18
Queensland	1,053	12.53	151,046	14.81
Western Australia	715	8.51	94,605	9.27
South Australia	504	6.00	64,210	6.29
Tasmania	175	2.08	13,292	1.30
Australian Capital Territory	87	1.04	19,885	1.95
Northern Territory	39	0.46	6,807	0.67
Location not identified or overseas	57	0.68		
Total	8,404	100.00	1,020,226	100.00

Source: Statistical data about number of RCAs compiled by The Treasury from the Register of Auditors. Statistical data about number of companies extracted from the ASC's ASCOT database.

319. An examination of the Register of Auditors indicates that a significant proportion of Australia's RCAs are based in State capital cities. Appendix C provides an overview of the distribution of RCAs within each State and Territory.

320. An analysis of the Register of Auditors that was undertaken by the ICAA and ASCPA in 1995 found that, of the 8,739 RCAs as at 30 November 1994, 1,722 were members of both the ICAA and ASCPA, 4,167 were members of only the ICAA and 2,315 were members of only the ASCPA. Of the other 535 RCAs, 259 were identified as being former members of either the ICAA or the ASCPA.³

³ The NIA has advised the Working Party that, as at 30 June 1996, 57 of its members were believed to be RCAs.

WORK UNDERTAKEN BY RCAs

321. Work undertaken by RCAs can be divided into the following categories:

- auditing company financial statements in accordance with the requirements of the Law;
- auditing the accounts of securities dealers and futures brokers in accordance with the requirements of the Law; and
- auditing financial statements and other accounts in accordance with the requirements of other Commonwealth, State and Territory Acts.

Company Financial Statements⁴

322. All disclosing entities, public companies and large proprietary companies⁵ are required by the Law to have their annual financial statements audited. In addition, a disclosing entity is required to have its half-year financial statements either audited or reviewed.

323. A small proprietary company does not have to have its accounts audited unless:

- (a) it is a disclosing entity;
- (b) it is controlled by a foreign company and its financial results are not included in any consolidated accounts of the foreign company lodged with the ASC;⁶ or

⁴ The legislative requirements outlined under this heading reflect the Law as amended by the First Simplification Act, which came into operation on 9 December 1995.

⁵ The Law provides that a proprietary company is a large proprietary company if it satisfies at least two of the following tests:

- (a) consolidated gross operating revenue for the financial year is \$10 million or more;
- (b) the value of the consolidated gross assets at the end of the financial year is \$5 million or more;
- (c) the company and any entities it controls have 50 or more employees at the end of the financial year.

⁶ Under section 283B of the Law, a small proprietary company does not need to prepare or lodge accounts or have them audited if a foreign parent company lodges accounts covering the small proprietary company's financial results. In January 1996 the ASC granted Class Order relief (96/82) which provided relief from preparation, lodgment and audit of accounts if a small proprietary company's financial results were covered by consolidated accounts lodged by the immediate Australian parent. This order was replaced on 24 April 1997 when Class Order 97/0566 was executed (the replacement order clarifying the periods for which the financial results of the

- (c) it is required by 5 per cent or more of shareholders or the ASC to prepare audited financial statements.

324. Notwithstanding the basic requirement that a large proprietary company must have its financial statements audited, section 313 of the Law permits the ASC to relieve a large proprietary company of the obligation to have its financial statements audited where such an audit would impose an unreasonable burden on the company. In considering whether it should grant such relief, the Commission is required to have regard to a number of issues including:

- (a) the expected costs of complying with the audit requirements;
- (b) the expected benefits of having the company or companies comply with the audit requirements; and
- (c) any practical difficulties that the company or companies face in complying with the audit requirements (for example, in the first year to which the audit requirements apply to the company or where the company or companies are likely to move frequently between the large and small proprietary company categories).

325. In assessing the expected benefits, the ASC is required to take account of the number of creditors and potential creditors, the ability of the creditors to independently obtain financial information about the company or companies, and the nature and extent of the liabilities of the company or companies.

326. Information provided to the Working Party by the ASC suggests that approximately 25,000⁷ public and proprietary companies are currently required to have their financial statements audited. However, the Working Party believes that many small proprietary companies may also choose to appoint an auditor.

company must be covered by consolidated accounts of a parent company), together with two other orders relating to small proprietary companies which are controlled by foreign companies:

- (a) 97/0565 which provides relief from the requirement for such a company to prepare and lodge accounts and to have them audited where the company is not part of a large group (ie the company, its siblings formed or operating in Australia, and their controlled entities are small when the section 45A test is applied to them on a combined basis);
- (b) 97/0567 which provides relief from the requirement to have audited accounts on a similar basis to the relief previously provided to large proprietary companies pursuant to Class Order 96/1850.

⁷ The estimate of 25,000 companies has been derived as follows: 18,000 public companies and 7,000 proprietary companies. By way of comparison, it has been estimated that as at 30 June 1994, prior to the introduction of the large/small test for determining the reporting and audit obligations of proprietary companies, 60,000 companies had auditors. This figure was derived as follows: 17,000 public companies, 23,000 non-exempt proprietary companies and 20,000 exempt proprietary companies.

327. As a result of the amendments made to the Law by the First Simplification Act, the provision that formerly allowed an exempt proprietary company to appoint as its auditor a person who is an officer of the company, or a partner, employer or employee of such an officer, now applies to all proprietary companies.⁸

Accounts of Dealers and Brokers

328. All bodies corporate and natural persons holding either a securities dealer's licence or a futures broker's licence must, within one month of obtaining the licence, appoint an RCA to audit the accounts that they are required to prepare in accordance with sections 860 (securities dealers) and 1218 (futures brokers) of the Law.

329. As at 30 June 1996, 1,508 securities dealers licences and 87 futures brokers licences were on issue.⁹

Other Audits

330. As noted earlier, there are a number of other Commonwealth, State and Territory Acts that require RCAs to audit financial statements or other accounts. These Acts, and the audit requirements that they impose, include:

- (a) auditing the accounts of life insurance companies in accordance with section 83 of the *Life Insurance Act 1995*;
- (b) auditing the accounts of general insurance companies in accordance with section 47 of the *Insurance Act 1973*;
- (c) auditing the accounts of regulated superannuation funds with more than four members in accordance with section 113 of the *Superannuation Industry (Supervision) Act 1993*;
- (d) auditing the accounts of financial institutions in accordance with the requirements of State and Territory Financial Institutions Codes;
- (e) auditing the accounts of incorporated associations in accordance with the requirements of State and Territory Associations Incorporation Acts; and

⁸ As a result of concerns raised with the Parliamentary Joint Committee on Corporations and Securities by the ICAA and the ASCPA, the Committee indicated in its report that it expects the problem 'will be addressed by the audit...working party' ('Report on the First Corporate Law Simplification Bill 1994', March 1995, paragraph 2.68). As explained in chapter 9 of this report, the Working Party does not support the amendment made by the First Simplification Act.

⁹ Source: ASC 1995-96 Annual Report.

(f) auditing accounts and trust accounts under other Commonwealth, State and Territory Acts, for example the *National Health Act 1953* (Commonwealth); *Fire Brigades Act 1989* (New South Wales); *Co-operative Industrial Societies Act 1928* (Tasmania); and the *Dairy Industry Act 1984* (Victoria).

331. Although the Working Party does not have a mandate to review the requirements of these Acts, chapter 10 briefly considers the consequences of this review for other Commonwealth, State and Territory Acts that require audits to be undertaken by RCAs.