

# **Review of Requirements for the Registration and Regulation of Company Auditors**

**Report of a Working Party of the  
Ministerial Council for Corporations**

**July 1997**

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## ABBREVIATIONS

|        |  |
|--------|--|
| AARF   | Australian Accounting Research Foundation                  |
| AAC    | Authorised audit company                                   |
| AAT    | Administrative Appeals Tribunal                            |
| AGM    | Annual general meeting                                     |
| AICD   | Australian Institute of Company Directors                  |
| AICPA  | American Institute of Certified Public Accountants         |
| ARB    | Auditors Registration Board                                |
| ASC    | Australian Securities Commission                           |
| ASCPA  | Australian Society of Certified Practising Accountants     |
| ASX    | Australian Stock Exchange                                  |
| ATMA   | Association of Taxation and Management Accountants         |
| AUP 32 | Statement of Auditing Practice AUP 32 – Audit Independence |
| AuSB   | Auditing Standards Board                                   |
| CALDB  | Companies Auditors and Liquidators Disciplinary Board      |
| CPA    | Certified Practising Accountant                            |
| FRRB   | Financial Reporting Review Board                           |
| ICAA   | The Institute of Chartered Accountants in Australia        |
| ICANZ  | Institute of Chartered Accountants of New Zealand          |
| ICAO   | Institute of Chartered Accountants in Ontario              |
| MINCO  | Ministerial Council for Corporations                       |
| MOU    | Memorandum of Understanding                                |
| NCSC   | National Companies and Securities Commission               |
| NIA    | National Institute of Accountants                          |
| NZSA   | New Zealand Society of Accountants                         |
| PY     | Professional Year  |
| RCA    | Registered company auditor                                 |
| RQB    | Recognised qualifying bodies                               |
| RSB    | Recognised supervisory bodies                              |
| SCAG   | Standing Committee of Attorneys-General                    |
| SEC    | Securities and Exchange Commission                         |
| UIG    | Urgent Issues Group  |

## GLOSSARY OF SELECTED TERMS

|                            |   |
|----------------------------|---|
| authorised accounting body | is an accounting body that meets the criteria listed in recommendation 4.2 and which registers and supervises company auditors under a delegation from the Australian Securities Commission |
| accounting profession      | includes individuals with accounting qualifications who hold themselves out as providing public accounting services, whether or not they are members of an accounting body                  |
| registering body           | the organisation or organisations responsible for the registration and supervision of company auditors  |

# 1. INTRODUCTION

101. During 1993, the Ministerial Council for Corporations (MINCO) decided that the present regulation of company auditors should be reviewed with a view to ensuring that an appropriate legal framework is in place for the registration, appointment, supervision and disciplining of company auditors in relation to their functions under the Corporations Law (the Law) and to ensure their independence.

102. MINCO also decided that the review should be convened by the Commonwealth Attorney-General's Department<sup>1</sup> with other members of the review team to include senior representatives from the Australian Securities Commission (ASC), the accounting profession and the States and Territories.

## MEMBERSHIP OF WORKING PARTY

103. The members of the Working Party established to undertake the review are:

- (a) Bob Grice, Partner, KPMG, Brisbane, representing The Institute of Chartered Accountants in Australia (ICAA);
- (b) Veronique Ingram, Assistant Secretary, Companies and Accounting Policy Branch, Department of the Treasury<sup>2</sup>;
- (c) Brian McPhail, Director, McPhail & Partners Services Pty Ltd, Melbourne, representing the Australian Society of Certified Practising Accountants (ASCPA)<sup>3</sup>;
- (d) Ken MacPherson, Auditor-General of South Australia (representing the States and Territories); and

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<sup>1</sup> Following the 1996 Federal Election, Ministerial responsibility for the Corporations Law was transferred from the Attorney-General to the Treasurer. As a result, the Department of the Treasury has now assumed responsibility for convening the Working Party.

<sup>2</sup> Prior to Ms Ingram's appointment to the Working Party, the Commonwealth Government was represented by Ian Govey, Principal Adviser, Business Law Division, Attorney-General's Department (August-October 1994), and Brian O'Callaghan, formerly Assistant Secretary, Companies and Accounting Branch, Attorney-General's Department (November 1994-May 1995).

<sup>3</sup> Prior to Mr McPhail's appointment to the Working Party in November 1995, the ASCPA was represented by the late Peter Edwards AM, Partner, Edwards Marshall & Co, Adelaide.

- (e) Bill Robinson, Member, ASC<sup>4</sup>.

104. The Working Party would like to take this opportunity to acknowledge the significant contribution to the work of the review made by Peter Edwards, who was a member of the Working Party prior to his death in September 1995. Mr Edwards was especially conscious of the aspirations and concerns of accounting practitioners in small and medium sized firms and his contribution to Working Party discussions did much to crystallise thinking on what could and/or should be done to assist such practitioners.

105. The Working Party would also like to acknowledge the work provided by Les Pascoe in the drafting of this report.

## **TERMS OF REFERENCE**

106. The terms of reference for the review are to:

- (a) examine the current system of registration, appointment and supervision (including disciplining) of auditors under the Law;
- (b) consider whether this system is adequate or needs to be revised or replaced;
- (c) consider the appropriate role of the relevant professional bodies and the ASC in the current system, having regard to overseas experience; and
- (d) prepare a report to MINCO including any recommendations for reform.

## **CONSULTATION**

107. The then Attorney-General requested the Working Party to consult widely with interested parties and organisations during the course of the review.

108. The Working Party decided to undertake this consultative process in three phases. In the first phase, it placed notices in the *Australian Financial Review* and the journals of the ICAA and ASCPA seeking comments on the issues to be addressed. The Working Party also wrote to government departments and agencies and selected

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<sup>4</sup> Stuart Grant, the ASC's Executive Director — Accounting Practice, advised Mr Robinson on technical matters and assisted the Working Party with the finalisation of the report.

accounting firms<sup>5</sup> seeking comments. In addition, discussions were held with representatives of peak business and professional organisations.

109. In the second phase, the Working Party circulated a discussion paper, which outlined the options that are available for reforming the requirements for the registration and regulation of company auditors, to selected groups, including peak business and professional organisations, government agencies and the larger accounting firms.

110. The third and final phase of the consultative process involved the release of the Working Party's draft report for public comment.

111. A list of the organisations and individuals who made submissions to the Working Party during the three phases of the consultative process is at Appendix A.

112. While the Working Party found the overall consultative process of significant benefit in developing and refining its proposals for reforming the legislative requirements and institutional arrangements for the registration and regulation of company auditors, the Working Party was, nevertheless, disappointed with the low number of submissions received from those most directly affected by the review — existing and potential registered company auditors (RCAs) and corporations that are users of auditing services.

## **BACKGROUND TO THE REVIEW**

113. In July 1992, MINCO established a Working Party of MINCO officers (the MINCO Working Party) to prepare a report concerning professional liability in respect of claims arising from the Law or under related common law remedies. The decision to establish the MINCO Working Party was made against the background of proposals in some jurisdictions to introduce legislation limiting professional liability by providing a maximum cap on such liability. The mandate of the MINCO Working Party was to examine the position in comparable jurisdictions overseas, to take into account the views of interested parties, and to outline any alternative options to a capping scheme of limitation of liability identified as a result of the examination of the position in overseas jurisdictions and the views of interested parties.

114. The MINCO Working Party presented its report to MINCO in June 1993.<sup>6</sup> The report concluded that, of those professionals who might be subject to claims under the

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<sup>5</sup> The six largest accounting firms, plus four or five small/medium firms in each State and Territory, were targeted by the Working Party in the first phase of the consultative process.

<sup>6</sup> Working Party of the Ministerial Council for Corporations, 'Professional liability in relation to Corporations Law matters', 1993.

Law, only accountants (primarily auditors) and directors face a significant level of liability specifically related to actions or functions under the Law. The major alternative option to capping of liability identified in the report was to permit auditors, operating through a company, to be registered as company auditors under the Law.

## **Regulation of Company Auditors**

115. The 1993 report of the MINCO Working Party also recommended that a review should be undertaken of the present regulation of company auditors with a view to ensuring that an appropriate legal framework is in place for the supervision, independence and disciplining of company auditors in relation to their functions under the Law.

116. The rationale for this recommendation was that a solution to the problems associated with professional liability should be accompanied by reasonable assurance that:

- (a) institutional arrangements in place ensure that only adequately qualified and experienced accountants are registered as company auditors; and
- (b) auditors are genuinely independent of the companies that they audit.

117. MINCO endorsed the recommendation that there should be a review of the regulation of company auditors and the Audit Review Working Party was established in the second half of 1994 to undertake the review.

## **Joint and Several and Proportionate Liability**

118. The MINCO Working Party's report further recommended that 'the arbitrary and unfair consequences of the present rules regarding joint and several liability of auditors should be addressed in a review of the law which takes into account the implications of changes in these rules beyond their impact on Corporations Law matters'.

119. An inquiry into the law of joint and several liability was subsequently established by the then Commonwealth and New South Wales Attorneys-General in February 1994. The inquiry was conducted by Professor Jim Davis from the Australian National University. It concluded with a report released in January 1995 recommending that joint and several liability of defendants in actions for negligence causing property damage or purely economic loss be replaced by liability which is proportionate to each defendant's degree of fault.

120. The report also noted that because of the similarities between professional liability for negligence and liability under section 52 of the *Trade Practices Act*

1974 (Cth) and section 995 of the Law, it would be anomalous if, in the case of multiple wrongdoers, any one of them should be exposed to different liability depending upon whether an action is brought under the common law or one of the statutory provisions. The report therefore also recommended that liability for loss arising from misleading conduct in contravention of the Trade Practices Act, the State and Territory Fair Trading Acts<sup>7</sup> or the Law be proportionate to each defendant's degree of responsibility for that loss.

121. Draft model provisions designed to implement the report's recommendations were released on 14 July 1996 by the New South Wales Attorney-General and Minister for Industrial Relations, Mr Shaw, and the former Parliamentary Secretary to the Treasurer, Senator the Hon. Brian Gibson AM, for public exposure for a period of three months. If adopted, the draft model provisions would amend the common law, State and Territory fair trading legislation, the Trade Practices Act and the Corporations Law. The draft legislation was prepared with the agreement of the Standing Committee of Attorneys-General (SCAG) on the basis that it did not involve any jurisdiction committing itself to the conclusions in the Davis report.

### **Other Significant Issues**

122. Since the commencement of the National Corporations Scheme in 1991, a number of concerns have been raised about various aspects of the regulation of company auditors. These issues have been addressed by the Working Party during the course of this review.

123. The most frequent complaint has concerned the difficulty that prospective company auditors, who are either resident in provincial centres or members of small firms, are having in meeting the Law's requirements on practical experience in auditing. This issue is considered in detail in chapter 5.

124. Another issue concerns the supervision of RCAs. The Working Party notes the lack of a legislative requirement for the maintenance of technical skills by such auditors. The Working Party also notes the view expressed in some submissions that the main post-registration reporting requirement contained in the Law, the triennial statement, serves little useful purpose in its present form. These matters are examined in chapter 6.

125. Ensuring the independence of auditors from company management is another issue that is being raised more and more frequently in representations to the Government. While these representations do not necessarily mean that company

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<sup>7</sup> *Fair Trading Act 1992 (ACT), Fair Trading Act 1987 (NSW), Consumer Affairs and Fair Trading Act 1990 (NT), Fair Trading Act 1989 (Qld), Fair Trading Act 1987 (SA), Fair Trading Act 1990 (Tas), Fair Trading Act 1985 (Vic) and Fair Trading Act 1987 (WA).*

auditors lack independence, it may, at best, indicate that some company auditors perform their functions in a manner that gives the perception that they lack independence. This question is examined in chapter 7.

126. A further area of complaint has been the operation of the Companies Auditors and Liquidators Disciplinary Board (CALDB). Complaints have included that the Board is too legalistic; that the costs of both presenting and defending cases are too high; that the range of penalties that may be imposed by the Board are inadequate and that too much of the Board's time is spent dealing with minor administrative matters. These concerns are addressed in chapter 8.

## **UNDERTAKING THE REVIEW**

127. In undertaking this review, and in preparing this report, the Working Party has been conscious of the highly skilled and significant responsibilities of auditors.

128. The independent external audit is a fundamental element of the world's capital market system. A report of the Public Oversight Board of the SEC<sup>8</sup> Practice Section, American Institute of Certified Public Accountants (AICPA),<sup>9</sup> sums it up in this way:

The independent audit fills an essential role for the investing public and creditors by enhancing the reliability of an operation's published financial statements and giving assurance of that reliability to users of those financial statements...

Strengthening the professionalism of the auditor requires an environment in which boards of directors and management of client companies have high expectations about the auditing firm's integrity, objectivity and professional expertise in which the auditor, in meeting these obligations recognises an overriding public responsibility...

**[Accounting] firms need to emphasise to all professional staff...that auditing is not just one of the many services offered to clients. It is special. It involves a 'public responsibility...'**

Auditing is different from other services the accounting firms render. It imposes special and higher responsibilities...

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<sup>8</sup> Securities and Exchange Commission (USA).

<sup>9</sup> Advisory Panel on Auditor Independence, 'Strengthening the professionalism of the independent auditor — Report to the Public Oversight Board of the SEC Practice Section, AICPA', Public Oversight Board, Stamford, 1994.

129. The Working Party considered the following key issues during the course of its deliberations:

- (a) Who should perform the registration and supervisory functions?
- (b) What should be the appropriate pre-requisites for registration?
- (c) What form should post registration supervision take?
- (d) How should the appointment of company auditors be undertaken and their subsequent independence be ensured?
- (e) What are the appropriate procedures for the removal of a company auditor?
- (f) Who should undertake the disciplinary function and what should be the disciplinary body's functions and powers?
- (g) The resource implications of the Working Party's preferred approach to performing the registration and supervisory functions and undertaking the disciplinary function.

130. Prior to formulating the recommendations set out in this report, the Working Party, as noted above, consulted extensively with parties having an interest in the outcome of the review.

131 In formulating its recommendations, the Working Party also had regard to developments within the accounting profession since 1981, when the forerunner of the existing legislative provisions was introduced. In addition, the Working Party noted the recommendations contained in the research study on bridging the expectation gap and the action taken by the ICAA and the ASCPA in respect of those recommendations.<sup>10</sup>

132. Wherever appropriate the Working Party has endeavoured to ensure that safeguards are built into the recommendations it has made. For example, the proposal to delegate the registration and supervision functions to authorised accounting bodies by way of an MOU will allow the ASC to review and, if necessary, resume control of these functions in the event of inadequate performance by those bodies.

133. The Working Party believes that, with the safeguards built into its recommendations, the proposed self regulatory approach will provide significant

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<sup>10</sup> For further information about these recommendations, see: ICAA and ASCPA, 'A research study on financial reporting and auditing — bridging the expectation gap', 1994; and ICAA and ASCPA, 'Beyond the gap', 1996.

benefits including allowing the authorised accounting bodies to perform the registration and regulation functions with optimum efficiency and in an environment which will allow continuing advances in standards to be made.

134. It is important to note that the work and recommendations of this Working Party constitute only one element in the process of strengthening the role of the external auditor. The work of other bodies and organisations, such as the Auditing Standards Board (AuSB), the accounting bodies, the Australian Stock Exchange (ASX), the ASC and the Australian Institute of Company Directors (AICD) all continue to play a part in the overall objective of strengthening the role of the independent external auditor.

## 2. SUMMARY OF ISSUES, CONCLUSIONS AND RECOMMENDATIONS

201. This chapter provides a summary of the issues considered by the Working Party during the course of the review and the Working Party's recommendations for dealing with those issues.

202. The Working Party divided the review into the following components:

- Who should perform the registration and supervisory functions?
- What should be the appropriate pre-requisites for registration?
- What form should post registration supervision take?
- How should the appointment of company auditors be undertaken and their subsequent independence be ensured?
- What are the appropriate procedures for the removal of a company auditor?
- Who should undertake the disciplinary function and what should be the disciplinary body's functions and powers?
- The resource implications of the Working Party's preferred approach to performing the registration and supervisory functions and undertaking the disciplinary function.

203. In considering these matters, the Working Party has had regard to the problems of the 1980s and has carefully considered the views of some respondents seeking greater and more stringent regulatory controls in respect of the appointment and supervision of company auditors. The Working Party has also had regard to significant developments since the 1980s, including initiatives by the ICAA, the ASCPA, the National Institute of Accountants (NIA), the Australian Stock Exchange (ASX) and the Australian Institute of Company Directors (AICD).

204. Wherever appropriate the Working Party has endeavoured to ensure that safeguards are built into the recommendations it has made.

## **PERFORMING THE REGISTRATION AND SUPERVISORY FUNCTIONS**

205. Four viable options for performing the registration and supervisory functions have been identified by the Working Party:

- having the ASC continue to perform the registration function with supervisory functions continuing to be performed by both the ASC and, in the case of RCAs who are members of accounting bodies, the accounting bodies;
- having the ASC delegate the registration function and its component of the supervisory function to authorised accounting bodies;
- having the Law confer responsibility for the registration and supervisory functions on authorised accounting bodies; or
- establishing a new Auditors Practice Board to perform the functions.

206. While each of these options has its advantages and disadvantages, the Working Party came to the view that the option giving authorised accounting bodies responsibility for the regulation and supervision of company auditors under delegation from the ASC is to be preferred.

207. The Working Party therefore makes the following recommendations concerning the performance of the registration and supervisory functions:

- The *Australian Securities Commission Act 1989* (the ASC Act) and the Law should be amended to authorise the ASC to delegate responsibility for the registration and supervision of company auditors to one or more Australian accounting bodies that satisfy specified conditions. **Recommendation 4.1.**
- 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. **Recommendation 4.2.**
- A decision of an authorised accounting body made during the course of performing a delegated function may be the subject of an appeal to the ASC. The decision taken by the ASC may, in turn, be the subject of an appeal to the AAT. **Recommendation 4.3.**
  - The ASC may set such additional conditions in a Memorandum of Understanding (MOU) as it considers are necessary to enable it to ensure that the delegated functions are performed in accordance with the requirements of the Law and in an effective and efficient manner. **Recommendation 4.4.**
  - The ASC may only delegate responsibility for the registration and supervision of company auditors to an accounting body when written agreement has been reached with that body on the conditions set down in the Law and any additional conditions that may be imposed by the ASC. **Recommendation 4.5.**
  - Where an authorised accounting body fails to comply with any of the conditions set out in either the Law or the MOU, the ASC may revoke the delegation. **Recommendation 4.6.**
  - Notwithstanding the delegation of registration and supervisory functions to one or more authorised accounting bodies, the ASC may continue to perform registration and supervisory functions in circumstances in which it would be unreasonable to expect a person to apply to an authorised accounting body for registration (for example, where the person has a conscientious objection, based on religious grounds, to the membership of a professional organisation). The registration of such a person should be subject to rules and conditions that are adopted by the ASC and which are equivalent to those imposed by an authorised accounting body. **Recommendation 4.7.**
  - Particulars of all RCAs are to be entered in a single Register of Auditors which is to be maintained in a manner and at a place approved by the ASC. **Recommendation 4.8.**
  - Subject to appropriate safeguards concerning the protection of information from unauthorised use or disclosure, section 127 of the ASC Act should be amended to allow the ASC to provide information to:

- (a) authorised accounting bodies concerning individuals who are members of one or more of the bodies;
  - (b) authorised accounting bodies about non-members who are RCAs or who are known to be making application for registration as an RCA.
- Recommendation 4.9.**

## **PRE-REQUISITES FOR REGISTRATION**

208. The Working Party considered three issues concerning the requirements for registration:

- educational qualifications;
- professional qualifications; and
- the appropriate level of practical experience in auditing.

### **Educational Qualifications**

209. The Working Party makes the following recommendations concerning the educational qualifications needed for registration as a company auditor:

- The existing educational pre-requisites for registration as a company auditor (ie tertiary qualifications in accountancy and commercial law) are considered to be adequate, subject to the introduction of an additional requirement that all applicants have completed a specialist course equivalent to the auditing module currently provided by the ICAA's Professional Year (PY) Program or the ASCPA's Certified Practising Accountant (CPA) Program.  
**Recommendation 5.1.**
- Relief from the requirement to undertake the course of study referred to in recommendation 5.1 should be granted to an applicant who holds suitable overseas qualifications or who can demonstrate to the registering body that he or she has qualifications that are equivalent to the auditing module.  
**Recommendation 5.2.**

### **Professional Qualifications**

210. A number of submissions received by the Working Party proposed that membership of an accounting body should be a pre-requisite for registration as a company auditor. However, the Working Party concluded that such a requirement

could be anti-competitive and thus contrary to the requirements of the *Trade Practices Act 1974*. Nevertheless, the Working Party has some sympathy with the view that individuals who are not members of an accounting body that is an authorised accounting body should agree to abide by the code of ethics and other rules of the authorised accounting body to which they submitted their application for registration.

211. The Working Party therefore recommends that:

- Where a person who is not a member of an accounting body that is an authorised accounting body seeks registration as a company auditor, he or she must agree to abide by the code of ethics and other rules of the authorised accounting body to which they submitted their application on the same basis as members of that body. **Recommendation 5.3.**

### **Practical Experience**

212. The question of what should be the appropriate level of practical experience for registration as a company auditor was one of the more difficult issues to confront the Working Party during the course of the review.

213. The Working Party has concluded that competency standards should ultimately be adopted as the principal basis for determining whether a person has sufficient practical experience in company auditing and auditing techniques to be registered as a company auditor. In coming to this decision, the Working Party notes that the adoption of competency standards will add a qualitative element which is currently missing from the existing requirements, will further the move towards a self-regulatory approach along the lines advocated elsewhere in this report, and will meet the concerns of accountants in smaller and provincial firms in that it will facilitate the registration of individuals who are proficient in auditing work but who cannot satisfy the existing practical experience requirements.

214. The Working Party has also concluded that an hours-based regime should continue to be used pending the introduction of competency standards by authorised accounting bodies.

215. The Working Party makes the following recommendations about the level of practical experience needed for registration as an auditor:

- Where an authorised accounting body has in place a competency standard in auditing that has been approved by the ASC, an applicant must satisfy the audit component of the competency standard in order to be registered. **Recommendation 5.4.**

- The ASC must be satisfied about the appropriateness and workability of the audit component of an authorised accounting body's competency standard before that standard may be approved for use by the authorised accounting body as a basis for deciding whether an applicant meets the practical experience requirements for registration as a company auditor. **Recommendation 5.5.**
- Where an authorised accounting body does not have an approved competency standard in auditing the level of practical experience required for registration as a company auditor should be:
  - (a) at least 2,000 hours work in auditing over five years under the supervision of an RCA; and
  - (b) a minimum of 500 hours of this time should be spent on work that involves a senior level of responsibility for audits. **Recommendation 5.6.**
- Subsection 324(12) of the Law, which provides that the ASC may appoint a suitably qualified or experienced person as auditor of a proprietary company where it is impractical for the company to obtain the services of an RCA because of the location where it carries on business, should be retained. **Recommendation 5.7.**

## **Re-registration**

216. The Working Party also concluded that there should be a different process for re-registration, and makes the following recommendations concerning the implementation of revised procedures:

- There should be simplified criteria for re-registration as a company auditor where the applicant had voluntarily relinquished his or her original registration. **Recommendation 5.8.**
- An applicant for re-registration as a company auditor must meet the following conditions:
  - (a) the applicant voluntarily relinquished his or her original registration;

- (b) the applicant was not subject to disciplinary proceedings in respect of an auditing-related matter following the relinquishment of the original registration or that the voluntary relinquishment did not occur in order to avoid disciplinary proceedings; and
- (c) the relinquishment of the original registration was not more than five years before the date of the application for re-registration.

**Recommendation 5.9.**

## **POST-REGISTRATION SUPERVISION**

217. Issues considered by the Working Party in the context of post-registration supervision of RCAs include:

- the adequacy of the existing requirements for reporting to the ASC;
- the need for RCAs to undertake continuing education; and
- whether RCAs should be required to undertake a minimum level of audit work in order to maintain their registration.

### **Annual Statement**

218. Although the triennial statement that each RCA has to lodge with the ASC is intended to allow the ASC to monitor the RCA's audit activities, the Working Party noted that there are widely held views that the statement fails to achieve this objective. Perceived deficiencies of the statement include that it does not provide up to date information for surveillance purposes, that it requires the disclosure of information that has already been provided to the ASC, and that the particulars of audits conducted during the period give no indication of the size or complexity of those audits.

219. After considering options of either abolishing the statement or requiring a statement containing revised information to be lodged annually, the Working Party concluded that the latter option was to be preferred.

220. The Working Party therefore makes the following recommendations concerning the reporting requirements of RCAs:

- The existing triennial statement should be replaced by a new annual statement.

**Recommendation 6.1.**

- The new annual statement should provide information about:
  - (a) an RCA's personal particulars;
  - (b) details of the nature and complexity of major audit work undertaken, including the aggregate hours, showing separately the work in respect of companies and other entities; and
  - (c) professional development undertaken by the RCA during the year. **Recommendation 6.2.**
  
- If the registration and supervision of RCAs is undertaken by authorised accounting bodies, the annual statement should be combined with the authorised accounting bodies' membership renewal forms. **Recommendation 6.3.**

## **Professional Development**

221. The Working Party considers that RCAs should be required to undertake a minimum amount of professional development, with the amount to be prescribed being similar to that required of ICAA and ASCPA members who hold public practice certificates.

222. Accordingly, it recommends that:

- RCAs should be required to undertake a minimum amount of professional development, calculated on either an annual or triennial basis, and their annual statement should include particulars about the audit content of that professional development. **Recommendation 6.4.**
  
- Failure to comply with a requirement to undertake a minimum amount of profession development should be grounds for disciplinary action against the RCA. **Recommendation 6.5.**

## **Practical Experience**

223. The Working Party recommends that:

- RCAs should not be required to undertake a specified level of audit work in any one year, but should be required to maintain their competence in audit work. Where an RCA has not undertaken any substantive audit work during a period of not less than five years or has failed to maintain competency in audit work, the supervisory body may require the RCA to show cause why his or her registration should not be cancelled. **Recommendation 6.6.**

## Quality Review

224. The Working Party recommends that:

- The work of all RCAs should be subject to periodic quality reviews conducted by authorised accounting bodies. **Recommendation 6.7.**
- Subject to privacy considerations, the Law should provide that all files in respect of audits that have been undertaken by an RCA must be available for inspection as part of a quality review. **Recommendation 6.8.**

## APPOINTMENT AND INDEPENDENCE OF AUDITORS

225. The Working Party identified the procedures for appointment of auditors by companies and measures to ensure the independence of auditors as important issues that needed consideration.

### Appointment

226. While Australian requirements for audit appointment are broadly in line with those of other developed countries, the Working Party noted that directly involving a company's audit committee or another committee of non-executive directors in the appointment process would complement the increasing emphasis on external directors and audit committees in the overall context of corporate governance.

227. The Working Party therefore recommends:

- If the ASX listing rules do not so provide, the Law should be amended to require listed companies to have an audit committee. Non-executive directors should constitute the majority of members of such a committee. **Recommendation 7.1.**
- Auditors of a listed company should be appointed and their remuneration determined on the recommendation of the company's audit committee or, where there is no audit committee, an appropriate committee of non-executive directors. **Recommendation 7.2.**
- Auditors of an unlisted company should be appointed on the recommendation of the company's audit committee where such a committee exists. **Recommendation 7.3.**

## **Independence**

228. The Working Party notes that independence for a professional is a state of mind and that no specific restrictions or requirements can achieve independence. However, it believes that some specifications can contribute significantly towards the maintenance of independence of mind, as well as the appearance of independence.

229. The Working Party is of the view that the following recommendations will assist company auditors in being, and in being seen to be, independent:

### **Level of Indebtedness**

- The level of indebtedness by an auditor to a client (as referred to in paragraphs 324(1)(e) and (2)(f) of the Law) should be increased from \$5,000 to \$10,000 or such other amount as may be prescribed by regulation, subject to recommendation 7.6. **Recommendation 7.4.**
- A prohibition should be placed on the indebtedness of a company to its auditor, with the exception of professional fees and amounts up to a maximum of \$100,000 deposited with a financial institution or life insurance company by a natural person on normal commercial terms and in the ordinary course of business of the financial institution or life insurance company, subject to recommendation 7.6. **Recommendation 7.5.**
- The monetary indebtedness prohibitions should only apply to partners of a firm of auditors who are directly engaged on the audit assignment and relatives of such partners. **Recommendation 7.6.**

### **Term of Appointment**

- There should be mandatory rotation of the audit partners responsible for the audit of listed companies in accordance with the principles laid down in Statement of Auditing Practice AUP 32 — Audit Independence (AUP 32). **Recommendation 7.7.**

### **Provision of Non-Auditing Services by Auditor**

- Providing there is a continuing mandatory requirement to adhere to the independence requirements of current ethical rulings and auditing standards, the Law should not place any restrictions on an auditor or his or her firm performing non-auditing services for an audit client. However in the current review of ethical requirements by the accounting bodies, it is recommended that attention be directed toward the provision of additional procedures (including allocation of responsibility for the additional services to a partner other than the

external audit partner) for application in the more contentious areas of accounting services, internal audit and specific and separate internal control reviews to strengthen independence in these areas. **Recommendation 7.8.**

- The current disclosure requirements relating to non-audit services should be expanded to require a breakdown of the nature of those services and to include services provided by entities whose beneficial ownership is substantially the same as that of the auditor's firm. **Recommendation 7.9.**
- Non-audit services provided to a company by its auditor or his or her firm should be reviewed annually by the company's audit committee or, where there is no audit committee, by the full board to satisfy itself that the non-audit services provided are not of a nature that would compromise the independence of the external auditor from the perspective of the company. **Recommendation 7.10.**

#### Method of Selecting Auditor

- The Law should not place any restrictions on the use of tendering as a means of selecting a company's auditors but companies should be encouraged to reduce the number of formal tenders required. **Recommendation 7.11.**

#### Relationship of the External Auditor with the Audit Committee or Non-Executive Directors

- The Law should be amended to provide that where a company's audit committee or the company's board is to discuss issues which have relevance to the audit, the company's auditor should be given notice of the meeting and be invited to attend the meeting or relevant part thereof. The Law should also be amended to permit an auditor (by prior notice) to attend an audit committee meeting or board meeting to raise and discuss issues which have relevance to the audit. **Recommendation 7.12.**

#### Compliance with Accounting Standards

- The Working Party encourages the establishment of a Financial Reporting Review Board (FRRB) or similar group to inquire into apparent departures from accounting standards or other reporting requirements. Where it was found that departures had occurred, it would seek appropriate remedies. If it is unsuccessful, matters should be referred to either the accounting bodies or the CALDB or both for appropriate disciplinary action. **Recommendation 7.13.**

## Removal and Resignation of Auditors

- The Law should be amended to provide that a proposed change to the auditor of a disclosing entity is a continuous disclosure matter. **Recommendation 7.14.**
- The Law should provide that any proposal for appointment of auditors of a disclosing entity must contain information on the proposed fees. **Recommendation 7.15.**

## Attendance at AGM

- The Law should be amended to require an auditor, or a representative of the auditor, to attend the annual general meeting (AGM) at which the auditor's report is tabled unless reasonable circumstances preclude his or her attendance. **Recommendation 7.16.**

## Restriction on Fee Levels for a Particular Client

- An appropriate mandatory standard of the accounting bodies should require that where the total fees in respect of all services in a financial reporting period paid by an audit client or group of clients exceeds 15 per cent of the gross fees of the practice, there must be detailed consideration and documentation on the relevant audit file of the implications for independence and that the document is to be available for review in the normal quality review process. **Recommendation 7.17.**

## Regulation or Self Regulation

- Regulatory requirements for auditors should, to the maximum extent practicable, be embodied in the mandatory standards and pronouncements and self regulatory framework of the authorised accounting bodies. **Recommendation 7.18.**

## Teaching of Professional and Business Ethics

- Endeavours should be made through the appropriate educational channels to introduce and strengthen the teaching of ethical principles in primary and secondary schools. **Recommendation 7.19.**
- The accounting bodies should require an adequate level of teaching of professional and business ethics as a pre-requisite to granting course accreditation to tertiary institutions for graduates entering the induction programs of the accounting bodies. **Recommendation 7.20.**

## DISCIPLINE

230. Four issues were considered by the Working Party in the context of discipline of RCAs:

- (a) whether the existing institutional arrangements for dealing with disciplinary matters operate in an efficient and effective manner;
- (b) whether the matters that may be dealt with by the CALDB are appropriate;
- (c) whether the penalties that may be imposed by the CALDB are appropriate; and
- (d) whether the CALDB or the ASC should be authorised to exchange information with authorised accounting bodies for the purpose of disciplinary proceedings.

## Institutional Arrangements

231. The Working Party noted that there are both advantages and disadvantages in leaving the disciplinary function with the CALDB, transferring the function to the ASC or merging the function with the authorised accounting bodies' disciplinary processes.

232. After considering the various issues associated with this question, they concluded, on balance, that the CALDB should be retained for dealing with conduct matters (such as whether a person has failed to adequately and properly carry out or perform the duties of an auditor or is a fit and proper person to be an RCA) and, accordingly, recommend that:

- The CALDB should be retained for dealing with those disciplinary matters that the Law provides should be brought before an independent disciplinary body. **Recommendation 8.1.**
- Where the ASC has delegated the registration of auditors to authorised accounting bodies, those bodies should be permitted to bring conduct matters directly before the CALDB. **Recommendation 8.2.**

233. The Working Party also considered several proposals having the objective of making the operation of the Board more efficient and ensuring that Board members have a wide range of legal, accounting and business skills.

234. The Working Party concluded that there is some merit in formally expanding the range of skills that CALDB members could bring to the Board's deliberations. The Working Party believes that the most appropriate way of achieving this objective would be to invite additional peak professional and business bodies to nominate persons for appointment to the Board. The Working Party also concluded that, in conjunction with changes to the skills of CALDB members and the bodies that may make nominations for appointment to the Board, it may be appropriate to revise the rules for the operation of the Board.

235. The Working Party therefore recommends that:

- The ASC Act should be amended to provide for the appointment of a deputy chairperson for the CALDB. **Recommendation 8.3.**
- The ASC Act should be amended to allow the CALDB to sit in more than one Division simultaneously. **Recommendation 8.4.**
- The ASC Act should be amended to provide that a Division of the CALDB is constituted by a member nominated by an authorised accounting body, a legal practitioner and one other person. **Recommendation 8.5.**
- The requirement that the chairperson of the CALDB be a legal practitioner should be repealed. **Recommendation 8.6.**
- The ASC Act should be amended to provide that the membership of the CALDB is to be constituted as follows:
  - (a) each authorised accounting body is to submit a panel of four names, with one person being appointed from each panel of names;
  - (b) two persons selected from a panel of five names submitted by the Law Council of Australia; and
  - (c) two persons selected from panels of names submitted by business and professional organisations that are invited by the Minister to make nominations. **Recommendation 8.7.**

## **Disciplinary Matters**

236. The matters that may currently be referred to the CALDB by the ASC can be divided into two broad categories — administrative matters (such as failure to lodge a statement) and conduct matters.

237. The Working Party considers that disciplinary procedures would be more effective if disciplinary matters of an administrative nature could be dealt with by the registering body, thus leaving the disciplinary body to concentrate on conduct matters.

238. To give effect to this proposal, the Working Party makes the following recommendations, which may be embodied in changes to the Law, the regulations or elsewhere as appropriate:

- Disciplinary matters of an administrative nature (as defined in paragraph 851) are to be dealt with by the registering body. **Recommendation 8.8.**
- Where the registration function has been delegated to an authorised accounting body, guidelines approved by the ASC should cover such matters as:
  - (a) the procedures for giving notice of the authorised accounting body's intention to deal with a matter;
  - (b) allowing the RCA who is the subject of the action to be heard; and
  - (c) the publication of the authorised accounting body's decision  
**Recommendation 8.9.**
- Where the registration function has been delegated to an authorised accounting body, a person whose registration is cancelled by the registering body may lodge an appeal against that body's decision with the ASC. **Recommendation 8.10.**
- A decision made by the ASC in respect of an administrative matter may be the subject of an appeal to the AAT. **Recommendation 8.11.**
- The CALDB should only deal with cases involving conduct matters or combined conduct and administrative matters. **Recommendation 8.12.**
- Where the ASC has delegated the registration function to authorised accounting bodies, those bodies may, subject to the approval of the Commission, deal with specified types of conduct matter within their own disciplinary systems. **Recommendation 8.13.**
- Where civil or criminal proceedings have been commenced against a person, such proceedings are not to act as a bar to disciplinary proceedings against the same person and arising out of the same matter being commenced or continued by an authorised accounting body, the ASC or the CALDB. **Recommendation 8.14.**

## **Penalties**

239. The Working Party recommends that:

- The CALDB should be permitted to impose fines up to a limit of \$100,000. Consideration should also be given to amending the Law to enable the CALDB to enforce orders made during the pre-hearing period. **Recommendation 8.15.**

## **Release of Information**

240. The Working Party further recommends that:

- The nature of the matter, the decision in respect of each disciplinary proceeding and the reasons for the decision should be published. **Recommendation 8.16.**
- The CALDB should be permitted to provide information obtained by it during the course of a disciplinary proceeding to the investigation and disciplinary committees of the authorised accounting bodies to facilitate the disciplinary procedures of those bodies. **Recommendation 8.17.**

## **OTHER CORPORATIONS LAW ISSUES**

241. The Working Party considered the changes to provisions dealing with the independence of auditors of proprietary companies that were made by the *First Corporate Law Simplification Act 1995* (First Simplification Act).

242. In the view of the Working Party, auditor independence is fundamental and should not be compromised. Accordingly, the Working Party recommends that:

- Paragraphs 324(1)(f) and (2)(g) of the Law should be amended to remove the exemptions which currently permit proprietary companies to appoint as their auditors persons who are officers of the company or persons who are related to officers of the company. **Recommendation 9.1.**

243. The Working Party also considers that consideration should be given to amending the Law to make it clear that an Auditor-General may, subject to any constraints contained in the Commonwealth, State or Territory legislation establishing his or her office, delegate to a person nominated by him or her responsibility for signing an auditor's report or an audit review prepared under Part 3.7 of the Law.

## **IMPLICATIONS FOR OTHER LEGISLATION**

244. The Working Party notes that RCA status has become the de facto bench-mark for identifying a competent auditor for many non-corporate audits.

245. The Working Party further notes that RCA status may not be essential for some non-corporate audits and, accordingly, considers that the States and Territories should review the audit requirements in their various Acts and, where they consider it appropriate, provide that an auditor may be a person who holds a certificate of public practice issued by a professional accounting body recognised in that legislation.

## **RESOURCE IMPLICATIONS**

246. The Working Party notes that the quantum of the costs associated with the performance of the registration function by authorised accounting bodies will largely depend on the way in which the function is performed by those bodies. Information provided to the Working Party by the ICAA and the ASCPA indicates that, if those bodies were authorised accounting bodies and they jointly performed the registration and supervisory functions, the cost of performing these functions would be approximately \$764,000 in the first year and \$617,000 in the second and subsequent years. While income from annual renewals and applications is currently about \$470,000 per annum, the ICAA and ASCPA estimate that fees revenue would be \$310,000 in the first year and \$293,000 in the second and subsequent years. In keeping with the Government's application of user pays principles, fees should ultimately cover these costs.

247. The Working Party notes that the question of whether authorised accounting bodies should receive additional Government funding or a transfer of resources from Government for undertaking the registration and supervisory functions will be one for the Government and the authorised accounting bodies to negotiate. Nevertheless, both the ICAA and the ASCPA have indicated that they would be unwilling to bear an excess of costs over revenues for the provision of the delegated activities.

248. In addition to the costs incurred by authorised accounting bodies, the ASC will also incur some expenditure in performing an audit-type function on compliance by the authorised accounting bodies with either the terms of the MOU or the conditions under which statutory conferral is made.

249. If the CALDB is to be responsible for hearing conduct-related disciplinary matters, annual costs similar to those incurred in 1995/96 (\$312,000) could be expected. In these circumstances, both the ASC and the authorised accounting bodies could be expected to incur discipline-related costs similar to those currently being incurred.

### **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...<sup>11</sup>

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.<sup>12</sup> 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

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<sup>11</sup> Victorian Parliament (House of Assembly) Hansard, 11 June 1895, pp. 224-225.

<sup>12</sup> 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                |                                |                     |
| <b>Total</b>                        | <b>8,404</b>             | <b>100.00</b>       | <b>1,020,226</b>               | <b>100.00</b>       |

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.<sup>13</sup>

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<sup>13</sup> 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 Statements<sup>14</sup>**

322. All disclosing entities, public companies and large proprietary companies<sup>15</sup> 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;<sup>16</sup> or

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<sup>14</sup> 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.

<sup>15</sup> 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.

<sup>16</sup> 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

- (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 25,000<sup>17</sup> 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.

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was executed (the replacement order clarifying the periods for which the financial results of the 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.

<sup>17</sup> 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:

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.<sup>18</sup>

### **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.<sup>19</sup>

### **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;

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17,000 public companies, 23,000 non-exempt proprietary companies and 20,000 exempt proprietary companies.

<sup>18</sup> 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.

<sup>19</sup> Source: ASC 1995-96 Annual Report.

- (e) auditing the accounts of incorporated associations in accordance with the requirements of State and Territory Associations Incorporation Acts; and
- (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.

## 4. UNDERTAKING THE REGISTRATION AND SUPERVISORY FUNCTIONS

401. This chapter considers the institutional arrangements that could be put in place for undertaking the functions of registration and supervision of company auditors.

402. The term 'supervision' can broadly be considered to cover many functions, including:

- (a) administration and lodgment of triennial statements (re-registration) including changes and voluntary cancellations;
- (b) dealing with administrative matters, such as failure to lodge a statement and bankruptcy (see also paragraph 851);
- (c) monitoring of continuing education;
- (d) monitoring of continuing experience;
- (e) performance of quality review/surveillance of audit work;
- (f) assessments and responses to complaints received;
- (g) disciplinary procedures where required;
- (h) independence considerations;
- (i) issues regarding appointment;
- (j) monitoring changes of auditors (for example, approval of resignation);  
and
- (k) public oversight and/or reporting.

403. Consideration of the issues associated with the qualifications and experience that a person should possess in order to satisfy the requirements for registration as a company auditor and the level and type of post-registration supervision for such auditors appears in chapters 5 and 6.

404. Issues associated with the institutional arrangements for dealing with disciplinary matters involving RCAs are considered separately in chapter 8.

## **CURRENT SYSTEM**

405. Since 1991 the ASC has been responsible for the registration and subsequent supervision of company auditors. The former National Companies and Securities Commission (NCSC) (through its State and Territory delegates) also performed these functions. However, prior to the NCSC assuming responsibility for the administration of company law in 1982, registration of company auditors was undertaken by Companies Auditors Boards in some jurisdictions and Public Accountants Registration Boards in others.

406. The work in relation to the registration and supervision of RCAs (and liquidators) has recently been consolidated into the ASC Regional Office located in South Australia. This office carries out a number of mandatory activities, including:

- (a) processing and assessing applications for registration;
- (b) administration of triennial statements;
- (c) dealing with changes in particulars;
- (d) dealing with administrative matters; and
- (e) approval of requests for resignation.

407. Routine disciplinary matters, such as failure to lodge triennial statements and bankruptcy, are collated by the South Australian Regional Office for forwarding to the CALDB. Conduct matters are dealt with by each local Regional Office.

408. The ASC also carries out functions for which its resource requirements may vary considerably, including:

- (a) a surveillance program covering selected auditors (in some States only);
- (b) assessing and responding to complaints; and
- (c) disciplinary procedures, particularly referral of auditors to the CALDB where they appear to be deficient in audit performance.

409. A 'Procedures Manual — Auditors and Liquidators Registration', which provides an explanation of the various provisions in the Law and the Regulations dealing with the registration of auditors, has been prepared by the ASC to provide guidance to the staff who perform the registration function and to ensure uniform administration of the provisions in all jurisdictions. This manual is available to the general public. In addition, in January 1993 the ASC published a booklet to assist

potential applicants for registration entitled 'An ASC Guide to the Registration and Supervision of Auditors'.

410. The ASC is required by the Law to maintain a record of all persons who have been registered as company auditors and whose registration is still current. Known as the Register of Auditors, the record is required by the Law to contain the following information about each RCA:

- (a) the name of the person;
- (b) the day on which the person's application for registration was granted;
- (c) the address of the principal place of business where the person practices as an auditor;
- (d) the name of the firm or the name or style under which the auditor practices;
- (e) particulars of any suspension of the person's registration as an auditor; and
- (f) such other particulars as the ASC considers appropriate.

411. The Register of Auditors is maintained on the ASC's ASCOT database. It may be inspected by members of the public upon payment of the prescribed fee (currently \$8).

## **OVERSEAS POSITION**

412. All of the overseas jurisdictions whose requirements were examined by the Working Party<sup>20</sup> have requirements dealing with the regulation of either company auditors or public accountants (including company auditors).

413. In Great Britain, there are requirements dealing specifically with the regulation of company auditors. The responsibility for this function is delegated by the Companies Act 1989 to recognised supervisory bodies (RSBs) that have been approved for the purposes of the legislation. The RSBs that have been approved are the main accounting bodies in Great Britain.

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<sup>20</sup> The Working Party examined the requirements of the Canadian Province of Ontario, Great Britain, New Zealand, South Africa and the United States of America.

414. Two other jurisdictions, Canada<sup>21</sup> and South Africa, require the registration of all public accountants (including company auditors). In Canada and South Africa the registration functions are undertaken by statutory public accountants' and auditors' boards.

415. Prior to 1993, the New Zealand authorities also achieved a similar result to that in Canada and South Africa by using the then New Zealand Society of Accountants (NZSA)<sup>22</sup> as a de facto public accountants' registration board. However, in 1993 the New Zealand legislation was amended to allow suitably qualified people who are not members of the NZSA to offer accounting services to the public.<sup>23</sup>

416. In the United States of America the regulation of the accounting profession is largely State-based. In most, if not all States, State Boards of Accountancy have been established under legislation enacted by the State legislature and these Boards are empowered to issue licences to practice public accountancy (including the provision of auditing services).

## **ISSUES**

417. One of the more significant issues to be addressed by the Working Party during the course of this review is whether the existing institutional arrangements for regulating auditors are operating in an efficient and effective manner.

418. The Working Party received a number of submissions dealing with the question of the institutional arrangements for the registration of company auditors. While the majority of these submissions either argued or asserted that the ICAA and ASCPA should assume responsibility for the registration and supervisory functions, a number of submissions proposed that these functions should be undertaken by an independent body.

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<sup>21</sup> Throughout this Discussion Paper a reference to the Canadian requirements should be read as the requirements in the Province of Ontario.

<sup>22</sup> During 1996 the NZSA changed its name to the Institute of Chartered Accountants of New Zealand.

<sup>23</sup> Notwithstanding this amendment, subsection 199(1) of the New Zealand Companies Act 1993 provided that a company auditor must be a member of the NZSA who holds a certificate of public practice, an officer of the Audit Department who is authorised to be an auditor of a company or a member of an accounting body formed outside New Zealand where the body has been approved by the Registrar and the member is eligible to conduct audits in the jurisdiction in which the body is formed. In 1996, in conjunction with the change of name of the NZSA, the Companies Act was amended by replacing the reference to NZSA members with a reference to chartered accountants (within the meaning of section 19 of the Institute of Chartered Accountants of New Zealand 1996) and, in addition, to allow audits to be conducted by a person who is eligible to conduct audits in jurisdictions other than New Zealand and who has been approved by the Registrar.

419. A number of the submissions that argued that the ICAA and ASCPA should be responsible for the institutional arrangements sought to justify this on the grounds that there is currently a duplication of effort between the ASC and the CALDB and the activities of the bodies in the areas of registration (including character checks), quality reviews and discipline. As the ASC is only responsible for auditors who perform one type of audit engagement, it was argued that it would be more efficient for the bodies to have responsibility for monitoring company auditors as part of their more extensive programs for monitoring the activities of members who are in public practice.<sup>24</sup>

420. While accepting the argument that there is some duplication of effort in the activities of the ASC and the accounting bodies, the Working Party notes that, in considering the appropriate form of institutional arrangements for the regulation of auditors, careful consideration must be given to the objectives of the legislators when they enacted the present requirements. In brief, the objective was, and still is, to ensure that suitably qualified natural persons are available to audit the financial statements of companies and thus provide some assurance about the reliability of those financial statements to securities market participants who rely on them for making investment decisions.

## OPTIONS FOR PERFORMING THE FUNCTIONS

421. The Working Party identified a number of alternative ways in which the registration and supervisory functions could be performed. The alternatives identified by the Working Party are:

- (a) continuing the existing institutional arrangements;
- (b) having authorised accounting bodies perform the functions under delegation from the ASC;
- (c) amending the Law to provide that authorised accounting bodies may be given full responsibility for performing the functions (statutory conferral); or
- (d) establishing a new Auditors Practice Board (APB) which could incorporate the current responsibilities of both the ASC and the CALDB.

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<sup>24</sup> There is one minor qualification to this statement. RCAs who are members of the ASCPA, whose gross annual income from public accountancy services is less than \$7,500 and who do not hold themselves out to the public as providing public accountancy services, are not required to hold public practice certificates and thus do not come within the scope of programs for monitoring the action of members in public practice.

422. The following paragraphs briefly outline each of these alternatives.

### **ASC Continues to Perform Functions**

423. This option envisages the continuation of the existing institutional arrangements for the registration and supervision of auditors.

424. Since 1991 the staff of the ASC's Corporate Regulation/Commercial Programs Division have built up a considerable level of expertise in processing applications for registration of auditors and the ongoing supervision of RCAs. The Working Party understands that, notwithstanding complaints by some applicants for registration as an auditor about the ASC's interpretation of the experience requirements, the present administrative arrangements for registering auditors are, for the most part, operating satisfactorily.

425. The principal advantage in adopting this option is that the National Corporations Scheme will continue to obtain the benefits of the administrative systems that have been put in place by the ASC and the expertise of the ASC staff responsible for performing these functions. In addition, an arms length body may dispel any perception of bias that might arise if authorised accounting bodies undertook the registration and supervisory processes.

426. The major disadvantages of retaining the existing arrangements include:

- (a) the need for the ASC to maintain an administrative structure for regulating one aspect of the work undertaken by members of the accounting profession;
- (b) a continuation of the difficulties currently experienced by ASC staff in assessing whether an applicant has satisfied the prescribed requirements concerning practical experience in auditing; and
- (c) ongoing supervision of RCAs would continue to be undertaken by the ASC and one or more accounting bodies, with the result that there would be continuing lack of cohesion and potential duplication of effort especially in terms of implementing and administering surveillance programs.

427. None of the overseas jurisdictions examined by the Working Party currently have institutional arrangements under which the corporate regulator is responsible for the registration and supervision of company auditors.

## **Authorised Accounting Bodies Responsible for Functions**

428. The Working Party has identified two ways in which authorised accounting bodies could be given responsibility for registering company auditors:

- (a) under delegation from the ASC, which would retain legislative responsibility for the functions; or
- (b) by statutory conferral of the functions, thus making them self-regulating bodies approved under the Law.

### **Under Delegation**

429. Under this option, the ASC would, on the face of the Law, retain responsibility for administering the provisions dealing with registration and supervision of company auditors. The Law would, however, be amended to provide that the ASC could delegate the functions of registration and supervision of company auditors to authorised accounting bodies which met specific criteria regarding their operations and which the ASC was satisfied were appropriate to undertake the functions.

430. The delegation of the functions of registration and supervision of auditors would require a formal act of delegation by the ASC to the authorised accounting bodies. Any such delegation would desirably be preceded by the negotiation of an appropriate MOU between the ASC and the bodies. That MOU would need to address the full range of issues associated with the performance of registration and supervision functions.

431. While the majority of MOUs currently entered into by the ASC are with other regulatory bodies (both domestically and internationally) and therefore refer mainly to the exchange of information between such regulatory bodies, these MOUs may provide important precedents for an MOU between the ASC and the accounting bodies. An MOU in the circumstances suggested here would need to specify the conditions upon which the delegation was to be exercised and this would include fairly detailed procedures relating to registration and supervision. An MOU would also need to address the appropriate form of liaison between the ASC and the bodies, the circumstances in which assistance could be provided between the ASC and the bodies, the way in which information generally could be exchanged and the circumstances in which matters unable to be appropriately dealt with by the bodies could be referred to the ASC for its more definitive regulatory action.

432. Provisions respecting the confidentiality of information exchanged would also need to be included in an MOU. An instrument of delegation of this kind would always need to be capable of revocation and an MOU would need to specify a mechanism for resolving any disputes or substantial differences of approach which

may arise between authorised accounting bodies acting under a delegation from the ASC.

433. In order to ensure transparency of the arrangements between the ASC and authorised accounting bodies, an MOU should be a public document.

434. It would be desirable for the legislation itself to set the framework around which delegation could take place. The legislation could be expected to provide that the ASC may delegate certain functions to the accounting bodies provided the ASC was satisfied that acceptable procedures and arrangements were in place to provide reasonable assurance regarding the equity, quality and consistency of relevant matters, including:

- (a) the adequacy of the resources to be devoted to the registration and supervision functions;
- (b) the adequacy of the appeal mechanisms in place;
- (c) the adequacy of indemnity insurance arrangements that are in place;
- (d) the effectiveness of the supervisory arrangements in place; and
- (e) the effectiveness of the continuing professional development program.

### **Statutory Conferral**

435. Under this option, the Law would provide that all of the functions associated with the registration and supervision of company auditors are to be undertaken by non-public sector organisations, such as the bodies constituting the accounting profession.

436. The precise mechanism to be used for achieving a statutory conferral of these functions to the accounting bodies is not canvassed in this report. However, it could include some or all of the following elements:

- (a) an application for approval of each of the bodies seeking to be involved in the administration of the function;
- (b) the approval of each applicant by the Minister or a delegate of the Minister;
- (c) the appointment of outside representatives to the bodies involved in the administration of the function;

- (d) the approval of the rules of each successful applicant to ensure that there is equity and fairness in the way the procedures for registering and supervising company auditors work; and
- (e) the Minister or his delegate having the power to disallow rules dealing with the procedures to be followed in registering and supervising company auditors.

437. Two overseas jurisdictions, Great Britain and New Zealand, have given one or more private sector organisations responsibility for the registration and supervision of company auditors.

438. In 1989, Great Britain amended its Companies Act to place primary responsibility for the standards and conduct of company auditors on RSBs. In addition, the Act placed primary responsibility for the qualifications and training of potential company auditors on recognised qualifying bodies (RQBs). In practice the professional bodies to which the company auditors belong have gained recognition as both RSBs and RQBs.

439. To obtain recognition as an RSB, for example, each professional body had to make application to the Secretary of State and each application had to be accompanied by supporting information including a copy of its rules (which have to make adequate provision for matters such as appropriate technical standards, the competence of company auditors, the monitoring and enforcing of its rules and the investigation of complaints). One interesting feature of the British Act is that the RSBs are required to maintain a joint register of the individuals, partnerships and companies that are eligible for appointment as company auditors.

440. In the case of New Zealand, the Institute of Chartered Accountants of New Zealand (ICANZ), the country's principal professional accounting body, is, for practical purposes, responsible for the registration and supervision of the majority of company auditors in New Zealand.<sup>25</sup>

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<sup>25</sup> Subsection 199(1) of the New Zealand Companies Act 1993 provides that companies may be audited by a person who is a chartered accountant (within the meaning of section 19 of the ICANZ Act); an officer of the Audit Department who is authorised to audit companies; a member of an accounting body formed outside New Zealand where the body has been approved by the Registrar and the member is eligible to conduct audits in the jurisdiction in which the body is formed; and a person who is eligible to conduct audits in jurisdictions other than New Zealand and who has been approved by the Registrar.

## Advantages and Disadvantages of Delegation and Statutory Conferral

441. Delegation of the registration and supervision functions to authorised accounting bodies could be expected to provide significant benefits for both the ASC and the bodies concerned. These benefits include:

- (a) making more efficient use of the resources of the ASC and each body that has been authorised through:
  - (i) elimination of some of the paper work associated with the registration and supervision of auditors; and
  - (ii) rationalisation of audit surveillance programs;
- (b) providing more efficient processing of applications for registration through having the applicant's peers considering whether the applicant has adequate practical experience in auditing;
- (c) using the revised procedures as a means of adding value to the register of members holding public practice certificates maintained by the bodies; and
- (d) enabling the ASC to use the resources currently committed to the registration and supervision of auditors for other high priority programs, assuming a portion of those resources is not transferred to the accounting bodies under an MOU arrangement.

442. The potential disadvantages of delegating these functions to authorised accounting bodies include:

- (a) whether the bodies would, in practice, be willing to self-regulate their activities to the standard expected of them by the wider community; and
- (b) creating a perception in some sections of the community that the government had allowed the authorised bodies to establish a 'closed shop' for company auditors.

443. The ways in which the concerns raised in the last paragraph might be overcome include:

- (a) a requirement for the authorised accounting bodies to provide the ASC with regular comprehensive reports on the administration of the delegated functions;

- (b) the establishment by the ASC of a mechanism for considering complaints about the manner in which the authorised accounting bodies are performing, or have performed, the delegated functions; and
- (c) legislative provisions or an MOU specifying matters about which the ASC must be satisfied.

444. As with the delegation of these functions to authorised accounting bodies, statutory conferral could be expected to provide significant benefits for the ASC and the bodies concerned. However, the safeguards that the Parliament might require from the bodies performing these functions could be expected to be more substantial and thus might result in greater intrusion into the affairs of these bodies than would be the case if the function were performed under delegation from the ASC.

### **Establishing an Auditors Practice Board<sup>26</sup>**

445. The establishment of a separate APB is another option that is available for performing the registration and supervisory functions. It would be expected that the majority of members would be appointed from nominations made by the accounting bodies.

446. An APB would take over responsibility for registering company auditors, based on criteria established in legislation and/or regulations. It would be most desirable for the possibility of conditions being attached to such registration to be introduced into the Law or regulations. It would also be expected as a minimum that an APB would assume responsibility for some other supervision functions described in paragraph 402, including:

- (a) the administration, supervision and lodgment of triennial statements, along with any changes or cancellations, including ensuring that any conditions of registration are met;
- (b) ensuring that appropriate designated requirements for continuing education and continuing experience are met;
- (c) dealing with letters of complaint; and
- (d) handling disciplinary matters, to the extent that the accounting bodies are not able to handle such matters through their internal disciplinary procedures (which would absorb the present audit-related functions of the CALDB).

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<sup>26</sup> This option is based on a proposal contained in a 1993 report, 'Registration of Auditors and Related Issues', prepared by a Working Party established by the ASC, the ICAA and the ASCPA.

447. The day-to-day procedures for these functions could largely be handled by staff of one or more of the accounting bodies under delegation from the APB. Furthermore it would be envisaged that these bodies would continue to carry out quality review programs. These programs may, however, need to be expanded. To ensure that the public interest is well served, an APB could also carry out public oversight of the quality review programs implemented by the accounting bodies. This public oversight process would be designed to ensure that the quality review programs covering audit work are properly designed and implemented, with appropriate follow-up action.

448. The establishment of a separate body to handle registration and other roles could have a number of advantages, including:

- (a) it has many of the features of self-regulation;
- (b) such a body could relieve or overcome some of the ASC's resource problems in relation to finance and people, through the elimination of its existing administrative role;
- (c) inefficiencies or inconsistencies which may arise from different Regional Offices of the ASC handling registration matters would be eliminated;
- (d) such a body would mean that professional people would be overseeing professional accreditation;
- (e) it would be possible to link registration and ongoing criteria requirements with existing requirements of the accounting bodies for practising certificates and the quality review programs, thereby overcoming gaps that exist at present;
- (f) such a body would be better able to determine appropriate ongoing requirements as to experience and education;
- (g) such a body could be organised as cohesive and all embracing, covering in due course all aspects of registration, regulation and supervision of auditors; and
- (h) the public interest would be, and would be seen to be, better served, with proper coverage of all relevant areas and public accountability.

449. On the other hand, it could be argued that an APB simply transfers functions from one statutory body (the ASC) to another — albeit one on which the accounting bodies have a significant representation. While there may be efficiencies in centralising the registration and supervisory functions in one office, the resources (funding and staffing) needed for the new board would almost certainly have to come from other agencies such as the ASC or the CALDB.

450. Two overseas jurisdictions, Canada and South Africa, have established public accountants registration boards that have functions which encompass the functions proposed for an APB. However, a significant difference between the proposed APB and the overseas models is that the Australian board would only be concerned with company auditors while the overseas boards are concerned with all accountants in public practice.

## **ADDITIONAL ISSUES THAT WOULD NEED TO BE ADDRESSED IF AUTHORISED ACCOUNTING BODIES PERFORMED THE FUNCTIONS**

451. If one or more accounting bodies were authorised to undertake the registration and supervision of company auditors, there would be a number of additional issues to be considered. These issues are:

- (a) registration of persons who are not members of an authorised accounting body;
- (b) the exchange of information between the ASC and authorised accounting bodies;
- (c) the form of the Register of Auditors; and
- (d) other administrative procedures of the authorised accounting bodies.

### **Non-members of Authorised Accounting Bodies**

452. An important issue concerns the procedures to apply to individuals who are qualified for, and are seeking registration as, an RCA but who are not members of an authorised accounting body (for example, individuals who are qualified for membership of an authorised body but have a conscientious objection to becoming a member of that body or are members of a body that has not been authorised).

453. There would appear to be two main options available for registering and supervising company auditors who are not members of an authorised accounting body. The first would be for the ASC to continue to have responsibility for the function. The principal disadvantage of this option is that, because of the smaller number of applications that would need to be processed, the ASC would have to keep systems in place for processing applications, periodic statements and other documents and for undertaking regular surveillance of such auditors. It is also possible that, with the relatively small number of applications and auditors to be monitored, the ASC's staff may gradually lose their expertise for dealing with such matters.

454. The second option would be for authorised accounting bodies to perform these functions on the same basis as they perform the functions in respect of their own members. Such applicants would be subject to the rules, codes of ethics and disciplinary procedures of the bodies on the same basis as members of those bodies. The Working Party notes that, prior to 1996, the then NZSA was required under section 34 of the NZSA Act to issue practising certificates to persons who had a conscientious objection to membership. Individuals to whom practising certificates were issued were required by the Act to pay fees to the NZSA and to comply with the provisions of the Act and the rules and codes of ethics of the NZSA relating to discipline as if they were members of the NZSA. The Institute of Chartered Accountants of New Zealand Act 1996 (ICANZ Act), which came into operation in 1996, does not contain a provision equivalent to section 34 of the NZSA Act.

455. A submission received by the Working Party suggests that some individuals who have a conscientious objection, based on religious grounds, to membership of accounting bodies may not be prepared to participate in a registration system under which:

- (a) the administrative functions are performed by authorised accounting bodies under delegation from the ASC; and
- (b) registrants are required to undertake to comply with the ethics and rules of authorised accounting bodies, irrespective of whether or not the registrant is a member of such a body.

456. The Working Party was initially of the view that these concerns could be overcome on the grounds that the Government would effectively continue to be responsible for the registration and regulation of RCAs as the authorised accounting bodies would be performing the functions under delegation from a Government agency. However, following discussions with the authors of the submission referred to above, the Working Party understands that the objection is to any involvement of the accounting bodies in the registration process. As a consequence, the Working Party believes that, for individuals with such a conscientious objection, delegating functions to authorised accounting bodies could effectively preclude them from being RCAs and thus could be considered to be discriminatory.

457. While the Working Party would prefer to follow the New Zealand approach, and have the authorised accounting bodies responsible for registering individuals who are conscientious objectors, it notes that constitutional considerations may make it necessary for the ASC to register such individuals. The registration of these individuals could be conditional on the registrant complying with auditing guidelines which are set or adopted by the ASC and which mirror matters dealt with in the ethics and rules of the authorised accounting bodies. While this approach still effectively results in such individuals being treated as if they are members of a professional body,

it has the advantage of ensuring that no RCAs have a competitive or other advantage through not having to comply with any ethics or rules.

### **Exchange of Information**

458. To facilitate the operation of a regime under which the registration and regulation of auditors is delegated to authorised accounting bodies, it is essential that there be an ongoing exchange of information between the ASC and the bodies performing the delegated functions.

459. Section 127 of the ASC Act currently provides that the ASC must take all reasonable measures to protect from unauthorised use or disclosure information given to it in confidence in or in connection with the performance of its functions or the exercise of its powers. The section imposes strict conditions on the bodies to which, and the circumstances under which, information may be disclosed by the ASC.

460. The Working Party is of the view that section 127 should be amended to permit the ASC to provide to authorised accounting bodies information concerning individuals who are members of one or more of the bodies. The ASC should also be empowered to give authorised accounting bodies information about non-members who are either RCAs or who are known to be making application for registration as an RCA.

461. Where information is given to authorised accounting bodies under section 127 of the ASC Act, those bodies should also be under an obligation to protect the information from unauthorised use or disclosure.

### **Register of Auditors**

462. The Working Party is of the view that, irrespective of how many accounting bodies are authorised by the ASC, there should be only one Register of Auditors. The Working Party is also of the view that information maintained on the Register should be capable of being accessed through the ASC's ASCOT computer system or a similar public database.

463. Issues such as where the Register is actually maintained and how it is to be updated are matters that should be addressed in the MOU, and perhaps the final instrument of delegation, between the ASC and the accounting bodies that are seeking authorisation.

## **Other Administrative Procedures**

464. The Working Party anticipates that a range of issues associated with the administration of delegated functions would also be addressed during the course of the discussions at which the MOU between the ASC and the accounting bodies that are seeking authorisation is developed.

465. In general terms, these administrative procedures will be ones for the accounting bodies to determine and the ASC's main concern should be one of whether they will enable delegated functions to be performed in an efficient and effective manner. It would, for example, be up to each authorised accounting body to decide whether to undertake the administration of the delegated functions on its own or in co-operation with other authorised accounting bodies.

## **RESOURCE IMPLICATIONS**

466. The various options outlined above have significantly differing financial implications. An overview of these implications is contained in the following paragraphs.

467. Payroll costs presently incurred by the ASC covering registration of auditors and the supervision functions described in paragraphs 402(a), (b) and (j) amount to approximately \$150,000-\$200,000 per annum, depending on the level of activities.

468. Additional significant costs are also incurred relating to the supervision functions described in paragraphs 402(e), (f) and (g). These can vary considerably from year to year. The approximate total amount incurred by the ASC during the year ended 30 June 1994 was \$900,000, which included significant out-of-pocket costs for expert opinions etc. For the year ended 30 June 1995 the total cost of payroll for ASC staff and external out-of-pocket costs was approximately \$650,000.

469. Information provided to the Working Party by the ICAA and ASCPA indicates that, if they were authorised accounting bodies that were jointly performing the registration and supervisory functions, expenses would amount to \$764,000 in the first year in which the functions are performed and by about \$617,000 in subsequent years. At present fees levels,<sup>27</sup> these expenses would lead to a significant excess of expenses over income.

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<sup>27</sup> As at 1 May 1997, the prescribed fees were: \$280 for an application for registration; \$115 for lodging a triennial statement; \$55 for lodging a document up to one month late; and \$230 for lodging a document more than one month late.

470. The Working Party notes that the quantum of the costs associated with the performance of the registration function by authorised accounting bodies would be largely dependent on the way in which the function is performed. If, for example, the registration function could be performed as an adjunct to another function, such as the issue of public practice certificates, lower costs may be incurred by the bodies.

471. The Working Party understands that some or all of the accounting bodies may be reluctant to become authorised accounting bodies unless they have an assurance that they will be compensated for any losses (ie excess of expenditure over income) that they incur in performing the registration and supervisory functions. The Working Party notes that the question of whether any compensation should be paid to authorised accounting bodies is one for the Government and the bodies to negotiate.

472. If authorised accounting bodies were to assume responsibility for the registration and supervision of RCAs, the ASC would continue to incur some expenditure in undertaking the registration of conscientious objectors and in performing an audit-type function on compliance by the bodies with either the terms of the MOU or the conditions under which statutory conferral is made.

473. The direct costs of the third option outlined in this chapter, the establishment of a new APB, would depend on the extent to which the APB delegated its functions to the accounting bodies. If the majority of the APB's functions could be delegated to the bodies (as proposed earlier in this chapter), the cost may be of the order of \$250,000-\$300,000 per annum.<sup>28</sup> However, if the APB had to undertake its functions using its own resources, the annual cost could be at least \$1.5 million.

## THE WORKING PARTY'S POSITION

474. Whilst each of the options outlined above has its advantages and disadvantages, the Working Party is of the view that the preferred options are those giving the accounting bodies responsibility for the regulation and supervision of auditors. This view is consistent with the comments contained in many of the submissions received in response to the invitation for comments on the issues that should be addressed during the course of the audit review.

475. On balance, the Working Party has formed the view that the option giving accounting bodies responsibility for the regulation of auditors under delegation from the ASC is to be preferred. However, as audit responsibilities under the Law are discharged in accordance with public interest requirements, it is the view of the Working Party that this necessarily requires that there be a continuing executive

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<sup>28</sup> The ARB may also have to provide some compensation to the major accounting bodies for the functions that they perform under delegation.

government role in this matter and that the ASC maintain an oversight responsibility. The Working Party also notes that the negotiation of suitable compensation arrangements for the accounting bodies may be an important pre-requisite to discussions about the delegation of the registration and supervisory functions.

476. In undertaking the registration function under either of the options, the authorised accounting bodies would assume responsibility for:

- (a) receiving applications from members and non-members for registration as company auditors;
- (b) processing applications in accordance with the requirements of the Law; and
- (c) dealing with appeals in circumstances where an application for registration had been refused.

477. For the purpose of supervising RCAs, the authorised accounting bodies would:

- (a) require an annual statement from RCAs (which would be submitted at the time of payment of annual membership fees);
- (b) deal with administrative matters;
- (c) conduct an ongoing quality review program and undertake any other necessary monitoring functions;
- (d) monitor compliance with continuing education and indemnity insurance requirements;
- (e) assess and respond to complaints received; and
- (f) where necessary, take disciplinary action against RCAs in respect of any matters arising from their performance as company auditors.

478. Before the accounting bodies could assume responsibility for the functions of registration and supervision, it would be necessary for them to demonstrate that they had procedures in place that would safeguard the public interest. Such procedures could include an effective and efficient quality review program, a mechanism for dealing with complaints about auditors and a disciplinary process that used publicly known and consistently applied standards and procedures. A further safeguarding of the public interest would come through the ASC overseeing the performance of the registration and supervision functions by the bodies.

479. In this regard, a key element of any arrangement for the delegation of functions to the accounting bodies will be the mechanisms that are put in place to ensure compliance with conditions imposed by the Law and the ASC. Authorised accounting bodies would be required to provide the ASC with regular reports on their administration of the delegated functions. Issues that should be addressed in such reports include the number of applications received, the number of applications approved, the number of complaints received concerning the activities of RCAs and a summary of the outcome of inquiries about those complaints, the number of RCAs who have had their work subject to a quality review and a summary of the overall results of those reviews.

480. In addition, the Working Party has given careful consideration to the type of appeal mechanism that should be put in place for dealing with matters arising in respect of the registration and supervision of auditors. As this report recommends that the functions should be performed by authorised accounting bodies under delegation from the ASC, the Working Party has concluded that the most appropriate means of obtaining a review of decisions of authorised accounting bodies would be to permit an appeal to the ASC. A decision of the ASC would, in turn, be subject to review in the same way as other administrative decisions of the ASC.

481. In settling its position, the Working Party has also been mindful of concerns raised in a number of submissions that delegating the functions to the accounting bodies could result in the establishment of a 'closed shop' for company auditors. The Working Party is of the view that the proposals contained in this chapter will guard against the possibility of a 'closed shop' being created. For example, every accounting body that satisfies the conditions contained in the legislation and of the ASC may seek to become an authorised accounting body. In addition, an authorised accounting body will be required by the Law to register a suitably qualified applicant irrespective of whether or not the applicant is a member of the body.

**Recommendation 4.1**

The ASC Act and the Law should be amended to authorise the ASC to delegate responsibility for the registration and supervision of company auditors to one or more Australian accounting bodies that satisfy specified conditions.

**Recommendation 4.2**

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 education 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.

**Recommendation 4.3**

A decision of an authorised accounting body made during the course of performing a delegated function may be the subject of an appeal to the ASC. The decision taken by the ASC may, in turn, be the subject of an appeal to the AAT.

**Recommendation 4.4**

The ASC may set such additional conditions in an MOU as it considers are necessary to enable it to ensure that the delegated functions are performed in accordance with the requirements of the Law and in an effective and efficient manner.

**Recommendation 4.5**

The ASC may only delegate responsibility for the registration and supervision of company auditors to an accounting body when written agreement has been reached with that body on the conditions set down in the Law and any additional conditions that may be imposed by the ASC.

**Recommendation 4.6**

Where an authorised accounting body fails to comply with any of the conditions set out in either the Law or the MOU, the ASC may revoke the delegation.

**Recommendation 4.7**

Notwithstanding the delegation of registration and supervisory functions to one or more authorised accounting bodies, the ASC may continue to perform registration and supervisory functions in circumstances in which it would be unreasonable to expect a person to apply to an authorised accounting body for registration (for example, where the person has a conscientious objection, based on religious grounds, to the membership of a professional organisation). The registration of such a person should be subject to rules and conditions that are adopted by the ASC and which are equivalent to those imposed by an authorised accounting body.

**Recommendation 4.8**

Particulars of all RCAs are to be entered in a single Register of Auditors which is to be maintained in a manner and at a place approved by the ASC.

**Recommendation 4.9**

Subject to appropriate safeguards concerning the protection of information from unauthorised use or disclosure, section 127 of the ASC Act should be amended to allow the ASC to provide information to:

- (a) authorised accounting bodies concerning individuals who are members of one or more of the bodies; and
- (b) authorised accounting bodies about non-members who are RCAs or who are known to be making application for registration as an RCA.

## 5. PRE-REQUISITES FOR REGISTRATION

501. This chapter focuses on the educational and professional qualifications and the level of practical experience that a person needs in order to obtain registration as a company auditor.

### CURRENT SYSTEM

502. A person (or firm) cannot be appointed auditor of a company unless the person (or, in the case of a firm, a partner in the firm) has been registered as a company auditor by the ASC. To obtain registration, the person must satisfy the educational and experience requirements set out in the Law and the Regulations.

503. Subsection 1280(2) of the Law provides that the ASC will register a person as an auditor if:

- (a) the person:
  - (i) is a member of the ICAA, the ASCPA or any other prescribed body;<sup>29</sup>
  - (ii) has tertiary qualifications in accountancy and commercial law; or
  - (iii) has other qualifications and experience that, in the opinion of the ASC, are equivalent to those mentioned above; and
- (b) the ASC is satisfied that the person has had the prescribed practical experience in auditing; and
- (c) the ASC is satisfied that the person is capable of performing the duties of an auditor and is otherwise a fit and proper person to be registered as an auditor.

504. Regulation 9.2.04(a) provides that the practical experience needed for registration as an auditor is work in auditing under the direction of a registered company auditor for a period of not less than three years, including appraising the operations of companies and forming opinions on matters specified in sections 331B,

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<sup>29</sup> Accounting bodies in Canada, Great Britain, New Zealand and the United States of America are prescribed.

331C, 331D and 331E of the Law.<sup>30</sup> In addition, at least one continuous year during the five years immediately before the date of the application must have been spent supervising audits of companies.

505. Regulation 9.2.04(b) provides that the ASC may accept other practical experience where it considers the other experience is equivalent to the practical experience set out in regulation 9.2.04(a). Paragraphs 365-415 of the ASC's Auditors Registration Manual indicate the matters that are to be considered by ASC staff when examining applications made under regulation 9.2.04(b). The Working Party understands the ASC's interpretation of 'or equivalent' experience has recently been modified to specify that only 25 per cent of time relating to audit experience requirements needs to be spent on work directly relating to company auditing. This is also to be regarded as a general guide only, subject to review and discretionary approval in marginal cases.

506. An application for registration as an auditor is to be made on Form 903A (see Appendix D for full details of the information that has to be disclosed in the application).

## **OVERSEAS POSITION**

507. The overseas jurisdictions whose requirements were examined by the Working Party all have educational requirements for registration as either an accountant or an auditor that are broadly equivalent to the Australian requirements.

508. Requirements for practical experience vary from jurisdiction to jurisdiction. In Canada, for example, the basic requirement for registration as a public accountant is membership of the Institute of Chartered Accountants in Ontario (ICAO). To become a member of the ICAO a person must have:

- (a) tertiary qualifications;
- (b) at least 30 months experience working for a chartered accounting firm, during which time a total of 2,500 chargeable hours must be accumulated (including a minimum of 1,250 in audit or review engagements); and
- (c) completed the ICAO's examinations.

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<sup>30</sup> These sections deal with issues such as whether the financial statements are properly drawn up [section 331B], matters concerning the consolidated accounts (if any) [section 331C], whether there are any defects, irregularities and omissions in the financial statements [section 331D] and whether the financial statements, and the auditor's report, are based on adequate information [331E].

## ISSUES

509. Since 1991, the greatest concern of public practitioners about registration of company auditors has been the inability of applicants from small and provincial firms to meet the experience requirements set out in regulation 9.2.04 of the Regulations.

510. The Commonwealth Government has recently received a number of representations from prospective auditors, who are either resident in provincial centres or members of small accounting firms, concerning the difficulty they are having in meeting the requirements on practical experience in auditing.

511. A number of submissions received by the Working Party have raised similar concerns.

512. The registration requirements that currently prevail were introduced with the commencement of the Co-operative Companies and Securities Scheme in 1982. Prior to that time, an accountant could be registered as a company auditor if he or she was a member of a recognised professional body or had appropriate educational qualifications and could satisfy a Companies Auditors Board<sup>31</sup> as to his or her general conduct and character and practical experience in accountancy.

513. It would seem that the introduction of practical experience requirements did not become a significant problem during the 1980s because the *Companies Act 1981* and associated State Codes:

- (a) grandfathered all pre-1982 registrants; and
- (b) replaced the requirement that all members of an auditing firm be registered company auditors with a requirement that at least one member of the firm be a registered company auditor.

514. As a result of the transitional provisions, there was a period of time immediately after 1982 in which there was less need for new partners of accounting firms to seek registration as auditors. However, with an increasing number of auditors registered before 1982 now retiring from public practice, many firms are finding that the remaining partners are experiencing difficulty in obtaining registration. It is said that this can be a particular problem in provincial communities where the numbers of companies may be such that no accounting firm has a substantial audit practice or at least one sufficient to generate the levels of practical experience expected of applicants for registration as auditors. The ultimate result could be that a region will be left without any registered company auditors.

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<sup>31</sup> A Public Accountants Registration Board in the case of New South Wales and Queensland.

515. Table 5.1 sets out the number of registered company auditors in each State and Territory and indicates whether their registration dates from the time of the Uniform Companies Acts/Ordinances, the time of the Co-operative Companies and Securities Scheme or since the commencement of the National Corporations Scheme.

**Table 5.1 — Registered Company Auditors as at 2 April 1997**

*Scheme under which registration obtained*<sup>32</sup>

| State or Territory                  | Uniform Companies Acts (ie before 1.7.83) | Co-operative scheme (ie 1.7.83 to 31.12.90) | National scheme (ie after 31.12.90) | Total — all schemes |
|-------------------------------------|---|---|-------------------------------------|---------------------|
| New South Wales                     | 2,476                                     | 866   | 246                                 | 3,588               |
| Victoria                            | 1,449                                     | 607   | 130                                 | 2,186               |
| Queensland                          | 760                                       | 235   | 58                                  | 1,053               |
| Western Australia                   | 500                                       | 155   | 60                                  | 715                 |
| South Australia                     | 392                                       | 80  | 32                                  | 504                 |
| Tasmania                            | 129                                       | 33  | 13                                  | 175                 |
| Australian Capital Territory        | 56  | 20  | 11                                  | 87                  |
| Northern Territory                  | 10  | 24  | 5                                   | 39                  |
| Location not identified or Overseas | 30  | 24  | 3                                   | 57                  |
| <b>Totals</b>                       | <b>5,802</b>                              | <b>2,044</b>                                | <b>558</b>                          | <b>8,404</b>        |

516. While the different registration requirements under the National Corporations Scheme and the Co-operative Companies and Securities Scheme were expected to, and indeed did, result in a lower number of registered company auditors than under the old Uniform Companies Acts, it is noted that the number of persons being registered as company auditors has continued to decline since the commencement of the National Corporations Scheme.

517. Table 5.2 compares the number of auditors registered each year during the last four years of the Co-operative Scheme with the number registered in the first six years of the National Corporations Scheme.

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<sup>32</sup> Although the Co-operative Companies and Securities Scheme commenced on 1 July 1982, auditors registered under the previous scheme were given until 31 December 1982 to apply to the NCSC for registration under the new scheme. Because of the number of applications received, it took some NCSC delegates until mid 1983 to process the applications. Accordingly, 1 July 1983 has been used as the starting point for statistics about the Co-operative Scheme.

**Table 5.2: Auditors Registered 1987-1996<sup>33</sup>**

| State or Territory                         | Co-operative Scheme |            |            |            | National Scheme |            |           |           |            |            |
|--|---------------------|------------|------------|------------|-----------------|------------|-----------|-----------|------------|------------|
|  | 1987                | 1988       | 1989       | 1990       | 1991            | 1992       | 1993      | 1994      | 1995       | 1996       |
| <b>New South Wales</b>                     | <b>87</b>           | <b>81</b>  | <b>134</b> | <b>76</b>  | <b>45</b>       | <b>41</b>  | <b>32</b> | <b>36</b> | <b>68</b>  | <b>58</b>  |
| Sydney metropolitan area                   | 72                  | 61         | 94         | 57         | 34              | 34         | 27        | 28        | 51         | 39         |
| Other areas                                | 15                  | 20         | 40         | 19         | 11              | 7          | 5         | 8         | 17         | 19         |
| <b>Victoria</b>                            | <b>45</b>           | <b>59</b>  | <b>54</b>  | <b>44</b>  | <b>27</b>       | <b>38</b>  | <b>26</b> | <b>21</b> | <b>22</b>  | <b>20</b>  |
| Melbourne metropolitan area                | 39                  | 46         | 44         | 39         | 25              | 31         | 23        | 21        | 21         | 20         |
| Other areas                                | 6                   | 13         | 10         | 5          | 2               | 7          | 3         | 0         | 1          | 0          |
| <b>Queensland</b>                          | <b>19</b>           | <b>22</b>  | <b>18</b>  | <b>17</b>  | <b>16</b>       | <b>4</b>   | <b>8</b>  | <b>20</b> | <b>12</b>  | <b>12</b>  |
| Brisbane metropolitan area                 | 13                  | 19         | 14         | 12         | 10              | 2          | 5         | 12        | 7          | 5          |
| Other areas                                | 6                   | 3          | 4          | 5          | 6               | 2          | 3         | 8         | 5          | 7          |
| <b>Western Australia</b>                   | <b>15</b>           | <b>17</b>  | <b>21</b>  | <b>19</b>  | <b>8</b>        | <b>18</b>  | <b>16</b> | <b>8</b>  | <b>12</b>  | <b>5</b>   |
| Perth metropolitan area                    | 14                  | 17         | 17         | 18         | 7               | 17         | 15        | 8         | 10         | 5          |
| Other areas                                | 1                   | 0          | 4          | 1          | 1               | 1          | 1         | 0         | 2          | 0          |
| <b>South Australia</b>                     | <b>9</b>            | <b>3</b>   | <b>9</b>   | <b>3</b>   | <b>0</b>        | <b>8</b>   | <b>6</b>  | <b>5</b>  | <b>6</b>   | <b>5</b>   |
| Adelaide metropolitan area                 | 9                   | 3          | 8          | 3          | 0               | 8          | 6         | 5         | 6          | 5          |
| Other areas                                | 0                   | 0          | 1          | 0          | 0               | 0          | 0         | 0         | 0          | 0          |
| <b>Tasmania</b>                            | <b>1</b>            | <b>4</b>   | <b>6</b>   | <b>5</b>   | <b>2</b>        | <b>0</b>   | <b>5</b>  | <b>4</b>  | <b>0</b>   | <b>3</b>   |
| Hobart metropolitan area                   | 0                   | 2          | 2          | 3          | 1               | 0          | 4         | 2         | 0          | 2          |
| Other areas                                | 1                   | 2          | 4          | 2          | 1               | 0          | 1         | 2         | 0          | 1          |
| <b>Australian Capital Territory</b>        | <b>8</b>            | <b>2</b>   | <b>2</b>   | <b>1</b>   | <b>3</b>        | <b>3</b>   | <b>2</b>  | <b>3</b>  | <b>1</b>   | <b>2</b>   |
| Canberra metropolitan area                 | 8                   | 2          | 2          | 1          | 3               | 3          | 2         | 3         | 1          | 2          |
| <b>Northern Territory</b>                  | <b>6</b>            | <b>1</b>   | <b>1</b>   | <b>2</b>   | <b>1</b>        | <b>0</b>   | <b>2</b>  | <b>1</b>  | <b>1</b>   | <b>1</b>   |
| Darwin metropolitan area                   | 6                   | 1          | 1          | 2          | 1               | 0          | 2         | 0         | 1          | 1          |
| Other areas                                | 0                   | 0          | 0          | 0          | 0               | 0          | 0         | 1         | 0          | 0          |
| <b>Location not identified or Overseas</b> | <b>3</b>            | <b>3</b>   | <b>2</b>   | <b>2</b>   | <b>0</b>        | <b>1</b>   | <b>0</b>  | <b>0</b>  | <b>1</b>   | <b>1</b>   |
| <b>Total</b>                               | <b>193</b>          | <b>192</b> | <b>247</b> | <b>169</b> | <b>102</b>      | <b>113</b> | <b>97</b> | <b>98</b> | <b>123</b> | <b>107</b> |
| Metropolitan areas                         | 161                 | 151        | 182        | 135        | 81              | 95         | 84        | 79        | 97         | 79         |
| Other areas                                | 32                  | 41         | 65         | 34         | 21              | 18         | 13        | 19        | 26         | 28         |

518. The Working Party is of the view that this continued decline in the number of applicants being registered is substantially a reflection of:

- (a) the specialisation that now occurs in the accounting profession;
- (b) the concerns that some members of the profession have about being subject to litigation for damages for alleged professional negligence;

<sup>33</sup> The statistics show the jurisdiction in which the RCA is currently resident rather than the jurisdiction in which registration was obtained.

- (c) the fact that auditing is now a mature market;
- (d) the fact that the Law does not require all members of an accounting partnership to be registered as company auditors; and
- (e) the more stringent experience requirements that were introduced in 1982 as part of the co-operative companies and securities scheme.

519. Having said this, while the pre-1982 requirements were clearly inadequate (at least in respect of audits of larger companies), some commentators now suggest that the current requirements may, nevertheless, go too far the other way and make it excessively difficult for many accountants to obtain registration as company auditors. This may result in an increase in the costs of audits to the general community due to a decrease in competition.

## **QUALIFICATIONS FOR REGISTRATION**

520. The Working Party has identified three issues concerning qualifications for registration. They are:

- (a) educational qualifications;
- (b) professional requirements; and
- (c) the appropriate level of experience.

521. Each of these issues is addressed in the following paragraphs.

### **Educational Qualifications**

522. As previously noted, to be registered as a company auditor under the Law, an applicant must:

- (a) be a member of either the ICAA or the ASCPA or another prescribed accounting body;
- (b) have tertiary qualifications in accountancy and commercial law; or
- (c) have other qualifications and experience that are equivalent to either of the abovementioned qualifications.

523. The inclusion of membership of the ICAA and ASCPA in subparagraph 1280(2)(a)(i) of the Law as meeting the educational requirements for registration as a

company auditor was principally intended to cover the situation where a member obtained his or her educational qualifications through the satisfactory completion of the professional bodies' own examinations. As a university degree or equivalent has been a pre-requisite for membership of both the ICAA and the ASCPA for more than 20 years, few, if any, applications for registration are now received from individuals who are not graduates. In these circumstances, the reference to the ICAA and ASCPA in subparagraph 1280(2)(a)(i) has little utility and could be omitted without affecting the current registration regime.

524. Comments provided to the Working Party about the issues to be addressed during the course of the review suggest that existing educational requirements of a university degree or equivalent are adequate and appropriate.

525. The Working Party has, nevertheless, expressed the view that auditing units included in many tertiary courses do not adequately deal with the topic. The Working Party considers that the educational requirements for registration as an auditor should, in addition to the existing requirements, require the successful completion of a specialised auditing module equivalent to that currently provided by the ICAA's PY Program or the ASCPA's CPA Program.

526. Applicants who have suitable overseas qualifications will not be required to undertake the auditing module. Similarly, applicants who can demonstrate to the registering body that they have sufficient equivalent qualifications and experience will also be relieved of the requirement to complete the auditing module.

### **Recommendation 5.1**

The existing educational pre-requisites for registration as a company auditor (ie tertiary qualifications in accountancy and commercial law) are considered to be adequate, subject to the introduction of an additional requirement that all applicants have completed a specialist course equivalent to the auditing module currently provided by the ICAA's PY Program or the ASCPA's CPA Program.

### **Recommendation 5.2**

Relief from the requirement to undertake the course of study referred to in recommendation 5.1 should be granted to an applicant who holds suitable overseas qualifications or who can demonstrate to the registering body that he or she has qualifications that are equivalent to the auditing module.

## **Professional Requirements**

527. At present membership of an accounting body is not a mandatory pre-requisite for registration as a company auditor.

528. Some submissions to the Working Party have proposed that membership of an accounting body should be made a mandatory pre-requisite for registration as a company auditor and the continuation of that registration. As the majority of applicants for registration as a company auditor are already members of at least one accounting body, implementation of such a proposal could be expected to have little impact on the accounting profession as a whole.

529. The proposal does, however, raise a number of questions, including:

- (a) Whether the introduction of such a requirement would be contrary to the requirements of the Trade Practices Act?
- (b) What provision should be made for people who do not wish to seek membership of an accounting body?

530. In its report on the accounting profession, the then Trade Practices Commission noted (in the context of State and Territory Acts that required audits to be conducted by members of either the ICAA or ASCPA):

Where mandatory membership is prescribed, the application by the professional bodies of their own standards and rules can prevent individual accountants with appropriate qualifications and experience from conducting audits irrespective of their competence. In a market as diverse and essentially deregulated as that for accounting services, the

assumption that only members of the major professional bodies are adequately qualified is open to question.<sup>34</sup>

531. If the Law were to be amended to make membership of an accounting body mandatory for RCAs, the move would almost certainly be seen as anti-competitive unless the Law contained special provisions in respect of individuals who were not members of an accounting body. In these circumstances, little purpose would seem to be served by making membership of an accounting body a mandatory requirement for RCAs.

532. Nevertheless, the Working Party believes that individuals who are not members of an accounting body that is an authorised accounting body should, in conjunction with their application for registration, be required to give a written undertaking to the body with which they are making application to abide by the code of ethics and other rules of that body as if they were members.

### **Recommendation 5.3**

Where a person who is not a member of an accounting body that is an authorised accounting body seeks registration as a company auditor, he or she must agree to abide by the code of ethics and other rules of the authorised accounting body to which they submitted their application on the same basis as members of that body.

### **Level of Experience**

533. The question of what should be the appropriate level of practical experience for registration as an auditor has been one of the more difficult issues to confront the Working Party during the course of the review.

534. As noted earlier in this chapter, the Law currently provides that an applicant for registration as an RCA must have not less than three years work in auditing under the direction of an RCA and, in addition, at least one continuous year during the previous five years must have been spent supervising audits of companies.

535. A wide range of views were put to the Working Party concerning:

- (a) the continuing appropriateness of these requirements as a pre-requisite for registration; and

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<sup>34</sup> Trade Practices Commission, Study of the professions — accountancy (final report — July 1992), p. 93.

- (b) the level and type of experience that should be a pre-requisite for registration as a company auditor.

536. The comments received by the Working Party have included that:

- (a) the existing experience requirements are adequate;
- (b) the existing time-based practical experience requirements should be replaced by a competency-based regime;
- (c) the existing experience requirements are too high for practitioners in smaller firms and in provincial centres;
- (d) consideration should be given to having a tiered registration system;
- (e) there should be an educational process to facilitate registration of persons who do not meet time requirements or whose experience is in non-company audits; and
- (f) consideration should be given to having a system of provisional registration.

537. The Working Party also noted that a number of submissions raised issues concerning the increasing difficulty that members resident in provincial centres, in particular, were having in satisfying the prescribed experience requirements for registration. As noted earlier in this report, similar concerns have been raised in representations to the Government.

538. The options considered by the Working Party as a means of resolving the problems associated with the practical experience requirements are outlined below.

## **OPTIONS FOR RESOLVING PROBLEMS WITH PRACTICAL EXPERIENCE REQUIREMENTS**

539. In light of the representations made to the Working Party concerning practical experience, the Working Party has revisited the entire question of what practical experience is needed by a person seeking registration as a company auditor. In undertaking this reassessment of the requirements, the Working Party has had particular regard to developments within the accounting profession since the existing requirements for practical experience were first introduced in 1981 as part of the legislation for the co-operative companies and securities scheme.

540. Prior to 1981, a person could be registered if the body responsible for registering company auditors was 'satisfied that he has sufficient practical experience in accountancy and has the capacity to act as a company auditor...'<sup>35</sup> While inquiries by the Working Party have not produced a positive explanation of the decision to revise the practical experience requirements contained in the co-operative companies and securities scheme legislation, it is believed that the decision was taken to overcome legal concerns about the vagueness of the expression 'sufficient practical experience'.

541. The Working Party has identified two basic ways in which the Law could deal with the issue of practical experience:

- (a) retain an hours-based regime with modifications to reflect developments within the accounting profession since the existing requirements were introduced in 1981; or
- (b) introduce a competency-based regime.

542. Prior to settling on the above options, the Working Party explored the possibility of adopting a form of provisional or conditional registration for those applicants who could not meet the practical experience requirements for full registration. Under the provisional or conditional approaches, an applicant would be registered as a company auditor for a period of three years provided he or she had practical experience equal to at least half that needed for full registration and, in addition, that he or she agreed to undertake a minimum amount of audit work each year (600 hours under the provisional proposal; 400 hours under conditional) for three years, agreed to have all audits that they undertook during that period reviewed by an RCA who had full registration and agreed to have the audit procedures used by them reviewed during the first and third years following registration as part of a quality review program.

543. Many of the submissions received by the Working Party were highly critical of the proposal that all audits undertaken by provisional/conditional RCAs should be reviewed by a full RCA, noting that the proposal had the potential to be administratively complex (reviews of audits; additional quality reviews). It was argued that this administrative complexity could increase the cost of audits performed by provisional/conditional RCAs and that this additional cost would have to be passed on to clients in the form of higher audit fees. This, in turn, might disadvantage provisional/conditional RCAs by making it less costly to engage an RCA with full registration.

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<sup>35</sup> ACT Companies Ordinance 1962, subsection 9(7). There were similar provisions in the Companies Acts of most States and the Northern Territory.

544. However, the principal criticism of the provisional/conditional registration scheme was reserved for the number of hours audit work that would have to be undertaken each year by a provisional/conditional RCA. Submissions received from smaller firms in both metropolitan areas and provincial centres outlined the difficulties that they would have in meeting even the 400 hours per annum requirement needed for conditional registration. An ICAA survey of approximately 4,000 chartered accounting practices that had a response rate of 17.5 per cent, found that 85 per cent of the respondent practices (ie partners and staff) performed audit work with 70.4 per cent of audit practices performing less than 600 hours audit work per annum and 58.5 per cent less than 400 hours. Only 20.6 per cent of the audit practices undertook more than 1,000 hours audit work per annum. With so many audit practices apparently performing such a low volume of work, the Working Party acknowledges that individual partners and staff members would have had great difficulty satisfying the hours requirements proposed for provisional/conditional registration.

545. While the Working Party considers that the proposals for provisional/conditional registration have considerable merit and are capable of implementation, concerns raised in submissions about the administrative difficulties of the proposals and the number of hours audit work that would have to be undertaken each year by a provisional/conditional RCAs have led the Working Party to conclude that it would be counter-productive to give further consideration to them.

### **An Hours-Based Requirement**

546. The existing requirement that an applicant for registration as an RCA must have not less than three years work in auditing under the direction of an RCA and, in addition, at least one continuous year during the previous five years must have been spent supervising audits of companies, is subjective to some extent in the sense that one person's interpretation of what is needed to satisfy the periods of time specified in the Law may be different to another person's interpretation. For example, where a person spends the majority of time in any one month on audit work, can the whole month be included when calculating whether the legislative requirements have been satisfied or is a more precise apportionment of the time required.

547. Following discussions with staff of the ASC, the Working Party concluded that, in order to satisfy the current experience requirements for registration as an RCA, an applicant could be required (on the basis of billable hours in larger firms) to spend a maximum of 4,725 hours working under the supervision of an RCA including at least 1,575 hours taking a senior level of responsibility for the audits of companies if a precise apportionment of time is required.

548. It is the view of the Working Party that such hours are excessive, especially in the light of the various initiatives, such as public practice certificates, continuing

professional education and quality review programs, that have been introduced by the accounting bodies over the last 15 years.

549. After consideration of a range of alternative hours-based experience requirements, the Working Party believes that the level of experience needed to obtain full and immediate registration if an hours based eligibility regime is to be retained should be 2,000 hours work in auditing over a period of five years. Some 500 hours of this time should be on work that involves taking a senior level of responsibility for the audits. In accordance with current ASC guidelines, 25 per cent of both the 2,000 hours and the 500 hours should be spent on company audits.

550. The principal advantage in retaining an hours-based regime for determining the practical experience requirements needed for registration as an RCA is that it is objective and certain. A person will be in a position to judge whether he or she has satisfied the requirements prior to making application for registration.

551. The disadvantages of an hours-based regime are that the selection of the number of hours' experience that need to be met is largely arbitrary, that achieving those hours gives no real indication whether a person has the level of skills and other attributes needed to perform audit work and that the regime will invariably discriminate against accounting practices that do not have a high level of audit work, regardless of the quality of that work.

## **A Competency-Based Requirement**

552. In a submission from the ICAA and the ASCPA and discussions the Working Party has had with these bodies and the NIA, it has been proposed that the existing hours-based practical experience requirements should be replaced by competency-based requirements modelled on the auditing component of the discussion paper on competency based standards prepared for the ASCPA, the ICAA and the NZSA by Professor Birkett.<sup>36</sup>

553. In the discussion paper, competency is described as 'the way in which individual attributes (knowledge, skills, attitudes) are drawn on in performing tasks in particular work contexts... Competency is realised in performance. Hence, it can be defined by reference to particular types of job performance, in terms of what is to be performed and how well a performance is to be constituted. The performances thus defined are referred to as competency standards. Competency standards involve an appropriate linkage between:

- (a) tasks to be performed,

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<sup>36</sup> Professor W P Birkett, 'Competency based standards for professional accountants in Australia and New Zealand: discussion paper', ASCPA, ICAA & NZSA, Sydney, 1993

- (b) the contexts in which tasks are to be performed,
- (c) specified performance criteria, and
- (d) individual attributes entailed by the performance.<sup>37</sup>

554. Since publication of the discussion paper, the ICANZ has moved to implement a competency assessment system based on the work of Professor Birkett. The New Zealand system relies on a significant amount of external verification and support by an appropriately qualified employer or mentor. The system is portable between employers and is documented as levels of competence are reached by a log book system.

555. The New Zealand log book requires practical experience to be gained in the following areas with more detailed breakdown of work areas involved in audit and a description of the outcomes that are achieved for each component of the work area:

- (a) design and implementation of methodologies for examining, verifying, evaluating and reporting on financial or non-financial representations of organisations;
- (b) design and implementation of methodologies for examining, verifying, evaluating and reporting on the level of compliance of activities, systems or processes within organisations with internally or externally generated policies, standards, legislation or other requirements;
- (c) design and implementation of methodologies for evaluating and reporting on managerial, operational or procedural processes in organisations;
- (d) participation in the development or evaluation of professional standards or benchmarks for auditing processes and outcomes;
- (e) management of audit work; and
- (f) management of the diverse and evolving contexts of accountability which bear on the conduct and outcomes of auditing work.

556. The ICAA and the ASCPA have advised the Working Party that they expect to have completed the documentation phase for implementing a competency-based regime by mid 1997 and that the new system could be operative in 1998.

557. While a competency-based regime has considerable merit in ensuring a high standard of applicants seeking registration as company auditors, the Working Party

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<sup>37</sup> Birkett, page ix.

notes that a potential deficiency of the regime could be its subjectiveness. Issues including objectivity, bench marking, consistency of assessment, and the extent of experience in the various fields of audit will need to be satisfactorily addressed.

558. The Working Party believes that a competency-based regime will need to be agreed with the ASC and as such must be designed to satisfy the requirements of the ASC.

### **Assessment of Options**

559. As noted above, each option has its advantages and disadvantages. The Working Party believes that the most important considerations are that whatever method is selected is transparent in its method of operation and that it produces outcomes that are impartial and equitable, as well as being capable of being consistently applied.

560. In assessing the options, the Working Party notes that:

- (a) An hours-based regime has the advantage of certainty (ie an applicant knows when he or she has satisfied the minimum requirements), but is deficient in that it says nothing about the quality of auditing work performed by the applicant. This deficiency could be overcome by using the time-based requirement in conjunction with a log book recording the nature and complexity of each audit assignment performed. It could be supplemented by documentation such as a quality review or a competency-based assessment.
- (b) A competency-based regime, while having the potential to indicate whether a person has the ability to perform auditing work, suffers at present from uncertainty surrounding the assessment system. The system also suffers from the fact that it is still only a proposal that has not been implemented by accounting bodies in Australia. Against that, the regime provides a mechanism for assessing the skills and abilities of individual accountants which ultimately has the potential to be more reliable than an assessment based on the number of hours of audit work that has been undertaken.

561. The Working Party, after consideration of the options, has concluded that competency standards should ultimately be adopted as the principal basis for determining whether a person has sufficient practical experience in company auditing and auditing techniques to be registered as a company auditor. In coming to this decision, the Working Party notes that the adoption of competency standards will add a further qualitative element, will further the move towards a self-regulatory approach along the lines advocated elsewhere in this report, and will meet the concerns of accountants in smaller and provincial firms in that it will facilitate the registration of

individuals who are proficient in auditing work but who cannot satisfy the existing practical experience requirements.

562. The Working Party has also concluded that an hours-based regime should continue to be used pending the introduction of competency standards by authorised accounting bodies, although it is expected that by time the recommendations in this report are implemented, the competency standards will be fully operational and the hours based regime will have become redundant.

563. For the purpose of implementing competency-based requirements, the Working Party considers that the Law should specifically provide that competency standards should be used to determine whether an applicant has attained an appropriate level of practical experience. In this regard, the ASC and each authorised accounting body would be required to negotiate the criteria to be considered in the approved competency standard and the benchmarks that would be used to determine whether an applicant's experience and performance in respect of each criteria is satisfactory or unsatisfactory. Details would be included in an MOU. The Working Party also considers that the mentor/employer involved in the completion of the competency statement should be an RCA.

564. At the end of the day, the ASC would need to be satisfied that a particular competency based regime of a body seeking authorisation to perform the registration function was sufficiently rigorous, transparent and objective before it would agree to allow the body to register auditors using that regime. If the ASC was not satisfied about the adequacy of the competency regime, but was satisfied about all other aspects of the body seeking authorisation, it could delegate the registration function to that body provided it only registered auditors on the basis of the prescribed hours requirements.

565. The following recommendations are based on the premise that the functions of registering and supervising company auditors will be delegated to authorised accounting bodies. In the event that the function is not delegated to such bodies, it may not be possible to implement, either in whole or in part, the recommendations dealing with competency standards. In these circumstances, the Working Party recommends that the revised hours-based regime should be used as the experience criteria in the Law.

#### **Recommendation 5.4**

Where an authorised accounting body has in place a competency standard in auditing that has been approved by the ASC, an applicant must satisfy the audit component of the competency standard in order to be registered.

#### **Recommendation 5.5**

The ASC must be satisfied about the appropriateness and workability of the audit component of an authorised accounting body's competency standard before that standard may be approved for use by the authorised accounting body as a basis for deciding whether an applicant meets the practical experience requirements for registration as a company auditor.

#### **Recommendation 5.6**

Where an authorised accounting body does not have an approved competency standard in auditing, the level of practical experience required for registration as a company auditor should be:

- (a) at least 2,000 hours work in auditing over five years under the supervision of an RCA; and
- (b) a minimum of 500 hours of this time should be spent on work that involves a senior level of responsibility for audits.

### **Auditor of Specific Company**

566. Subsection 324(12) of the Law provides that where it is impractical for a proprietary company to obtain the services of an RCA as auditor of the company by reason of the place where the company carries on business, a person who is suitably qualified or experienced and who is approved by the ASC may be appointed as auditor of the company. Such a person is deemed to be an RCA.

567. While this requirement is little used, the Working Party considers that it should be retained in the legislation as it provides a safety net for dealing with a situation where a company is required to have its financial statements audited but, for the reasons specified in the provision, is unable to engage an RCA.

**Recommendation 5.7**

Subsection 324(12) of the Law, which provides that the ASC may appoint a suitably qualified or experienced person as auditor of a proprietary company where it is impractical for the company to obtain the services of an RCA because of the location where it carries on business, should be retained.

**RE-REGISTRATION OF AUDITORS**

568. Under the existing legislative requirements, a registration as a company auditor is opened ended. An RCA's name can only be removed from the Register of Auditors where:

- (a) the RCA requests the ASC to do so; or
- (b) the CALDB directs the registration to be cancelled.

569. It has been suggested to the Working Party that one consequence of these provisions is that, even where RCAs have ceased having an active involvement in audit work, they are reluctant to ask the ASC to remove their names from the Register. This, in turn, means that there are an unknown number of inactive auditors whose names still appear on the Register.

570. The Working Party understands that one reason for inactive auditors being reluctant to have their names removed from the Register is the difficulty of obtaining re-registration should they decide to resume auditing work. Under present requirements, a person seeking re-registration as an auditor would have to satisfy the same educational and experience requirements as a first-time applicant.

571. The Working Party concluded that the Law should be amended to provide a different process for re-registration. In establishing the criteria for re-registration, specific recognition should be given to earlier auditing experience.

572. The Working Party considers that the following conditions must be satisfied by an applicant for re-registration as an auditor:

- (a) the applicant voluntarily relinquished his or her original registration;
- (b) the applicant was not subject to disciplinary proceedings in respect of an auditing-related matter following the relinquishment of the original registration or that the voluntary relinquishment did not occur in order to avoid disciplinary proceedings; and

- (c) the relinquishment of the original registration was not more than five years before the date of the application for re-registration.

**Recommendation 5.8**

There should be simplified criteria for re-registration as an auditor where the applicant had voluntarily relinquished his or her original registration.

**Recommendation 5.9**

An applicant for re-registration as an auditor must meet the following conditions:

- (a) the applicant voluntarily relinquished his or her original registration;
- (b) the applicant was not subject to disciplinary proceedings in respect of an auditing-related matter following the relinquishment of the original registration or that the voluntary relinquishment did not occur in order to avoid disciplinary proceedings; and
- (c) the relinquishment of the original registration was not more than five years before the date of the application for re-registration.

## 6. POST-REGISTRATION SUPERVISION

601. This chapter considers issues associated with the supervision of registered company auditors. In particular, it examines the type and frequency of post-registration reporting requirements and considers whether continuation of registration should be subject to requirements such as continuing education, participation in audit quality review programs and the maintenance of a minimum level of audit work. The various functions covered by 'supervision' are listed in paragraph 402.

### CURRENT SYSTEM

602. Once a person is registered as a company auditor, there is only limited regulatory supervision.

603. Section 1288 of the Law requires each RCA to lodge a triennial statement (Form 907) that contains a range of information about the auditor, including details of a maximum of ten audits that he or she has conducted since either registration or lodgment of the previous triennial statement (see Appendix E for full details of the information that has to be disclosed in the statement). Although triennial statements are not a renewal of registration, in practice they can serve that purpose since failure to lodge a statement may result in the matter being referred to the CALDB and, ultimately, cancellation of registration.

604. In addition, RCAs are required by the Law to advise the ASC of matters such as ceasing to practise as an auditor and changes to their name, their principal or other place of practice or their firm name (Form 905). They are also required to inform the ASC if they become insolvent, are convicted for fraud or dishonesty or become subject to an order prohibiting them from managing a company (Form 906). (Appendix F contains further details of these disclosure requirements.)

605. The ASC also has an auditors' surveillance program which aims to ensure that auditors perform their duties in accordance with the Law, the common law and auditing standards. The program seeks to do this by:

- (a) determining whether the auditor has complied with his or her statutory duties;
- (b) identifying whether the duties of reasonable skill, care and competence as required by common law have been exercised; and

- (c) identifying whether the requirements of accounting standards, auditing standards and related pronouncements issued by the accounting bodies have been complied with.

## **OVERSEAS POSITION**

606. In general terms, the existing requirements in overseas jurisdictions are similar to those in Australia.

607. In Canada, the Public Accountants Council is required to renew periodically the registration of public accountants. In South Africa, each registered accountant and auditor is required to pay an annual fee to the Public Accountants and Auditors Board while they remain registered.

608. In New Zealand, the ICANZ has recently amended its rules. Under the new rules, three 'colleges' are established: Chartered Accountants, Associated Chartered Accountants and Accounting Technicians. Continuing education is mandatory for the Chartered Accountants and Accounting Technicians colleges. There is some grandfathering initially, but effectively audits of companies must be undertaken by members of the Chartered Accountants' college who hold practice certificates. Such members are required to undertake a minimum of 40 hours mandatory continuing education per annum.

## **ISSUES**

609. Submissions that have been received by the Working Party have raised a number of issues concerning the post-registration supervision of RCAs. These issues include:

- (a) the adequacy of the existing requirements for reporting to the ASC;
- (b) the need for RCAs to undertake continuing education; and
- (c) whether RCAs should be required to undertake a minimum level of audit work in order to maintain their registration.

610. An additional issue that requires consideration is the formalisation of arrangements for monitoring the quality of auditing work undertaken by RCAs.

611. Each of these issues is considered in the following paragraphs.

612. The Working Party notes that some of the proposals for post-registration supervision of RCAs could be more efficiently implemented if one or more of the accounting bodies were authorised to register and supervise RCAs. As noted in the previous chapter, persons registered as RCAs who are not members of an authorised accounting body would be required to comply with the code of ethics and other rules of the body to which they submitted their application for registration.

613. In addition, to ensure the efficient and effective operation of a regulatory regime in which responsibility for the registration and supervision of auditors is delegated to authorised accounting bodies, the Working Party has proposed that there be only one Register of Auditors.<sup>38</sup>

### **Post-Registration Reporting**

614. The triennial statement that each RCA has to lodge with the ASC is intended to allow the ASC to monitor the RCA's audit activities.

615. There are, however, widely held views that the statement fails to achieve its objectives. Some of the deficiencies drawn to the attention of the Working Party include:

- (a) because statements are lodged every three years, they do not provide up-to-date information for surveillance/supervision purposes;
- (b) the statement requires the disclosure of information (for example, details of any prohibitions or civil penalty disqualifications) that has already been provided to the ASC;
- (c) particulars of audits conducted during the period covered by the statement give no indication of the size and complexity of the audit, whether the RCA is still undertaking the audit and, in the event that he or she is no longer doing the audit, the reason for ceasing; and
- (d) the absence of information about professional development activities during the period and other monitoring carried out by the RCA's professional body.

616. On the basis of comments made to the Working Party, there would seem to be little justification for retaining the triennial statement in its present form.

617. Two principal options were seen to be available to overcome the perceived deficiencies of the triennial statement:

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<sup>38</sup> See chapter 4.

- (a) abolish the statement; or
- (b) require a statement containing revised information to be lodged annually.

618. Abolition of the requirement for auditors to lodge a statement, whilst superficially attractive as a deregulatory measure, has the disadvantage of leaving the ASC or any other regulatory agency without a means of periodically checking the particulars of RCAs or the appropriateness of continuing their registration.

619. The other option, having an annual statement, would ensure the supply of more timely information to the ASC. The information to be included on an annual statement could cover matters such as:

- (a) the auditor's personal particulars (serving the purpose of confirming or up-dating the ASC's records);
- (b) details of the nature and complexity of major audit work undertaken by the RCA; and
- (c) particulars of professional development undertaken by the RCA during the year.

620. The Working Party notes that the annual statement would, for practical purposes, become an annual renewal of registration.

621. If the ASC continues to be the supervisory body for RCAs, the processing of statements annually instead of every three years would add to the ASC's administrative costs. In view of the Government's policy that user pays principles should apply to the National Corporate Regulation Scheme, lodgment fees for annual statements may have to be greater than one-third of the existing fee of \$115 for triennial statements.

622. On the other hand, if authorised accounting bodies become responsible for supervising RCAs, significant efficiencies may be able to be achieved by merging the annual membership renewals of those bodies and the RCA requirements.

623. The Working Party, on the basis of the information considered by it, is of the view that the existing triennial statement should be replaced by a new annual statement. The new statement should contain information of the type proposed at paragraph 619.

**Recommendation 6.1**

The existing triennial statement should be replaced by a new annual statement.

**Recommendation 6.2**

The new annual statement should provide information about:

- (a) an RCA's personal particulars;
- (b) details of the nature and complexity of major audit work undertaken, including the aggregate hours, showing separately the work in respect of companies and other entities; and
- (c) professional development undertaken by the RCA during the year.

**Recommendation 6.3**

If the registration and supervision of RCAs is undertaken by authorised accounting bodies, the annual statement should be combined with the authorised accounting bodies' membership renewal forms.

**Continuing Educational Requirements**

624. Once a person has been registered as a company auditor, the Law does not impose any ongoing educational requirements. Yet RCAs work in a continually changing environment. They have to become familiar with new or revised auditing and accounting standards, decisions of the UIG and new or amended legislative requirements if they are to perform their auditing engagements in an efficient and effective manner.

625. Where RCAs are members of accounting bodies that have continuing education, the requirements of those bodies that their members undertake a minimum amount of continuing educational development either each year or over a set period of time largely compensates for the lack of any legislative requirements.

626. However, the accounting bodies' requirements do not, and cannot, assist in those cases where an RCA is not a member of a body. In these circumstances, it would be necessary to have a statutory requirement that each RCA undertake a prescribed level of professional development in any given period. Failure to undertake the professional development could become grounds for taking disciplinary action against the RCA. Alternatively registration as an RCA of a person not a member of an

accounting body could carry with it a requirement to meet the continuing professional development obligations of members of one of those bodies.

627. A number of submissions received by the Working Party expressed firm support for the concept of professional development. The question does arise, however, whether restrictions would have to be placed on the subjects in which RCAs may receive credit in respect of professional development. The Working Party has noted that restricting professional development to 'audit related areas' could, and perhaps should, cover financial reporting issues in addition to the more specific subjects such as developments in auditing standards and auditing techniques. The Working Party also saw the value of maintaining broad business skills.

628. The Working Party considers that RCAs should be required to undertake a minimum prescribed amount of professional development. The amount to be prescribed could be similar to that currently required by members of accounting bodies who hold public practice certificates.

#### **Recommendation 6.4**

RCAs should be required to undertake a minimum amount of professional development, calculated on either an annual or triennial basis, and their annual statement should include particulars about the audit content of that professional development.

#### **Recommendation 6.5**

Failure to comply with a requirement to undertake a minimum amount of professional development should be grounds for disciplinary action against the RCA.

### **Practical Experience**

629. Notwithstanding the practical experience requirements that need to be satisfied by a person seeking to become an RCA, once the person is an RCA he or she is under no obligation to undertake any particular level of audit work.

630. Triennial statements lodged with the ASC indicate that many RCAs are reporting the performance of little or no auditing work. Under present legislative requirements, the ASC cannot take steps to have the registrations of such RCAs cancelled. However, it is noted that the question about cancellation of registration that the ASC has included on the triennial statements, when combined with significantly higher fees for lodging such statements, has seen some 2,000 RCAs seek cancellation of their registrations during the last six years.

631. Submissions received by the Working Party expressed conflicting views on whether maintenance of RCA status should depend on a requirement to undertake a minimum level of audit work. The accounting bodies, for example, said that they saw no merit in setting an arbitrary minimum threshold for the conduct of audit work as minimum thresholds place emphasis on quantity as opposed to quality. Other submissions, including those from ASC staff and the ASX, indicated support for having a minimum level of audit work, but did not seek to quantify the amount of work that should be undertaken.

632. Subject to paragraph 634, the Working Party does not favour suggestions that RCAs be required to undertake a specified level of audit work in any one year in order to retain their registrations as RCAs. It believes that the proposal that RCAs must participate in a program of continuing education obviates the need for a work level requirement as does adherence to ethical standards which require a practitioner to perform work only in areas where he or she is appropriately qualified and experienced.

633. The Working Party is not aware of any overseas jurisdictions that provide that a specified minimum amount of work must be undertaken in order to retain registration.

634. The Working Party notes, nevertheless, that the public interest requires an RCA to maintain his or her professional competence. Accordingly, it has decided that where statements submitted to the supervisory body by an RCA show that no substantive audit work has been undertaken by the RCA over a period of not less than five years, the supervisory body should be able to require the RCA to show cause why his or her registration should not be cancelled.

### **Recommendation 6.6**

RCAs should not be required to undertake a specified level of audit work in any one year, but should be required to maintain their competence in audit work. Where an RCA has not undertaken any substantive audit work during a period of not less than five years or has failed to maintain competency in audit work, the supervisory body may require the RCA to show cause why his or her registration should not be cancelled.

### **Quality Review**

635. As noted earlier in this chapter, the ASC has an auditors' surveillance program which results in visits being made to RCAs to examine various aspects of their audit work. The scope of the program varies from state to state and, in many cases, the level of compliance and type of problems detected dictate the nature of subsequent work.

636. The quality review programs being implemented by the ICAA and the ASCPA are wider in scope than the ASC's program but, to the extent that they examine audit work, the two programs overlap. However, the Working Party understands that the focus of the accounting bodies' programs is significantly different to that of the ASC's surveillance program. At present, and for the immediate future, the programs of the accounting bodies are largely of an educative nature. As a consequence, the ASC will need to maintain its current targeted surveillance program, which also responds to complaints. Only when the accounting bodies decide to use quality review programs for investigative as well as educative purposes will it be possible for the ASC to phase down its surveillance program (including specific cases where its special powers are needed).

637. The accounting bodies believe that continuation of registration as an RCA should be based on a satisfactory report from the quality review program. Under the accounting bodies' proposal, an RCA would be expected to undergo a quality review at least once every five years.

638. Where a quality review identifies significant deficiencies in the work of an individual RCA, two courses of action would be available to the supervisory body:

- (a) issue a warning to the RCA and schedule his or her work for more frequent reviews; or
- (b) refer the matter for appropriate disciplinary action.

639. The Working Party believes that quality review programs are an essential element in ensuring that the standard of audit work is not only maintained but progressively improved.

640. However, the Working Party notes that such programs are expensive to implement and maintain. Given the present budgetary climate, it is unlikely that sufficient Government funding would be available to enable the supervisory body to undertake a quality review program on the scale envisaged by the accounting bodies.

641. In these circumstances, any quality review program that is implemented may have to be limited in scope. A range of criteria, including random checking and investigating complaints, could be used to select the RCAs whose work is to be reviewed.

642. The Working Party notes that implementation of quality review programs may raise a series of legal issues, including auditor-client confidentiality, right of access by reviewer to audit working papers, liability of reviewer for defamation actions in respect of any comments made in his or her report and whether a reviewer who fails to notice deficiencies in audited accounts could be joined with the auditor in any professional negligence action.

643. While some of these concerns appear to have been largely overcome by the accounting bodies in the course of implementing their quality review programs, others may necessitate legislative amendments. Accordingly, the Law should provide that all files in respect of audits that have been undertaken by an RCA must be available for inspection as part of a quality review conducted by an authorised accounting body.

**Recommendation 6.7**

The work of all RCAs should be subject to periodic quality reviews conducted by authorised accounting bodies.

**Recommendation 6.8**

Subject to privacy considerations, the Law should provide that all files in respect of audits that have been undertaken by an RCA must be available for inspection as part of a quality review

## **7. APPOINTMENT AND INDEPENDENCE OF AUDITORS**

701. This chapter examines the issues associated with the appointment of a person (or firm) as auditor of a company and the subsequent independence of the auditor from the company and its management.

702. Independence for a professional is a state of mind. No specific restrictions or requirements can achieve independence. However, some specifications can contribute significantly towards the maintenance of independence of mind, as well as the appearance of independence. In practice, independence has three main elements:

- (a) adequacy of remuneration (to ensure that the professional is less likely to be placed under financial pressure);
- (b) adequacy or security of tenure (to ensure that the professional has some degree of protection in order to be able to form an independent opinion); and
- (c) freedom from undue influence in making decisions.

### **CURRENT SYSTEM**

703. The initial appointment of an auditor of a company after its incorporation may be made by either the directors of the company or the company in general meeting. A person appointed in this way holds office until the next AGM of the company, at which time the company must appoint an auditor who will hold office until death, retirement or removal. Casual vacancies in the office of auditor are filled in a similar manner.

704. The Law also contains provisions that have the objective of ensuring that an auditor is independent of each company he or she audits. For example, section 324 provides that a registered company auditor shall not consent to be appointed as an auditor of a company or act as auditor of a company if:

- (a) the person (or, in the case of a firm, any member of the firm), or a body corporate in which the person is a substantial shareholder, owes more than \$5,000 to the company being audited, to a related body corporate or to an entity that the company controls (except in respect of loans in the ordinary course of its ordinary business by a bank or life assurance

company, to natural persons to finance the purchase of that person's principal place of residence); or

- (b) except in the case of a proprietary company, the person is an officer of the company, is a partner, employer or employee of an officer of the company, or is a partner or employee of an employee of an officer of the company.

705. The ethical rules of the ICAA and ASCPA contain detailed requirements relative to independence, including independence as an auditor, as do auditing standards which are mandatory for members of these two bodies.

## **ISSUES**

706. It would seem that in many cases the directors of a company have the ability to control or influence the majority of voting shares and thus can ensure that any resolution they might place before the AGM of the company is carried.

707. Many members of the accounting profession and the wider business community argue that although there have been a few instances where the independence of an auditor could be questioned, in the vast majority of cases the auditors have been, and continue to be, independent of the directors who nominated them for appointment. On the other hand, some accountants and representatives of smaller investors and shareholder groups believe that lack of independence is a significant problem and that the auditor is, in practice, responsible to management or the directors.

## **PROPOSALS**

708. The Working Party has identified the procedures for appointment of auditors by companies and measures to enhance the independence of auditors as important issues that need to be addressed.

### **Appointment**

709. The options identified by the Working Party for appointing auditors include:

- (a) retaining the existing requirements with or without the provision of a period of fixed tenure for the appointment;
- (b) restricting voting at AGMs on resolutions to appoint auditors to those shareholders:

- (i) who are not directors; or
- (ii) who have not exercised a right (whether written or otherwise), based on the size of their share holdings, to have a nominee appointed to the board of directors;
- (c) having the auditor appointed according to existing requirements but on the recommendation of an audit committee or a committee of non-executive directors; and
- (d) having the auditor appointed by a completely independent body such as the ASC, the Court or an independently established tribunal.

710. Australia's regulations relating to audit appointment are broadly in line with those of other developed countries. There is no precedent for appointment by an independent body (option d) and, on the evidence before it at this time, the Working Party is of the view that a move in this direction would create more problems than it would solve. The Working Party believes options (b) and (c) have merit, particularly option (c) which would complement the increasing emphasis on external directors and audit committees in the overall context of corporate governance. It is also in line with the recent recommendations of the Auditing Practice Board in Great Britain.

711. The Working Party considers that auditors of listed companies should be appointed on a recommendation of the audit committee or, where there is no audit committee, on a recommendation of an appropriate committee of non-executive directors. In the case of unlisted corporations, the Working Party recommends that the auditor should be appointed on the recommendation of the audit committee where such a committee exists.

712. To facilitate the implementation of this proposal, the Working Party considers that either the ASX listing rules or the Law should be amended to make it mandatory for listed companies to have an audit committee. Non-executive directors should, preferably, constitute the majority of members of such a committee.

713. The Working Party is also of the view that changes to the auditors of a disclosing entity should be made a continuous disclosure matter. This matter is considered further later in this chapter.

**Recommendation 7.1**

If the ASX listing rules do not so provide, the Law should be amended to require listed companies to have an audit committee. Non-executive directors should constitute the majority of members of such a committee.

**Recommendation 7.2**

Auditors of a listed company should be appointed and their remuneration determined on the recommendation of the company's audit committee or, where there is no audit committee, an appropriate committee of non-executive directors.

**Recommendation 7.3**

Auditors of an unlisted company should be appointed on the recommendation of the company's audit committee where such a committee exists.

**Independence**

714. A failure on the part of an auditor to maintain his or her independence can have significant consequences for the auditor, including:

- (a) being subject to a damages action by a party that claims to have suffered loss as a result of the auditor's lack of independence or by the ASC under section 50 of the ASC Act;
- (b) under section 52 of the Trade Practices Act (or under a Fair Trading Act) for 'conduct that is misleading or deceptive';
- (c) where the lack of independence arises through the auditor's breach of subsection 324(1), being prosecuted under section 1311 of the Law;
- (d) being subject to a hearing by the CALDB as to whether the auditor is a fit and proper person to remain registered as an auditor
  - (i) where the auditor is convicted of an offence under section 1311;  
or
  - (ii) when the ASC has formed the prima facie view that an auditor has failed to carry out or perform adequately and properly the duties of an auditor (section 1292);

- (e) being subject to disciplinary action by the auditor's accounting body (if he or she is a member of such a body); and
- (e) criminal action.

715. The need to ensure that significant arrangements are in place to maintain an auditor's independence raises a number of issues including:

- (a) whether the level of indebtedness (\$5,000) referred to in paragraphs 324(1)(e) and (2)(f) of the Law continues to be appropriate;
- (b) whether the requirements of section 327 dealing with the duration of an auditor's appointment are appropriate;
- (c) whether the external auditor of a company, or his or her firm, should be permitted to provide any other services to the company;
- (d) the impact that practices such as audit tendering are having on the quality and independence of auditors;
- (e) the relationship of the external auditor with independent directors and the audit committee;
- (f) the impact of opinion shopping on audit independence;
- (g) whether the current provisions relating to the removal and resignation of auditors are appropriate;
- (h) whether the auditor's role and privilege with respect to attendance and speaking at AGMs should be extended;
- (i) whether a limitation should be placed on the dependence of an auditor or his or her firm on fees derived from one particular client;
- (j) the extent to which independence issues should be laid down by regulation or alternatively delegated to professional bodies for incorporation into self regulated professional standards and ethical rulings; and
- (k) the place of the teaching of business ethics in tertiary institutions and by professional bodies.

## Level of Indebtedness

716. Indebtedness has two aspects: the auditor being indebted to the audit client and the audit client being indebted to the auditor.

717. Indebtedness by an auditor to a client is addressed in section 324 of the Law. The limitation of \$5,000 for both individual auditors and firms has remained the same since 1982. If permitted indebtedness had been indexed in line with changes in the Consumer Price Index, the figure would now be \$10,000. No submissions have been made to the Working Party on this point. Although the Working Party is of the view that the level of indebtedness is not a critical issue providing it is not material, an increase to \$10,000 or such other amount as may be prescribed by regulation would appear to be appropriate.

718. As part of this question there is some concern about how widespread the indebtedness restriction should apply within an audit firm. One view is that indebtedness considerations should extend no further than those partners directly engaged on the audit. At present, indebtedness between any partner and the audit client is subject to this limitation.

719. A corollary of this question is whether particular types of indebtedness should be excluded from the calculation. Where, for example, the audit client is a bank or other financial institution, it has been proposed that borrowings of up to \$100,000 from the institution by partners not involved in the audit should be permitted. The one qualification on such relationships would be that the indebtedness only arose in the ordinary course of business and was written on normal commercial terms.

720. There has been no suggestion that the present exemption granted by subsection 324(3), in respect of home loans from banks and life assurance companies, be changed.

721. The prohibitions on indebtedness outlined above should also apply to relatives of an auditor. These relatives could be expected to include:

- (a) a spouse or de facto spouse of an auditor;
- (b) a parent, son or daughter of such an auditor, spouse or de facto spouse;
- (c) an entity over which a person of the kind referred to above has control, either individually or in association with another person (including another auditor or a relative of that other auditor).

722. The second aspect of indebtedness relates to amounts owed by the audit client to the auditor. Although AUP 32<sup>39</sup> raises the issue, there is no Australian prohibition on the owing of money by an audit client to the auditor. This is not the case in the USA. The Working Party considers that there is merit in prohibiting an auditor from accepting (or continuing) an audit engagement when the audit client is indebted to the auditor. Indebtedness in respect of outstanding professional fees, or deposits with a financial institution of up to \$100,000 by partners not involved in the audit, should be permitted.

#### **Recommendation 7.4**

The level of indebtedness by an auditor to a client (as referred to in paragraphs 324(1)(e) and (2)(f) of the Law) should be increased from \$5,000 to \$10,000 or such other amount as may be prescribed by regulation, subject to recommendation 7.6.

#### **Recommendation 7.5**

A prohibition should be placed on the indebtedness of a company to its auditor, with the exception of professional fees and amounts up to a maximum of \$100,000 deposited with a financial institution or life insurance company by a natural person on normal commercial terms and in the ordinary course of business of the financial institution or life insurance company, subject to recommendation 7.6.

#### **Recommendation 7.6**

The monetary indebtedness prohibitions should only apply to partners of a firm of auditors who are directly engaged on the audit assignment and relatives of such partners.

### **Term of Appointment**

723. There are divergent views on whether company auditors should be appointed until 'death or removal or resignation' as provided for in section 327 of the Law or for some fixed period.

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<sup>39</sup> It should be noted that, despite the codification of auditing standards whereby the new standards become operative from 1 July 1996, AUP 32 remains operative in its present form with interim endorsement.

724. Under section 327 of the Law, a person or firm appointed as auditor of a company holds office until death or removal or resignation. Section 329 of the Law provides that:

- (a) an auditor may be removed from office by resolution of the company at a general meeting of which special notice has been given; and
- (b) an auditor of a public company may resign if the ASC has consented to the resignation (the auditor of a proprietary company does not need the ASC's consent to resign).

725. Options available in respect of the tenure of auditors include:

- (a) retaining the existing requirements;
- (b) retaining existing requirements but with a fixed minimum term of appointment;
- (c) termination of the audit appointment after a specific period of time, with or without the opportunity to reappoint the existing auditor;
- (d) requiring, where the auditor is a firm, the rotation of the responsible partner after a specified period of time;
- (e) placing, in the case of a sole practitioner or a firm, a restriction on the period for which the sole practitioner or firm may hold office; and
- (f) requiring the appointment of a second or review partner within the auditor's firm or, in the case of a sole practitioner, from another firm.

## Audit Rotation

726. In some European countries, the audit appointment is limited to three years with the incumbent auditor eligible for reappointment. Only in Spain and Italy is there a requirement to rotate the audit after a specified period of time (nine years).

727. Submissions received by the Working Party showed little support for audit rotation. On the contrary, the anticipated cost, disruption and loss of experience to companies is considered unacceptably high, as is the unwarranted restriction on the freedom of companies to choose their own auditors.

728. Although the Working Party believes that a minimum fixed term of appointment (in the absence of a takeover) has merit, the Working Party is disinclined to the view that the term of appointment should be fixed or that audit rotation should be mandated.

## Audit Partner Rotation

729. AUP 32 recommends consideration of periodic rotation of the audit partner and staff on an assignment after a suitable period of time. There is also international support for audit partner rotation.

730. Submissions generally supported rotation of the audit partner although rotation is not favoured by small practitioners who regard such a requirement as discriminatory. The Working Party sees merit in the audit partner rotation proposal but is concerned about the potential impact on small practitioners.

731. The Working Party concluded that there should be mandatory rotation of audit partners in accordance with the principles laid down in AUP 32 for all listed companies.

### **Recommendation 7.7**

There should be mandatory rotation of the audit partners responsible for the audit of listed companies in accordance with the principles laid down in AUP 32.

## Second (Review) Partner

732. A procedure currently employed in many firms is to have a second (review) partner who signs off on an audit opinion prior to its signature by the audit engagement partner. This process is followed as a quality control measure that complements the audit partner rotation concept.

733. The Working Party is interested in the possible formalisation of a second (review) partner concept but again is concerned about the possible impact on small practitioners. The Working Party is also concerned that introduction of a second partner from another firm may involve difficult professional indemnity issues.

734. Accordingly, the Working Party is not inclined to mandate a second (review) partner except as a possible alternative option for rotation of the audit partner.

## Provision of Non-auditing Services by Auditor

735. An issue that is closely related to the independence of auditors is whether an accounting firm that has been appointed as the external auditor of a company should be permitted to provide 'other services' to that company. Other services range from performance of a formal internal audit function through provision of accounting-related services to matters such as executive search and management consultancy.

736. Since 1971, Schedule 5 to the Regulations and its predecessors (Schedule 7 to the Companies Regulations and the Ninth Schedule of the State/Territory Companies Acts/Ordinances) have required the financial statements of a company to disclose separately the amounts paid to the auditor of the company for ‘auditing the accounts’ and ‘other services’, thus clearly recognising the fact that auditors provide other services to the companies that they audit.<sup>40</sup>

737. One of the policy objectives underlying the requirement for separate disclosure of these amounts is to provide sufficient information to enable a reader of the financial statements to make his or her own assessment of the auditor’s dependence on income from other services. It can be argued that, as the income an auditor receives from other services increases, the greater will be the temptation for the auditor to do nothing that will affect the relationship with the client (such as a substantial qualification of the audit report).

738. Options available in respect of provision of ‘other services’ include:

- (a) maintaining the status quo (that is, no requirements other than those dealing with disclosure) with a possible additional requirement for the provision of information on nature of other services;
- (b) restricting the range of other services that the auditor of a company may provide to the company by prohibiting specified types of other services;
- (c) placing a total prohibition on the provision of other services to a company by the auditor of that company; and
- (d) requiring the directors of a company to obtain audit committee and/or shareholder approval (either generally or for specific services up to or in excess of a particular monetary amount) before engaging the auditor of the company to provide other services or in some way monitoring the other services provided.

739. In terms of developed countries, only Italy and France prohibit the delivery of management consulting type services by a firm to an audit client. In other countries there are selective prohibitions on specific services (such as executive recruitment and share registry services in the USA).

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<sup>40</sup> In December 1996, the Australian Accounting Standards Board (AASB) issued accounting standard AASB 1034 ‘Information to be Disclosed in Financial Reports’, which has replaced Schedule 5 to the Corporations Regulations in respect of financial years ending on or after 30 June 1997. The standard contains a requirement equivalent to the current disclosure requirement, which is in clause 27 of Schedule 5.

740. The ethical rulings and audit statements of the accounting bodies (in particular REC 4 ('Professional Independence')<sup>41</sup> and AUP 32) provide extensive guidance to auditors performing other services, particularly in sensitive areas such as internal control, accounting services and internal control reviews (especially in the latter case in the context of systems involving advanced information technology). Among other things the statements provide that:

- (a) AUP 32 requires auditors to be 'free of any interest which might be regarded, what ever its actual effect, as being incompatible with integrity and objectivity'.
- (b) 'In each professional assignment he undertakes, a member in public practice shall both be and be seen to be free of any interest which is incompatible with objectivity. This is self evident in the exercise of the reporting function and also applies to all other professional work' (REC 4).
- (c) 'When providing management consulting services to an audit client, a practice or a person in the practice must not participate in the executive function of that client. Decision making is part of the duties of the board of directors and management of a company and not of its auditors' (REC 4).
- (d) '[a] A practice should not participate in the preparation of the books of a public company audit client save in exceptional circumstances.  
  
[b] In the case of a private company audit client it is recognised that it is frequently necessary to provide a much fuller service than would be appropriate in the case of a public company audit client and this may include participation in the preparation of books.  
  
[c] In all cases in which a practice is concerned in the preparation of the books of an audit client, particular care must be exercised to ensure professional independence and to ensure that the client accepts full responsibility for such books and that no person in the practice has taken part in the executive decision making functions of the client' (REC 4).
- (e) 'The concept of independence is fundamental to auditing, since the auditor's objective is to enhance, through the expression of an independent opinion, the credibility of the reported financial information of an entity' (AUP 32).

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<sup>41</sup> This is the ICAA document. The equivalent ASCPA document is F.1 'Professional Independence'.

- (f) ‘When the auditor is involved in providing “other services”...there are particular independence issues which must be resolved’ (AUP 32).
- (g) ‘In principle there is no objection to providing a client with services additional to audit services. However care should be taken to ensure that:
  - ‘[a] actual independence is not at risk by the auditor performing management functions or making management decisions; and
  - ‘[b] perceived independence is not at risk because of a perception that the auditor is too closely aligned with the entity’s management’ (AUP 32).
- (h) ‘The provision of internal audit services by the external auditor of the same entity may...place at risk the perception of the independence of the external auditor from the perspective of the financial report users and other interested parties’ (AUP 32). The statement goes on to detail the steps necessary in order for the external auditor performing internal audit work to demonstrate independence.

741. Submissions provided little support for a legislative prohibition on other services. One submission proposed that internal audit not be performed by the external auditor but the overwhelming view was that no restrictions should apply, save that in accepting an undertaking to provide other services, the auditor should comply with the ethical requirements and audit standards referred to in paragraph 740 above.

742. Submissions generally supported the right of a company to engage whoever they considered most appropriate for non-audit work and stressed that the auditor may well be the most appropriate person to do that work.

743. The Working Party is of the view that additional services provided by an external auditor in the areas of accounting services, internal audit and special-purpose reviews of internal control involve a higher degree of risk of impairment of the independence of the work of the external auditor. Even if there is no actual impairment, these services could well give rise to an appearance of impairment of independence. Therefore it seems appropriate that additional procedures apply to help to eliminate any difficulties in this area.

744. For accounting services, REC 4 already specifies precautionary procedures that should be followed and limits the extent of involvement of the external auditor. It is the view of the Working Party that where the principal role of the accounting firm is in the provision of external audit services, then another partner should take responsibility for any accounting services. The general rules applicable to acceptance of such additional work will of course remain in place.

745. Regarding internal audit services, these services are an extension of the role of the internal controls of the enterprise being audited, being quite separate in their nature from external audit work. Therefore, to help ensure that the different roles are not confused, it would seem essential that the partner handling the internal audit work be not the same as the partner handling the audit engagement.

746. Internal control reviews and assessments are a vital part of the work of the external auditor. As a by-product of the audit, the external auditor will bring to the attention of management and the directors issues of concern which have been noted.

747. Particular care needs to be taken where the external auditor has a formal responsibility to report to third parties on aspects of internal controls; sufficient work needs to be performed on the internal controls to be able to make the necessary report.

748. In this situation it would seem inappropriate for the auditor to undertake a specific and separate assignment to review internal controls, for the benefit of management and/or the directors.

#### *Working Party's Position*

749. Having regard to the significant legal and professional sanctions when there is a failure by an auditor to maintain his or her independence and the emphasis on disclosure referred to in the next paragraph, the Working Party is not inclined to the view that any specific restrictions should be placed on non-audit services being performed by the auditor or his or her firm.

750. However, the Working Party believes there are good reasons to require the current disclosure requirements relating to non-audit services to be extended to provide a broad breakdown of the nature of those services.

751. Non-audit services provided to a company by its auditor or his or her firm should be reviewed annually by the company's audit committee or, if there is no audit committee, by another committee of non-executive directors.

**Recommendation 7.8**

Providing there is a continuing mandatory requirement to adhere to the independence requirements of current ethical rulings and auditing standards, the Law should not place any restrictions on an auditor or his or her firm performing non-auditing services for an audit client. However in the current review of ethical requirements by the accounting bodies, it is recommended that attention be directed toward the provision of additional procedures (including allocation of responsibility for the additional services to a partner other than the external audit partner) for application in the more contentious areas of accounting services, internal audit and specific and separate internal control reviews to strengthen independence in these areas.

**Recommendation 7.9**

The current disclosure requirements relating to non-audit services should be expanded to require a breakdown of the nature of those services and to include services provided by entities whose beneficial ownership is substantially the same as that of the auditor's firm.

**Recommendation 7.10**

Non-audit services provided to a company by its auditor or his or her firm should be reviewed annually by the company's audit committee or, where there is no audit committee, by the full board to satisfy itself that the non-audit services provided are not of a nature that would compromise the independence of the external auditor from the perspective of the company.

**Method of Selecting Auditor**

752. There is a perception in some sections of the community that the practice of some companies' directors of seeking tenders for the auditing of their companies' financial statements has led to a decline in the quality of company audits. This could also lead to concerns regarding independence, as adequate remuneration is considered to be an ingredient of independence (see paragraph 702).

753. While there does not appear to be any empirical data that supports this perception, it would, nevertheless, seem to be fundamental that if the remuneration auditors are receiving for individual company audits is either declining or remaining static, in the long term costs associated with the audit must also be reduced or contained.

754. The point has been made to the Working Party that the cost to both tenderers and companies is very high in that many companies call for a substantial number of tenders all of which require a significant amount of preparation and presentation time.

There is also concern that additional tenders are sometimes called to place fee pressure on a preferred auditor in circumstances where there is no real prospect of the additional tenderers being appointed.

755. As tendering is a normal procedure for obtaining goods and services in both the public and private sectors, restricting or preventing its use as a means of selecting company auditors could involve some difficulty. Suggestions have been made to the Working Party, however, that tender procedures should be overseen by an independent tribunal and/or that tender proposals be made available to all tenderers; also that the number of detailed tender proposals called for be limited in some way such as by a preliminary filtering process to reduce costs.

756. The use of tendering for selecting company auditors would indicate the need for measures such as scrutiny via quality reviews and the establishment of audit committees and the further strengthening of the profession's ethical guidelines in this area.

757. The Working Party appreciates the need for freedom for companies to negotiate the audit fee. Having said this the Working Party sees audit services as 'special' services provided for the protection of shareholders (see paragraph 128) and therefore somewhat different in nature to the provision of other products or services where tendering has long been an established practice. The Working Party also believes there is a need to strengthen the role of the auditor in audit tender situations to safeguard the maintenance of high quality audit services. As a consequence, the Working Party generally supports suggestions contained in AUP 32 that the audit fees should be commensurate with the service provided and that recovery of the cost of an audit in any one period should not depend upon an expectation of recovery from the fees of future audits and/or other services to be provided to the client. The Working Party also sees merit in the specific targeting of audits recently won by tender in the quality control review processes of the ICAA and ASCPA.

#### *Working Party's Position*

758. The Working Party does not believe it is appropriate to remove tendering as one of the possible methods for selecting auditors. As previously indicated, however, the Working Party is of the view that auditors of listed corporations should be appointed on the recommendation of an audit committee. This view carries with it the expectation that audit committees will be closely involved in the calling and evaluation of tenders where this method of selection is employed.

759. The Working Party also considers that the provisions of AUP 32 on audit tenders should be embodied in the mandatory audit or ethical standards of the accounting bodies.

760. The Working Party also believes that steps need to be taken to limit the number of auditors invited to submit detailed proposals to firms identified (if necessary, by a brief preliminary process such as inviting expressions of interest) as meeting a company's major criteria and therefore having a realistic opportunity for appointment.

### **Recommendation 7.11**

The Law should not place any restrictions on the use of tendering as a means of selecting a company's auditors but companies should be encouraged to reduce the number of formal tenders required.

## **Relationship of the External Auditor with the Audit Committee or Non-Executive Directors**

761. The Working Party notes the growing debate on corporate governance issues and in particular the trend toward the introduction of audit committees and the strengthening of the role of non executive directors. The Working Party is supportive of these trends which it believes can significantly strengthen the role of the auditor.

762. The Working Party also sees a need to increase the level of communication between auditors and the board of directors, for example by attending board meetings. In this respect it is significant to note that auditors do not have the right to attend board meetings.

763. Valuable insight and discussion on the role of the audit committee was contained in the Kirk Report,<sup>42</sup> issued in September 1994 in the United States. The Report considered the relationship of the auditor with the board of directors and the audit committee:

Today, in most companies, the auditor's interaction with the board of directors is through the board's audit committee. The audit committee assists the board in fulfilling its oversight responsibilities in the areas of financial reporting, internal controls, financial policies, and the independent and internal audit processes. While it is certainly appropriate and effective for the board to delegate those responsibilities to the audit committee, the Panel believes that the auditors can add to the effectiveness of the board in monitoring corporate performance on behalf of the shareholders without detracting from the important role of audit

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<sup>42</sup> Advisory Panel on Auditor Independence, 'Strengthening the professionalism of the independent auditor — Report to the Public Oversight Board of the SEC Practice Section, AICPA', Public Oversight Board, Stamford, 1994.

committees by direct involvement with the full board and particularly its independent directors.

The Panel believes it essential that the full board and particularly the independent directors have more exposure to the outside auditor to assist the board in meeting its responsibilities to shareholders. The independent auditor can provide the board a wide and objective perspective of the company's operations as well as its financial reporting policies and practices.

**As the shareholders' representative, the board is accountable to them for monitoring the company's performance in achieving its goals and plans. That accountability is discharged, in part, by ensuring that shareholders receive relevant and reliable financial information about the company performance and financial position. The board should expect the auditor to assist it in discharging that responsibility to the shareholders, and the auditor should assume the obligation to do so. Therefore, the full board needs to have direct exposure to the auditors at least once a year prior to reappointment of the auditor.**

The involvement of the auditor with the full board of directors is not intended in any way to bypass the audit committee or to replicate the committee's work at the full board level. The committee would continue to review with the auditors the details of the company's financial statements, management's discussion and analysis [MD&A], other financial data and systems, and audit findings and judgements related thereto. It is the intention of the Panel's suggestions that audit committees would report the auditor's views at meetings of the full board and would ask the auditor to be present at such meetings as frequently as necessary, but at least once a year.

764. The Working Party also believes that the Law should be amended to allow an auditor by prior notification, to attend any meeting of the board of directors to discuss issues which have relevance to the audit.

765. Finally, the Working Party favours a requirement for auditors to meet with the full board at least annually to discuss financial statements tabled for adoption by the board and to meet with the audit committee where such a committee exists.

### **Recommendation 7.12**

The Law should be amended to provide that where a company's audit committee or the company's board is to discuss issues which have relevance to the audit, the company's auditor should be given notice of the meeting and be invited to attend the meeting or relevant part thereof. The Law should also be amended to permit an auditor (by prior notice) to attend an audit committee meeting or board meeting to raise and discuss issues which have relevance to the audit.

### **Compliance with Accounting Standards**

766. The Working Party has noted the potential for opinion shopping to erode the independence of the auditor. Although the ICAA and ASCPA have introduced ethical rulings with respect to opinion shopping, the Working Party is inclined to the view that more needs to be done in this area.

767. The Working Party believes that one means of achieving this may be to revisit the proposal of the ASCPA and the ICAA to establish a FRRB to:

- (a) provide specific guidance to individual companies and their auditors on contentious accounting issues and interpretations of accounting standards; and
- (b) investigate suspected breaches of accounting standards and where appropriate to refer matters for disciplinary action against directors and/or auditors.

768. The establishment of the Urgent Issues Group (UIG) has provided a mechanism for dealing with issues surrounding the application of accounting standards which are of concern to members of the accounting profession and the wider business community. As a consequence, the UIG has reduced the need for the interpretative role that had been proposed for the FRRB. However, there would still appear to be a role for it in investigating suspected departures from accounting standards or other reporting anomalies. Under this proposal, the FRRB would investigate and, where it found that there had been a prima facie breach of an accounting standard or other reporting anomalies, it would seek appropriate remedies. If it is unsuccessful, the matter would be referred to either the accounting bodies or the CALDB for further action.

### **Recommendation 7.13**

The Working Party encourages the establishment of a Financial Reporting Review Board (FRRB) or similar group to inquire into apparent departures from accounting standards or other reporting requirements. Where it was found that departures had occurred, it would seek appropriate remedies. If it is unsuccessful, the matter should be referred to either the accounting bodies or the CALDB or both for appropriate disciplinary action.

## **Removal and Resignation of Auditors**

769. The Working Party has received submissions suggesting that consideration should be given to circumstances when it may be appropriate for a change of auditors to take place other than at an AGM or without the requirement to obtain ASC approval. The Working Party is concerned at the potential in these circumstances for the independence of the auditor to be compromised.

770. There is concern that executive management may be in a position to exert undue influence on the role of the auditor in reaching an independent professional opinion. The position for the auditor is unique, in that the appointment is officially made by shareholders as an independent group, but in practice the day to day dealings and payment of fees to the auditor are made by executive management. It would be very much in the public interest if the existing power and influence of executive management over the auditor could be minimised in the interest of auditor independence.

771. Any proposal to remove the auditor from office should be the subject of a continuous disclosure notice to be filed with the ASX and/or the ASC, on the basis that it is 'material' information. This should also indicate reasons. Similarly any resignation by an auditor should be the subject of a continuous disclosure notice which contains a statement of the auditor's reasons for resigning.

772. Any appointment of a new auditor of a public company or disclosing entity must, at present, be approved by shareholders at the next AGM. Existing requirements established by the ASC restricting voting on the change of auditor upon resignation largely to the AGM and to dates not near the financial year end should be retained; however, there should be provision for approval for the resignation in other special circumstances by the ASC. There should also be a requirement that any proposal for appointment of auditors should contain information on proposed fees.

**Recommendation 7.14**

The Law should be amended to provide that a proposed change to the auditor of a disclosing entity is a continuous disclosure matter.

**Recommendation 7.15**

The Law should provide that any proposal for appointment of auditors of a disclosing entity must contain information on the proposed fees.

**Attendance at AGM**

773. Subsection 332(8) of the Law currently provides that an auditor of a company or an agent of the auditor is entitled to attend any general meeting of the company and to be heard on any part of the business of the meeting that concerns the auditor in the capacity of auditor.

774. The Working Party received submissions suggesting the role of the external auditor at a company's AGM should be strengthened as this is the only forum where the auditor and the persons to whom he or she is accountable can meet on a face to face basis. The Working Party is supportive of the underlying principles involved.

775. The Working Party believes that there should be a requirement for an auditor to attend the AGM at which his or her audit report is tabled, either in person or by nominee, except in exceptional circumstances. This would appropriately complement the draft provision in the Second Corporate Law Simplification Bill which provides that if a company's auditor or his or her representative is at the AGM, the chairperson of the AGM must allow a reasonable opportunity for members at the meeting to ask questions of the auditor relevant to the conduct of the audit and the preparation of the auditor's report.

776. The Working Party notes that subsection 1289(1)(a) provides that an auditor has qualified privilege in respect of any statement that he or she makes, orally or in writing, in the course of his or her duties as auditor.

**Recommendation 7.16**

The Law should be amended to require an auditor, or a representative of the auditor, to attend the AGM at which the auditor's report is tabled unless reasonable circumstances preclude his or her attendance.

**Restriction on Fee Levels for a Particular Client**

777. AUP 32 recommends that, in order to strengthen independence, fees from one audit client or a group of audit clients not exceed an appropriate limit of the gross fees of the practice, set according to individual circumstances. AUP 32 states that the auditor should consider and document the effect on independence when the total fees in the financial reporting period paid by the audit client or group of clients exceeds 15 per cent of the gross fees of the practice.

778. Small practitioners are opposed to such a recommendation becoming mandatory on the grounds of discrimination. They point out that independence is a state of mind and in view of the stringent ethical rulings of the ICAA and ASCPA relative to independence, there is no need or benefit to be obtained from greater restrictions.

779. The Working Party is of the view that the principles outlined in AUP 32 provide sound guidance. AUP 32 is not mandatory, however, and the Working Party believes that where total fees in the financial reporting period paid by the audit client or group of clients exceeds 15 per cent of the gross fees of a practice, there should be detailed consideration and documentation on the relevant audit file of the implications for independence and this document should be available for review in the normal quality review process.

**Recommendation 7.17**

An appropriate mandatory standard of the accounting bodies should require that where the total fees in respect of all services in a financial reporting period paid by an audit client or group of clients exceeds 15 per cent of the gross fees of the practice, there must be detailed consideration and documentation on the relevant audit file of the implications for independence and that the document is to be available for review in the normal quality review process.

## Regulation or Self-regulation

780. The Working Party has received submissions which on the one hand favour the introduction of additional regulation into the Law and similar legislation to deal with proposals of the type considered by the Working Party. On the other hand there is a strong view that proposals to be adopted should, in the main, be introduced by way of ethical and technical standards of the accounting bodies.

781. The Working Party has noted the strong self-regulatory standards of the ICAA and the ASCPA and the willingness of these bodies to introduce new and strengthened regulations where appropriate. Current self-regulatory controls include:

- (a) high education entry requirements;
- (b) rigorous induction programs;
- (c) careful character checks before entry;
- (d) compulsory public practice induction program;
- (e) compulsory continuing professional development;
- (f) extensive ethical rulings and codes of ethics;
- (g) separate public practice registration;
- (h) compulsory quality review program;
- (i) compulsory professional indemnity insurance; and
- (j) detailed mandatory auditing standards and auditing pronouncements.

782. The Working Party considers that whilst it will be necessary to retain direct legislative control over certain requirements, it would be preferable to embody as much of the detail of the regulatory requirements as possible in the profession's mandatory standards and pronouncements and self regulatory framework.

### **Recommendation 7.18**

Regulatory requirements for auditors should, to the maximum extent practicable, be embodied in the mandatory standards and pronouncements and self regulatory framework of the authorised accounting bodies.

## Teaching of Professional and Business Ethics

783. The Working Party is aware that the ICAA and ASCPA have incorporated a substantial segment on professional ethics into their induction programs. It is of the view, however, that there should be greater encouragement for the inclusion of business ethics in approved tertiary courses so as to inculcate ethical principles in undergraduate education.

784. The Working Party believes that endeavours should be made through the appropriate educational channels to introduce and strengthen the teaching of ethical principles in primary and secondary schools.

785. The Working Party also believes that the accounting bodies should specifically require an adequate level of teaching of professional and business ethics as a pre-requisite to granting course accreditation to tertiary institutions for graduates entering the induction programs of the accounting bodies.

### **Recommendation 7.19**

Endeavours should be made through the appropriate educational channels to introduce and strengthen the teaching of ethical principles in primary and secondary schools.

### **Recommendation 7.20**

The accounting bodies should require an adequate level of teaching of professional and business ethics as a pre-requisite to granting course accreditation to tertiary institutions for graduates entering the induction programs of the accounting bodies.

## **8. DISCIPLINE**

801. This chapter outlines the existing administrative and institutional arrangements for handling disciplinary matters affecting registered company auditors and compares them with the arrangements in place in other countries. The chapter then outlines a number of proposals that have been put forward by the CALDB. Finally, options for revising the existing arrangements are considered.

### **COMPANIES AUDITORS AND LIQUIDATORS DISCIPLINARY BOARD**

#### **Establishment**

802. The CALDB is a statutory board established by section 202 of the ASC Act. Sections 203 and 209 of the ASC Act provide for the Board's membership to consist of:

- (a) a chairperson (who must be a lawyer who has been enrolled for at least five years);
- (b) a member and deputy member selected by the Minister from a panel of five nominations put forward by the ICAA; and
- (c) a member and deputy member selected by the Minister from a panel of five nominations put forward by the ASCPA.

#### **Functions of CALDB**

803. The CALDB is responsible for dealing with disciplinary matters concerning auditors and liquidators referred to it by the ASC.

804. Matters that may be referred to the CALDB under section 1292 of the Law include:

- (a) the failure of an auditor to lodge a triennial statement;
- (b) the failure of an auditor to carry out or perform adequately and properly the duties of an auditor;

- (c) the failure of an auditor to carry out or perform adequately and properly any duties or functions required by an Australian law to be carried out or performed by a registered company auditor;
- (d) that an auditor is subject to a section 229 prohibition, a section 230 order, a section 599 order, a section 600 notice or a civil penalty disqualification;<sup>43</sup>
- (e) that the auditor is incapable, because of mental infirmity, of managing his or her own affairs; and
- (f) that (in the opinion of the ASC) a person is not a fit and proper person to remain registered as an auditor.

805. Section 218 of the ASC Act provides that the proceedings of the CALDB are to be conducted with as little formality and technicality, and with as much expedition, as the requirements of the Law and a proper consideration of the matters before the Board permit. The section also provides that the Board is not bound by the rules of evidence. However, the CALDB is required to observe the rules of natural justice.

### **Powers of CALDB**

806. Penalties that may be imposed by the CALDB are the cancellation of an auditor's registration or the suspension of that registration for a specified period of time. The CALDB may also deal with a person:

- (a) by admonishing or reprimanding the person;
- (b) by requiring the person to give an undertaking that he or she will not engage in specified conduct; or
- (c) by requiring the person to give an undertaking that he or she will not engage in specified conduct except under certain conditions.

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<sup>43</sup> Sections 229, 230, 599 and 600 all deal with circumstances in which a person is prohibited from managing a corporation.

807. Under the former co-operative companies and securities scheme legislation the CALDB could also impose a monetary penalty not exceeding \$5,000. Constitutional considerations prevented the inclusion of an equivalent provision in the *Corporations Act 1989*. However, with the subsequent modification of the national scheme from a Commonwealth only to a Commonwealth-State arrangement (based on State and Territory powers), the Law could be amended to allow the imposition of monetary penalties.

### **Review of CALDB Decisions**

808. Subsection 1317B(1) provides that a decision of the CALDB may be reviewed by the Administrative Appeals Tribunal (AAT). A review of a decision may be sought by any person (including the ASC) whose interests are affected by the decision.

### **Amendments Proposed by CALDB**

809. The CALDB has proposed a number of minor amendments to the Law which it believes would assist in its functioning. These amendments include:

- (a) providing for the appointment of a Deputy Chairperson of the Board;
- (b) giving the Board the ability to sit simultaneously in two divisions;
- (c) giving statutory authority to the Registrar of the Board to attend to certain matters, particularly those of a procedural nature, such as mentions, pre-hearing conferences and costs and taxation matters (presently there is no legislative authority for the Registrar to so act);
- (d) clarifying the Board's ability to issue practice notes, enforce orders made during the pre-hearing process, and impose monetary penalties as well as, or in lieu of, a cancellation or suspension of a registration;
- (e) giving the Board the power to publicise its hearings and decisions;
- (f) giving the Board clear statutory authority to use mediation and/or arbitration; and
- (g) streamlining procedures which enable parties to settle a matter which is before the Board.

810. The Board's proposals are considered under appropriate headings later in this chapter.

## **OVERSEAS POSITION**

811. In the overseas jurisdictions examined by the Working Party, there are two basic ways of dealing with disciplinary matters:

- (a) by the professional bodies, as in Great Britain, New Zealand and the United States;<sup>44</sup> and
- (b) by public accountants registration boards, as in Canada (Ontario) and South Africa.

812. The Working Party understands that, in the jurisdictions where public accountants registration boards deal with disciplinary matters in respect of a particular person, the accounting bodies in those jurisdictions may also take appropriate disciplinary action against that person.

## **ISSUES**

813. The Working Party has identified a number of issues concerning the requirements for disciplining auditors that they consider should be examined as part of this review. The issues are:

- (a) whether the existing institutional arrangements for dealing with disciplinary matters operate in an efficient and effective manner;
- (b) whether the matters that may be dealt with by the CALDB are appropriate;
- (c) whether the penalties that may be imposed by the CALDB are appropriate; and
- (d) whether the CALDB and/or the ASC should be authorised to exchange information with the accounting bodies for the purpose of disciplinary proceedings.

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<sup>44</sup> The Working Party understands that in the United States discipline is done by the professional bodies under a regime that is overseen by the regulatory bodies.

814. The Working Party also notes that, in theory at least, it is possible to have up to six separate actions against an RCA in respect of the one matter. These actions are:

- (a) being subject to a damages action by a party that claims to have suffered loss as a result of the auditor's lack of independence or by the ASC under section 50 of the ASC Act;
- (b) under section 52 of the Trade Practices Act (or under a Fair Trading Act) for 'conduct that is misleading or deceptive';
- (c) where the lack of independence arises through the auditor's breach of subsection 324(1), being prosecuted under section 1311 of the Law;
- (d) being subject to a hearing by the CALDB as to whether the auditor is a fit and proper person to remain registered as an auditor
  - (i) where the auditor is convicted of an offence under section 1311; or
  - (ii) when the ASC has formed the prima facie view that an auditor has failed to carry out or perform adequately and properly the duties of an auditor (section 1292);
- (e) being subject to disciplinary action by the auditor's accounting body (if he or she is a member of such a body); and
- (f) criminal action.

815. While issues associated with criminal prosecutions of RCAs and civil actions for damages are outside the Working Party's terms of reference, the Working Party has kept in mind the need to try and streamline procedures for CALDB hearings and disciplinary action by the professional bodies when those bodies are considering the issues identified above.

## **INSTITUTIONAL ARRANGEMENTS**

816. The options regarding institutional arrangements for taking disciplinary action against RCAs are very similar to those that have been identified for undertaking the registration and supervisory functions. In summary, they are:

- (a) retaining the existing arrangements (possibly with some minor modifications to improve the efficiency and effectiveness of the disciplinary process);
- (b) transferring the function to the ASC or to a newly established ARB; or
- (c) having the accounting bodies assume primary responsibility for the disciplinary function.

817. The form of institutional arrangements for disciplinary procedures has also been considered by the Working Party established to review the regulation of corporate insolvency practitioners. The report of that Working Party has recommended that the existing institutional arrangements should be retained for conduct matters, with administrative matters being dealt with by the registering body. The report also recommends that the CALDB should be given greater flexibility in the penalties it may impose and that it should be given powers to enforce orders made during the pre-hearing period and to use mediation and arbitration.

818. The Working Party also notes that, irrespective of which model is ultimately chosen for dealing with the disciplinary function, provision must be made for the three distinct phases of the disciplinary process:

- (a) the investigation of complaints;
- (b) the disciplinary hearing; and
- (c) the appeal process.

819. The Working Party further notes that, in deciding upon the form of institutional arrangements for taking action against RCAs, it is important that the disciplinary body is, and is seen to be, independent, impartial, expert, informed and proactive.

## Retain Existing Arrangements

820. Putting aside for the moment the disciplinary processes of the accounting bodies, under existing disciplinary arrangements the ASC is responsible for the investigation of complaints, the CALDB is responsible for the disciplinary hearing and the AAT is responsible for the appeal process.

821. There are a wide range of views on the effectiveness of these arrangements. Some submissions received by the Working Party indicate that the existing arrangements are adequate, others argue that some matters are too expensive to process through the CALDB.

822. A strength of the existing institutional arrangements is that the CALDB is independent of the ASC and the accounting bodies. This enables it to be totally impartial in considering the evidence presented to it and in giving a judgment.

823. Retention of an independent body for disciplining RCAs would also be in keeping with the kind of disciplinary arrangements that have been recommended for the legal profession. The 'Access to Justice' report<sup>45</sup> recommends that the governments of all States should vest the regulatory functions relating to the legal profession in a body independent of the legal profession.

824. A number of options are available for improving the way in which the CALDB currently operates. For example, consideration could be given to allowing the accounting bodies to refer significant matters concerning the conduct of RCAs that had been detected during the course of quality reviews to the CALDB. The amendments proposed by the CALDB would also have the potential to streamline its operations.

825. While the retention of the CALDB would result in some duplication of effort with the accounting profession's disciplinary processes, this could be minimised if the CALDB were authorised to provide information to the Investigation and Disciplinary Committees of the accounting bodies.<sup>46</sup>

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<sup>45</sup> Report of the Access to Justice Advisory Committee, 'Access to Justice — an Action Plan', 1994, p. 103.

<sup>46</sup> The submission by the ICAA and the ASCPA states that the findings of the CALDB are now provided to accounting bodies in respect of members. Such findings form the basis of an alleged breach which can be the subject of the accounting bodies' disciplinary process.

826. None of the overseas jurisdictions examined during the course of this Review has established a disciplinary body for dealing with matters involving either auditors or liquidators. In Great Britain and New Zealand the accounting bodies of those countries are responsible for disciplinary matters, while in Canada and South Africa the public accountants registration boards deal with disciplinary matters.

### **Accounting Bodies to Undertake Function**

827. The second option identified by the Working Party — and the one advocated in many of the submissions about the issues that should be considered during this Review — is for the accounting bodies to assume responsibility for the disciplinary function.

828. The Working Party notes that the ICAA and ASCPA have long established procedures for disciplining members, including members who have already been disciplined by other bodies such as the CALDB. A significant advantage of having the accounting bodies undertake the disciplinary function would therefore be the merging of the CALDB and the disciplinary processes of the accounting bodies.

829. As with the functions of registering and supervising RCAs, the disciplinary function could either be delegated to the accounting bodies by the ASC or conferred on them by legislation. The former approach would also necessitate the Law being amended to transfer the function from the CALDB to the ASC. In addition, mechanisms would need to be put in place to enable the accounting bodies' performance of the disciplinary function to be monitored.

830. A disadvantage of having the accounting bodies undertake the disciplinary function is that they are not seen as being totally independent and impartial. In this regard, there has been concern expressed in some quarters about the profession's ability to handle disciplinary cases which may involve breaches of the Law or criminal misconduct. Furthermore, in major cases of significant public interest (eg Qintex, Estate Mortgage), it would seem unreasonable for the accounting bodies to bear the full burden of costs.

831. In the case of the accounting profession, the disciplinary procedures of the accounting bodies already have a high level of transparency in that disciplinary committees include lay members and the findings of the disciplinary and appeal committees are published in the professional journals. Nevertheless, procedures would need to be put in place to ensure that all complaints against RCAs are recorded and the results of subsequent investigations are documented.

832. Giving the accounting bodies responsibility for the disciplinary function would bring Australia broadly into line with New Zealand, where the NZSA is responsible for taking any disciplinary action that may be necessary against those members (and

non-members) who hold certificates of public practice issued by the NZSA and who have accepted appointments as auditors of New Zealand companies.<sup>47</sup> It would also result in the Australian requirements being similar to the requirements in Great Britain.

### **ASC to Undertake Function**

833. A third option would be for the ASC, or another statutory body such as an ARB, to assume responsibility for the disciplinary function.

834. The ASC already exercises disciplinary powers in respect of occupational licence holders in the futures and securities industries and, accordingly, there would appear to be no reason why the ASC could not perform a similar function in respect of RCAs.

835. An advantage of having the ASC undertake the disciplinary function is that it would be a totally independent and impartial body. This would especially be the case if the accounting bodies performed the registration and supervisory functions, as proposed elsewhere in this paper. Nevertheless, even if the ASC continued to perform the registration and supervisory functions, arrangements could be put in place to ensure that the person or persons hearing a matter had had no prior involvement in the matter and thus could be regarded as independent and impartial.

836. The principal disadvantage of this option is that it would still result in some duplication of effort with the accounting bodies' disciplinary processes. The ASC may also be seen to be lacking in personnel with appropriate expertise.

### **Working Party's Position**

837. The Working Party notes that there are both advantages and disadvantages in leaving the disciplinary function with the CALDB, transferring the function to the ASC or merging the function with the accounting bodies' disciplinary processes. They also note that many of the submissions received by the Working Party advocate or support giving the disciplinary function to the accounting bodies.

838. Public interest considerations necessitate that the disciplinary process, where the outcome can result in the removal of the right to practice as a professional auditor and/or the imposition of substantial monetary penalties, be undertaken by a body that is 'independent' or in circumstances where the disciplinary process is transparent. Such a body must have the resources to 'carry through' complex and lengthy

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<sup>47</sup> While this comment refers specifically to auditors of New Zealand companies, the NZSA has the power to take disciplinary action against all of its members and any non-members who have been issued with certificates of public practice.

proceedings to a conclusion and, as a matter of law, be required to comply with the rules of natural justice.

839. One approach is that the accounting bodies could assume responsibility for the discipline function, subject to the bodies taking appropriate steps to ensure complaints handling and disciplinary procedures are fully transparent, thus giving the government and the public confidence in the procedures.

840. An alternative approach is based on the view that, having regard to the nature of the audit function as, in essence, an extension of an executive government responsibility to ensure continuing confidence in the capital and securities markets, the responsibility for discipline should be undertaken by a statutory body (that is, the CALDB or the ASC). An appeal can be made to the AAT from a decision of such a body and the result of that appeal both with respect to the facts and the reasons for the decision are made public.

841. The Working Party believes, on balance, that the CALDB should be retained for dealing with conduct matters.

842. The Working Party also believes that, where the ASC has delegated the registration function to authorised accounting bodies, the authorised accounting bodies should be permitted to bring conduct matters before the CALDB. It was noted that allowing authorised accounting bodies to bring matters before the CALDB also offered potential for making the disciplinary procedures of the bodies more efficient.

#### **Recommendation 8.1**

The CALDB should be retained for dealing with those disciplinary matters that the Law provides should be brought before an independent disciplinary body.

#### **Recommendation 8.2**

Where the ASC has delegated the registration of auditors to authorised accounting bodies, those bodies should be permitted to bring conduct matters directly before the CALDB.

## MEMBERSHIP OF CALDB

843. The Working Party considered several proposals having the objective of making the operation of the Board more efficient and ensuring that Board members have a wide range of legal, accounting and business skills.

844. The CALDB has proposed that the ASC Act should be amended to provide for the appointment of a deputy to the chairperson. The CALDB notes that, while there has never been a situation in which the chairperson has had a conflict of interest or otherwise found it necessary to disqualify himself, such a situation could arise. In these circumstances, not having a chairperson could seriously delay the work of the CALDB as it would be necessary for the chairperson to either resign or take leave. In the former case, the Minister would have to appoint a new chairperson while in the latter he could appoint an acting chairperson.

845. The CALDB has also proposed that the ASC Act should be amended to allow the Board to sit simultaneously in two divisions. Such an arrangement would have the potential to facilitate the operations of the CALDB, especially at times when the Board had a number of major matters listed for hearing.

846. A further issue, raised with the Working Party by the Group of 100 (G100), is whether the membership structure of the CALDB needs to be significantly different to that of the current Board if it is to be seen to be independent, impartial, expert, informed and proactive and it is to avoid being seen to be excessively legalistic and/or bureaucratic. In this regard, the G100 indicated some concern about the current legislative requirements under which the ICAA and the ASCPA nominated two of the three members of the CALDB and questioned whether, under this arrangement, members of the public may not consider the aim of clear independence to be realised.

847. To overcome the problems it envisages, the G100 proposes that the Board's membership should comprise people with legal knowledge, auditing skills, business skills and business accounting skills. The Working party notes that members of the Board, as currently constituted, have legal knowledge and auditing skills. Whether Board members have business skills and business accounting skills depends entirely on the professional backgrounds of the nominees of the ICAA and the ASCPA.

848. The Working Party, after consideration of these issues, concluded that there is some merit in formally expanding the range of skills that CALDB members could bring to the Board's deliberations. The Working Party also concluded that the most appropriate way of achieving this objective would be to invite additional peak professional and business bodies to nominate persons for appointment to the Board. Although the Working Party did not reach a decision on which bodies should be invited to make nominations for appointment to the Board, it notes that the following bodies are indicative of the type that should be invited to nominate:

- (a) each authorised accounting body;
- (b) Law Council of Australia;
- (c) Insolvency Practitioners Association of Australia;
- (d) Business Council of Australia;
- (e) Australian Institute of Company Directors; and
- (f) Australian Shareholders Association.

849. The Working Party considers that, in conjunction with changes to the skills of CALDB members and the bodies that may make nominations for appointment to the Board, it may be appropriate to revise the rules for the operation of the Board. Changes that should be made include:

- (a) appointing a Deputy Chairperson;
- (b) permitting the Board to sit in more than one Division simultaneously; and
- (c) having each Division of the Board constituted by a member nominated by an authorised accounting body, a legal practitioner and one other person.

### **Recommendation 8.3**

The ASC Act should be amended to provide for the appointment of a deputy chairperson for the CALDB

### **Recommendation 8.4**

The ASC Act should be amended to allow the CALDB to sit in more than one Division simultaneously.

**Recommendation 8.5**

The ASC Act should be amended to provide that a Division of the CALDB is constituted by a member nominated by an authorised accounting body, a legal practitioner and one other person.

**Recommendation 8.6**

The requirement that the chairperson of the CALDB be a legal practitioner should be repealed.

**Recommendation 8.7**

The ASC Act should be amended to provide that the membership of the CALDB is to be constituted as follows:

- (a) each authorised accounting body is to submit a panel of four names, with one person being appointed from each panel of names;
- (b) two persons selected from a panel of five names submitted by the Law Council of Australia; and
- (c) two persons selected from panels of names submitted by business and professional organisations that are invited by the Minister to make nominations.

**DISCIPLINARY MATTERS**

850. The matters that may currently be referred to the CALDB by the ASC can be divided into two broad categories:

- (a) administrative matters; and
- (b) conduct matters.

## **Administrative Matters**

851. The Working Party views the following matters as being of an administrative nature:

- (a) under paragraph 1292(1)(a), the failure of an auditor to lodge a triennial or other statement;
- (b) under paragraph 1292(7)(a) when an auditor is bankrupt; and
- (c) an auditor who is subject to a section 229 prohibition, a section 230 order, a section 599 order, a section 600 notice or a civil penalty disqualification.

852. It could also be argued that where an RCA is incapable, because of mental infirmity, of managing his or her own affairs, the matter should be treated as being of an administrative nature. However, where notice is given that such a matter will be contested, it may be more appropriate for it to be dealt with as a conduct matter.

853. At present the CALDB deals with a significant number of administrative matters, mainly in respect of failures to lodge triennial statements. There would seem little justification for using the disciplinary body's resources on such matters. A more appropriate procedure would be for the body responsible for the registration and supervision of RCAs ('the registering body') to deal with those matters.

854. This could be achieved by requiring the registering body to deal with administrative matters in accordance with guidelines approved by the ASC. These guidelines could be expected to cover matters such as:

- (a) the procedures for giving notice of the registering body's intention to deal with a matter;
- (b) allowing the RCA who is the subject of the action to be heard; and
- (c) the publication of the registering body's decision in the *Gazette* and, where the registering body is an authorised accounting body performing the registration function under delegation from the ASC, the body's journal.

855. The person whose registration was dealt with by the registering body would be entitled to appeal the registering body's decision. If the registering body is the ASC or another statutory body, the appeal would be to the AAT. However, if the ASC has delegated the registration function to an authorised accounting body, an appeal should be capable of being lodged with the ASC. In accordance with the Law, a decision of the ASC may be the subject of an appeal to the AAT.

856. The Working Party considers that disciplinary procedures would be more effective if disciplinary matters of an administrative nature could be dealt with by the registering body, thus leaving the disciplinary body to concentrate on conduct matters.

**Recommendation 8.8**

Disciplinary matters of an administrative nature (as defined in paragraph 851) are to be dealt with by the registering body.

**Recommendation 8.9**

Where the registration function has been delegated to an authorised accounting body, guidelines approved by the ASC should cover such matters as:

- (a) the procedures for giving notice of the registering body's intention to deal with a matter;
- (b) allowing the RCA who is the subject of the action to be heard; and
- (c) the publication of the registering body's decision.

**Recommendation 8.10**

Where the registration function has been delegated to an authorised accounting body, a person whose registration is cancelled by the registering body may lodge an appeal against that body's decision with the ASC.

**Recommendation 8.11**

A decision made by the ASC in respect of an administrative matter may be the subject of an appeal to the AAT.

**Conduct Matters**

857. Conduct matters are essentially matters concerned either with the manner in which an RCA performed his or her duties as an auditor or with the professional behaviour of the RCA.

858. The following matters are considered by the Working Party to be conduct matters:

- (a) the failure of an auditor to adequately and properly carry out or perform the duties of an auditor;

- (b) the failure of an auditor to adequately and properly carry out or perform any duties or functions required by an Australian law to be carried out or performed by a registered company auditor; and
- (c) that (in the opinion of the ASC) a person is not a fit and proper person to remain registered as an auditor.

859. In the opinion of the Working Party such matters should continue to be dealt with by the disciplinary body at a formal hearing and the disciplinary body should observe the rules of natural justice at and in connection with the hearing.

860. The Working Party also concluded that there should be no barrier to the CALDB hearing administrative matters where they arise in conjunction with conduct matters.

861. It was noted, however, that there may be some relatively minor conduct matters that could be dealt with more efficiently within the disciplinary procedures of the authorised accounting bodies than by referring them to the CALDB. The MOU between the ASC and the authorised accounting bodies could set out which matters may be dealt with by the bodies and which must be referred to the CALDB.

862. The Working Party also noted that the initiation of either civil or criminal proceedings against an auditor could significantly delay the commencement or finalisation of any disciplinary proceedings in respect of conduct matters for that person. Such a delay enables a person to continue in public practice and creates a perception that the disciplinary procedures are ineffective.

863. The Working Party understands that in some overseas jurisdictions, such as Canada, disciplinary matters can proceed or be continued, notwithstanding the existence of either civil or criminal proceedings arising out of the matter that gave rise to the disciplinary proceedings. Under the Canadian system, evidence given for the disciplinary proceedings is quarantined and cannot be used for the civil or criminal proceedings.

864. There would appear to be some merit in amending the Law to allow disciplinary proceedings to take place concurrently with civil or criminal proceedings. As in Canada, some safeguards would appear to be desirable.

**Recommendation 8.12**

The CALDB should only deal with cases involving conduct matters or combined conduct and administrative matters.

**Recommendation 8.13**

Where the ASC has delegated the registration function to authorised accounting bodies, those bodies may, subject to the approval of the Commission, deal with specified types of conduct matter within their own disciplinary systems.

**Recommendation 8.14**

Where civil or criminal proceedings have been commenced against a person, such proceedings are not to act as a bar to disciplinary proceedings against the same person and arising out of the same matter being commenced or continued by an authorised accounting body, the ASC or the CALDB.

## **PENALTIES**

865. As noted above, the penalties that may be imposed by the CALDB are the cancellation of an auditor's registration or the suspension of that registration for a specified period of time. The CALDB may also deal with a person by admonishing or reprimanding the person, by requiring the person to give an undertaking that he or she will not engage in specified conduct; or by requiring the person to give an undertaking that he or she will not engage in specified conduct except under certain conditions.

866. It would seem desirable for the disciplinary body to have greater flexibility in the range of penalties that may be imposed, particularly as far the imposition of fines is concerned. In this regard, the Working Party considers that the CALDB should be permitted to impose fines of up to \$100,000.

867. It would also seem desirable for the disciplinary body to be able to use mediation and/or arbitration and to be able to enforce orders made during the pre-hearing period.

868. The Working Party considers that disciplinary procedures would be more effective if the disciplinary body had greater flexibility in the range of penalties that it could impose.

### **Recommendation 8.15**

The CALDB should be permitted to impose fines up to a limit of \$100,000. Consideration should also be given to amending the Law to enable the CALDB to enforce orders made during the pre-hearing period, to use mediation and to use arbitration.

## **RELEASE OF INFORMATION**

869. Section 1296 of the Law provides that the CALDB will give a person who has appeared before it a notice in writing setting out the decision and the reasons for it. The CALDB is also required to provide a copy of the notice to the ASC.

870. In addition, disciplinary orders made by the CALDB under section 1292 must be published in the *Gazette* within 14 days after the Board has made its decision. However, unlike the notice given to the ASC and the person who appeared before the Board, the *Gazette* notice gives no indication of the nature of the matter dealt with or the reasons for the decision.

871. Section 216 of the ASC Act provides that, unless an auditor requests that a hearing take place in public, the CALDB must hold its hearings in private. Further, section 213 of the ASC Act requires the CALDB to take all reasonable measures to protect information given to it in confidence or in connection with the performance of its functions from unauthorised use or disclosure. Such information cannot be disclosed by the CALDB except in limited circumstances.<sup>48</sup>

872. The ASC has expressed the view that, because of sections 213 and 216 of the ASC Act, the extent to which it can publicise completed CALDB matters is unclear. The ASC has also indicated that there is doubt about the usefulness of incurring the costs associated with taking a matter to the CALDB if the deterrent effect of publicity associated with a successful outcome is not available.

873. In contrast, if a CALDB decision is appealed to the AAT, the AAT's reasons for its decision are available to the public even if the AAT had ordered the proceedings to be held in private.

874. Similarly, although both the ICAA and the ASCPA hold their disciplinary proceedings in private, they publish the findings in their professional journals.

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<sup>48</sup> Apart from disclosures permitted by the Law, the CALDB may only disclose information to assist an authority or person in a State or Territory or another country to perform or exercise a function or power that corresponds to any of the CALDB's or the ASC's powers or functions.

875. The Working Party notes that if greater publicity was given to disciplinary matters, including the publication of reasons for all decisions, the disciplinary process may have a greater deterrent effect than it has at present. In addition, giving the CALDB the authority to provide information to the investigation and disciplinary committees of the accounting bodies could facilitate the disciplinary procedures of those bodies.

876. The Working Party considers that disciplinary procedures would be more effective if the disciplinary body made the nature of the matter and the reasons for its decision public.

877. The Working Party also considers that disciplinary procedures would be more effective if the disciplinary body was authorised to provide information to the investigation and disciplinary committees of the accounting bodies for the purpose of facilitating the disciplinary procedures of those bodies.

**Recommendation 8.16**

The nature of the matter, the decision in respect of each disciplinary proceeding and the reasons for the decision should be published.

**Recommendation 8.17**

The CALDB should be permitted to provide information obtained by it during the course of a disciplinary proceeding to the investigation and disciplinary committees of the authorised accounting bodies to facilitate the disciplinary procedures of those bodies.

## **9. OTHER CORPORATIONS LAW ISSUES AFFECTING REVIEW**

901. This chapter outlines:

- (a) the changes to provisions dealing with the independence of auditors of proprietary companies contained in the First Simplification Act and examines the effect of those changes;
- (b) a proposal that the Law be amended to allow companies to be appointed auditors of other companies; and
- (c) the impact of the review on Commonwealth, State and Territory Auditors-General.

902. It is appropriate at this point to note that, with the establishment of this Working Party to consider the requirements for the registration and regulation of auditors and the establishment of another Working Party to consider a range of issues associated with Insolvency Practitioners,<sup>49</sup> the Corporations Law Simplification Task Force (the Task Force) has decided to defer any work on the provisions in Part 9.2 of the Law (dealing with the registration of auditors and liquidators) until after the Working Parties have finalised their reports and submitted them to the Government. Further consideration of the provisions in Division 1 of Part 3.7 (dealing with the appointment and removal of auditors) will also be deferred until after the Working Party has finalised its report.

### **INDEPENDENCE OF PROPRIETARY COMPANY AUDITORS**

903. Amendments contained in the First Simplification Act have changed the provisions dealing with the independence of an auditor.

904. Subsections 324(1) and (2) of the Law, which previously allowed an exempt proprietary company to appoint as its auditor a person who is an officer of the

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<sup>49</sup> In December 1993 the Attorney-General established a Working Party to consider whether any changes should be made to the system for registration, appointment and remuneration of insolvency practitioners. The Working Party released a discussion paper, 'Review of the Regulation of Corporate Insolvency Practitioners', in January 1995.

company, or a partner, employer or employee of such an officer, now apply to all proprietary companies, including those that are subsidiaries of listed corporations.

905. The Working Party notes that these amendments to section 324 are viewed by the Task Force as following ‘on from the abolition in the First...Simplification Act of the distinction between exempt proprietary companies and other proprietary companies’.<sup>50</sup>

906. However, the ICAA and the ASCPA, in a submission to the Parliamentary Joint Committee on Corporations and Securities’ inquiry into the Bill, suggested that:

Any examination by a person who is not independent of management and is not appropriately qualified, is not an ‘audit’ and should not be given legislative recognition as if it were an audit. If a company is required to (or chooses to) produce an ‘audited’ financial report, the audit must be carried out by an independent, qualified auditor, otherwise there is a significant danger that members of the public will be seriously misled about the level of credibility that can be attached to an ‘audited’ financial report.

907. The Parliamentary Joint Committee, while accepting the advice of the Task Force on these auditing issues and concluding that the issues did not require an amendment to the Bill, noted that the Audit Review Working Party would address the problem highlighted by the accounting bodies.

## **Comment**

908. As noted above, the amendments to subsections 324(1) and (2) contained in the First Simplification Act mean that any proprietary company may appoint as its auditor either a person who is an officer of the company, or a partner, employer or employee of such an officer or a firm, one of the members of which is an officer of the company, or a partner, employer or employee of such an officer.

909. Other provisions dealing with the qualifications of auditors, including the need for the auditor to be an RCA (subsections 324(1)(d) and (2)(d)) and the level of indebtedness that a person may have to the company that he or she audits (subsections 324(1)(e) and (2)(f)), have not been amended by the First Simplification Act.

910. It is understood that one of the major objectives of the amendment to subsections 324(1) and (2) is to reduce the administrative and cost burdens that may be placed on formerly unaudited exempt proprietary companies that, under the new

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<sup>50</sup> Evidence given by Mr Ian Govey to the Parliamentary Joint Committee on Corporations and Securities, *Hansard* 22 February 1995, p. 13.

regime, are classified as large proprietary companies and thus required to appoint an auditor.

911. The most likely situation in which an officer of a company could be appointed the company's auditor is where an accountant who is in public practice is the company's secretary. Whether such an accountant would be prepared to accept appointment as company auditor would depend on his or her interpretation of their professional body's ethical rules and the precise nature of the services that are provided to the company. In any event, such an outcome is unlikely to provide any significant concern in respect of proprietary companies that are currently classified as exempt as most of them are small and, therefore, not required to be audited.

912. The position in respect of proprietary companies that are currently classified as non-exempt is not as clear. Such companies are usually — but not always — part of an economic entity that has a listed corporation as its parent entity. Economic entities of this type usually have an in-house financial area and it is possible that one of the employees of that area could be an RCA. As a result of the amendments to section 324, it would be possible for such an employee to be directed to audit one or more of the proprietary companies in the group. In such a situation the main controls on the conduct of the audit would appear to be:

- (a) the employee's view of the ethical rules of his or her professional body (always assuming that he or she is a member of such a body); and
- (b) the fact that the auditor of the parent entity of the economic entity is completely independent of that entity and that, as part of the audit of the consolidated accounts for the economic entity, he or she would need to examine the auditors' reports for the controlled entities before preparing the report for the parent entity.

### **The Working Party's Position**

913. The Working Party has identified the following options for dealing with the audit issues raised by the accounting bodies:

- (a) leave the provisions as amended by the First Simplification Act;
- (b) remove the proprietary company exemption from paragraphs 324(1)(f) and (2)(g), thus requiring all companies that have to have an audit to appoint as their auditors persons having no connection with the company;  
or
- (c) modify the requirement so that only selected proprietary companies gain the benefit of the exemption.

914. The Working Party is of the view that proprietary companies that are controlled by listed corporations should not be permitted to appoint as their auditors persons who are connected with the company. However, requiring all companies to appoint as their auditors persons who are not connected with the company could impose additional cost burdens on closely held family companies.

915. The Working Party fundamentally opposes different standards of audit. Accordingly, the Working Party is of the view that section 324 should be amended to remove the proprietary company exemption from paragraphs 324(1)(f) and (2)(g), thus requiring all companies to appoint as their auditors persons having no connection with the company. In the view of the Working Party, auditor independence is fundamental and should not be compromised, particularly in the proposed circumstances whereby all of the companies which will be required to appoint an auditor will be substantial in size and therefore likely to have minority shareholders and substantial liabilities.

#### **Recommendation 9.1**

Paragraphs 324(1)(f) and (2)(g) of the Law should be amended to remove the exemptions which currently permit proprietary companies to appoint as their auditors persons who are officers of the company or persons who are related to officers of the company.

## **INCORPORATION OF AUDITORS**

916. Following MINCO consideration of the issue the Government is considering a proposal that companies be allowed to undertake audits of other companies.

917. The incorporation of auditors is seen as one means of overcoming the liability problems associated with partnerships, whereby each of the partners in a firm is jointly and severally liable with all the other partners in the firm in the event of a successful damages claim being made against any of the partners.

## **Overseas Developments**

918. Since October 1991, Great Britain has allowed company auditors to be incorporated. However, there are a number of conditions which auditors and their supervisory bodies must meet before they may take advantage of registration under the legislation. In particular, the legislation requires the existence of provisions to ensure that arrangements are in place to meet claims arising out of audit work, whether by professional indemnity insurance or otherwise.

919. Incorporation of audit practices is also permitted in Canada and in a number of states of the United States. A number of firms have incorporated although incorporation is not considered by them to be a complete solution for addressing the problem of unlimited liability (reform of tort law to replace the present system of joint and several liability with a system of proportional liability is also necessary).

920. There is also a difference between the system of incorporation in North America and that proposed for Australia in that incorporations in the United States have been on the basis of limited liability partnerships, with the result that the significant stamp duty and taxation problems which arise on establishment of a separate corporate entity are largely avoided.

## **Australian Developments**

921. The proposal, which in broad terms is along similar lines to the procedures relating to the approval of securities and futures exchanges, provides that the accounting bodies responsible for the administration of the scheme (to be known as 'prescribed accounting bodies') will approve the bodies corporate that are authorised to act as auditors (to be known as 'authorised audit companies' or AACs). In addition, the accounting bodies, like the securities and futures exchanges, would be required to provide a framework against which potential participants in the industry could be assessed and against which their conduct could be judged.

922. As noted earlier in this report, an inquiry into the law of joint and several liability was established by the then Commonwealth and New South Wales Attorneys-General in February 1994. The final report of the inquiry, which was released in January 1995, recommends that:

- (a) joint and several liability of defendants in actions for negligence causing property damage or purely economic loss be replaced by liability which is proportionate to each defendant's degree of fault; and

- (b) the liability for loss arising from misleading conduct in contravention of the Trade Practices Act, the State and Territory Fair Trading Acts or the Law be proportionate to each defendant's degree of responsibility for that loss.

923. These recommendations are being considered by the Standing Committee of Attorneys-General.

## **AUDITORS-GENERAL**

924. Section 1281 of the Law provides that a person who holds office as, or is exercising the powers and performing the duties of, Auditor-General of the Commonwealth, a State or a Territory shall be deemed to be registered as an auditor.

925. With all levels of government undertaking the corporatisation of their business enterprises, the need for Auditors-General to be able to audit companies is probably more relevant now than it has been at any time in the past.

926. The Working Party therefore considers that a requirement equivalent to that in section 1281 should be retained in the Law.

927. The Working Party also considers that consideration should be given to amending the Law to make it clear that an Auditor-General may, subject to any constraints contained in the Commonwealth, State or Territory legislation establishing his or her office, delegate to a person nominated by him or her responsibility for signing an auditor's report or an audit review prepared under Part 3.7 of the Law.

## **REGISTERED INDEPENDENT AUDITOR**

928. A number of submissions received by the Working Party proposed that the expression 'registered company auditor' should be changed to 'registered independent auditor' or 'registered auditor'.

929. Registered company auditor status has become the de facto benchmark for identifying a competent auditor for many non-corporate audits. The proposed change of terminology would result in an expression which is more appropriate for incorporation into legislation that deals with non-corporate reporting matters. In addition, it would reflect the fact that not all auditing requirements contained in the Law are in respect of companies.

930. The Working Party notes that implementation of the proposal would necessitate amendments to a significant number of Commonwealth, State and Territory Acts.

931. In these circumstances, the Working Party is reluctant to recommend immediate adoption of the proposal. Nevertheless, it believes that the idea should be kept under review and that further consideration be given to it at a time when other amendments to the Law require consequential amendments to other Commonwealth, State and Territory Acts.

## 10. IMPLICATIONS OF REVIEW FOR OTHER LEGISLATION

1001. This chapter briefly considers the implications of the audit review for other Commonwealth, State and Territory legislation that requires either financial statements or other accounting documents to be audited or examined by a registered company auditor.

### OTHER LEGISLATION

1002. As noted in chapter 3 of this report, 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
- (f) auditing accounts and trust accounts under other Commonwealth, State and Territory Acts, including the *National Health Act 1953* (Commonwealth); *Fire Brigades Act 1989* (NSW); *Co-operative Industrial Societies Act 1928* (Tasmania); and the *Dairy Industry Act 1984* (Victoria).

1003. The Working Party notes that it is outside its terms of reference to comment on whether it is appropriate for these Acts to require the audit work in question to be undertaken by RCAs. The Working Party, however, acknowledges that the RCA status has become the de facto bench-mark for identifying a competent auditor for many non-corporate audits.

## **COMMENT**

1004. Matters dealt with in this report that have implications for Commonwealth, State and Territory agencies that administer legislation containing audit requirements that must be performed by RCAs include:

- (a) the proposal that the accounting bodies assume responsibility for the registration and supervision of RCAs;
- (b) the proposal that the educational requirements needed for registration be strengthened by requiring all applicants to have completed the auditing module offered as part of the PY program of the ICAA and the CPA program of the ASCPA;
- (c) the proposal that applicants who have not satisfied the practical experience requirements for full and immediate registration as RCAs be given conditional registration on the basis of lower practical experience and other appropriate conditions; and
- (d) the proposed modifications to the disciplinary procedures.

1005. The Working Party is of the opinion that the proposals set out in this report at least maintain the existing standards for the registration of RCAs. Accordingly, legislation that requires RCAs to undertake audit work would not require amendment to accommodate the proposals in this paper.

1006. One issue that other agencies may need to consider is whether, given the proposed change in educational requirements, RCAs might be 'over qualified' for some of the audits they would be required to undertake.

1007. The Working Party notes that the qualifications for auditors vary both between and within States and Territories, with some Acts describing auditor's qualifications in the following terms:

- (a) a member of the ICAA, the ASCPA or the NIA; or
- (b) a person who holds a certificate of public practice issued by the ICAA or the ASCPA.

1008. The Working Party considers that the States and Territories should review the audit requirements in their various Acts and, where they consider it appropriate, provide that an auditor may be a person who is either a member of or who holds a certificate of public practice issued by a professional accounting body recognised in that legislation.

1009. The full implications of the Review for State and Territory legislation would seem to be a matter for MINCO and SCAG to consider. State and Territory Governments, through a consultative process such as SCAG, could consider the proposals and amend the audit requirements of their legislation as appropriate.

## 11. RESOURCE IMPLICATIONS

1101. This chapter provides an overview of the resources (mainly in terms of funding) that are currently required for performing the functions of registration of company auditors and their post-registration supervision and for undertaking the disciplinary function. An estimate is also provided of the resources that would be required to implement the arrangements proposed by the Working Party.

### CURRENT POSITION

1102. There are three main areas of expenditure at present:

- (a) the processing of various documents lodged with the ASC, including applications for registration as auditors, triennial statements and documents notifying changes in the personal particulars of RCAs and the conduct of hearing when required;
- (b) the surveillance programs of the ASC and the quality review programs of the ICAA and the ASCPA; and
- (c) disciplinary matters dealt with by the professional accounting bodies, along with matters brought by the ASC and the CALDB.

### Registration and Supervision

1103. Payroll costs presently incurred by the ASC covering registration of auditors and the supervision functions described in paragraphs 402(a), (b) and (j) amount to approximately \$150,000-\$200,000 per annum.

1104. Additional significant costs are also incurred relating to the supervision functions described in paragraphs 402(e), (f) and (g). These can vary considerably from year to year. The approximate amount incurred by the ASC during the year ended 30 June 1994 was \$900,000, which included significant out-of-pocket costs for expert opinions etc. For the year ended 30 June 1995 the total cost of payroll for ASC staff and external out-of-pocket costs was approximately \$650,000.

1105. The Working Party notes that, in keeping with the Government's application of user-pays principles to company and occupational licensing matters dealt with under the Law, fees are payable on applications for registration as an RCA and on the lodgment of triennial statements. Applications for registration currently attract a fee of

\$280 while the fee for lodging a triennial statement is \$115. Further fees arise from late lodgment of documents, being \$55 within one month and \$230 after that.

1106. On the basis of activity levels in 1995/96, and assuming that one-third of RCAs lodge a triennial statement each year, fees revenue from auditors in 1996/97 is estimated to be \$470,000 — significantly less than the costs generally incurred by the ASC.

1107. It has also to be acknowledged that any self-regulatory functions undertaken by a professional body can only be undertaken at some cost. Therefore, in addition to the costs incurred by the ASC and the CALDB in the regulation of auditors, the ICAA and ASCPA and those members who hold public practice certificates incur substantial costs particularly in respect of the quality review program. The amounts are significant not only in terms of the costs directly met by the practitioner but also in terms of the costs borne by the accounting bodies. Costs borne by the ICAA and ASCPA in the development and initial administration of the program over the last five years are in the order of \$2 million. Costs borne by practitioners, who will be reviewed each five years, will amount to around \$2 million per annum, excluding the practitioners' own time. Ongoing costs borne by the ICAA and ASCPA for administering the program are between \$500,000 and \$1 million per annum, including the cost of further enhancements to the program. Such costings exclude the time the Committee members of the ICAA and ASCPA have spent and will continue to spend on the development and on ongoing maintenance of the program.

## **Disciplinary Functions**

1108. According to the latest annual report of the CALDB, the expenditure of the CALDB over the last three years was as follows:

|                           | <b>1995-96</b> | <b>1994-95</b> | <b>1993-94</b> |
|---------------------------|----------------|----------------|----------------|
|                           | <b>\$</b>      | <b>\$</b>      | <b>\$</b>      |
| Administrative expenses   | 205,000        | 200,000        | 233,000        |
| Salaries and sitting fees | 107,000        | 118,000        | 147,000        |
|                           | <b>312,000</b> | <b>318,000</b> | <b>380,000</b> |

## **PROPOSALS**

1109. The estimated costs of performing the registration and supervisory (including disciplinary) functions differ for each of the options set out in this Paper.

1110. The following paragraphs outline the estimated costs that the Working Party anticipates would be incurred in implementing the administrative arrangements proposed by the Working Party.

### **Registration and Supervision**

1111. Information provided to the Working Party by the ICAA and ASCPA indicates that, on the basis of them being authorised accounting bodies and jointly performing the registration and supervisory functions, the cost of performing these functions would be approximately \$764,000 in the first year and \$617,000 in the second and subsequent years. While income from annual renewals and applications is currently expected to be about \$470,000 per annum, the ICAA and ASCPA estimate that fees revenue would be \$310,000 in the first year and \$293,000 in the second and subsequent years.

1112. The Working Party notes that the quantum of the costs associated with the performance of the registration function by authorised accounting bodies will largely depend on the way in which the function is performed by the accounting bodies. If, for example, the registration and supervisory functions can be performed as an adjunct to other functions, for example, the issue of public practice certificates, lower additional costs may be incurred by the authorised accounting bodies.

1113. If the authorised accounting bodies were to assume responsibility for the registration and aspects of the supervision of RCAs, the ASC would continue to incur some expenditure in performing an audit-type function on compliance by the authorised accounting bodies with either the terms of the MOU or the conditions under which statutory conferral is made.

1114. Fees for registration and submission of statements would be payable to the authorised accounting bodies. It is envisaged that the quantum of such fees would be a matter for the authorised accounting bodies to determine although the bodies have indicated a reluctance to see any substantial increase in fees beyond their present level arising out of a change in the institutional arrangements in view of the 'special' and public benefit nature of auditing and the current funding arrangements.

1115. The Working Party notes that the question of whether authorised accounting bodies should receive additional Government funding or a transfer of resources from Government for undertaking the registration and supervisory functions will be one for the Government and the authorised accounting bodies to negotiate. Nevertheless, both the ICAA and the ASCPA have indicated that they would be unwilling to bear an excess of costs over revenues for the provision of the delegated activities. The Working Party further notes that any submission for funding over and above that which is presently provided by Government under the existing regulatory requirements would have to demonstrate that additional costs incurred by the authorised accounting

bodies in performing the functions were the result of increased and improved procedures for registration and supervision and that, in total, costs involved for the registration and supervisory functions exceeded revenue that could be reasonably obtained through the imposition of fees.

### **Disciplinary Functions**

1116. If the CALDB is to be responsible for hearing conduct-related disciplinary matters, annual costs no greater than the \$312,000 incurred in 1995/96 could be expected. In these circumstances, both the ASC and the accounting bodies could be expected to incur discipline-related costs similar to those currently being incurred.

## SUBMISSIONS RECEIVED BY WORKING PARTY

| Name of individual or organisation                             | Issues | Discussion Paper | Draft Report |
|--|--------|------------------|--------------|
| <b>National Corporate Regulation Scheme agencies</b>           |        |                  |              |
| Australian Securities Commission (staff comments)              | ✓      | ✓                |              |
| Companies Auditors and Liquidators Disciplinary Board          | ✓      | ✓                | ✓            |
| <b>Other Government agencies</b>                               |        |                  |              |
| Australasian Council of Auditors-General                       |        | ✓                |              |
| Australian Financial Institutions Commission                   | ✓      | ✓                |              |
| Insurance and Superannuation Commission                        | ✓      | ✓                | ✓            |
| Reserve Bank of Australia                                      | ✓      |                  |              |
| Trade Practices Commission                                     |        | ✓                |              |
| Australian Capital Territory Treasury                          | ✓      |                  |              |
| The Audit Office of New South Wales                            | ✓      |                  |              |
| The Treasury (New South Wales)                                 | ✓      |                  |              |
| Office of Business Affairs<br>NT Attorney-General's Department | ✓      | ✓                |              |
| Northern Territory Auditor-General's Office                    |        | ✓                |              |
| Queensland Audit Office  | ✓      | ✓                |              |
| Auditor-General (Tasmania)                                     | ✓      |                  |              |
| Department of Treasury and Finance (Tasmania)                  | ✓      |                  | ✓            |
| Department of Finance (Victoria)                               | ✓      |                  |              |
| Victorian Auditor-General's Office                             | ✓      |                  |              |
| Corporate Affairs Branch<br>WA Ministry of Justice             |        | ✓                |              |
| Office of the Auditor General (Western Australia)              | ✓      | ✓                |              |

| <b>Name of individual or organisation</b>  | <b>Issues</b> | <b>Discussion Paper</b> | <b>Draft Report</b> |
|--|---------------|-------------------------|---------------------|
| Treasury (Western Australia)   | ✓             |                         |                     |
| <b>Accounting Profession</b>   |               |                         |                     |
| Association of Taxation and Management Accountants                                 |               |                         | ✓                   |
| Auditing Standards Board   | ✓             |                         |                     |
| Australian Society of CPAs and The Institute of Chartered Accountants in Australia | ✓             | ✓                       | ✓                   |
| The Institute of Chartered Accountants in Australia (ACT Office)                   | ✓             |                         |                     |
| Midwest Accountants Group  |               | ✓                       |                     |
| National Institute of Accountants  | ✓             | ✓                       | ✓                   |
| New Zealand Society of Accountants   | ✓             |                         | ✓                   |
| Practising Accountants Centre for Education Inc                                    | ✓             | ✓                       |                     |
| <b>Other Professional and Business Organisations</b>                               |               |                         |                     |
| Australian Corporate Lawyers Association   | ✓             |                         |                     |
| Australian Institute of Company Directors  | ✓             | ✓                       |                     |
| Australian Stock Exchange  | ✓             |                         |                     |
| Group of 100   | ✓             | ✓                       | ✓                   |
| Insolvency Practitioners Association of Australia                                  | ✓             |                         | ✓                   |
| Trustee Corporations Association of Australia                                      |               | ✓                       | ✓                   |
| <b>Accounting Firms</b>  |               |                         |                     |
| Asset Management Services  |               | ✓*                      |                     |
| Bird Cameron Partners (Canberra)   | ✓             |                         |                     |
| BMO Accountants Group  |               | ✓                       |                     |
| Brown Burns & Co   | ✓             |                         |                     |
| Bye, John W  |               |                         | ✓                   |
| Byfields   |               | ✓                       |                     |
| Alex Campbell & Co   |               |                         | ✓                   |

| Name of individual or organisation | Issues | Discussion Paper | Draft Report |
|------------------------------------|--------|------------------|--------------|
| Campbell-Smith & Associates        |        | ✓*               |              |
| Geoff Coleman & Company Pty Ltd    |        |                  | ✓            |
| Collins Creek Consultants Pty Ltd  | ✓      |                  |              |
| Coopers & Lybrand                  | ✓      | ✓                | ✓            |
| Creagh, Chapman, Barker Pty Ltd    |        | ✓                |              |
| Deloitte Touche Tohmatsu           | ✓      |                  |              |
| Edwards Irvine and Facius Pty Ltd  |        | ✓*               |              |
| Ernst & Young                      |        |                  | ✓            |
| Everall Merrett Mann Pty           |        | ✓                |              |
| Fleay Gardiner & Associates        |        | ✓*               |              |
| Fleming Partners                   |        |                  | ✓            |
| Forsyths                           |        |                  | ✓            |
| Geers & Pusey                      |        | ✓*               |              |
| Gillard Turner & O'Brien Pty Ltd   |        | ✓*               |              |
| Hearne, G F O                      |        | ✓*               |              |
| Hennessy, Eris M                   | ✓      |                  |              |
| Herries Davidson & Co              |        | ✓                |              |
| Hollands & Partners                |        | ✓                |              |
| Hudson & Co                        |        | ✓*               |              |
| R T Kidd & Associates              |        | ✓*               |              |
| KPMG                               |        |                  | ✓            |
| Ledger Rutledge & Wilkinson        |        | ✓                |              |
| Lee, Timothy                       |        | ✓*               |              |
| Lillingston Milne                  |        | ✓*               |              |
| Lovetts                            |        |                  | ✓            |
| Ludwig, Ross                       |        | ✓*               |              |
| McCleary, Brian                    |        |                  | ✓            |
| McNeil, Marie                      |        | ✓*               |              |
| Marlow Bluhm                       |        | ✓                |              |

| <b>Name of individual or organisation</b> | <b>Issues</b> | <b>Discussion Paper</b> | <b>Draft Report</b> |
|---|---------------|-------------------------|---------------------|
| Metcalf Spahn                             | ✓             | ✓                       |                     |
| K J Meyer Pty Ltd                         |               | ✓*                      |                     |
| John W Muntz & Co                         |               | ✓*                      |                     |
| James Murphy & Co                         |               | ✓                       |                     |
| Nipper, M R                               |               | ✓                       | ✓                   |
| Price Waterhouse                          | ✓             | ✓                       |                     |
| Reid, Subra and Associates                |               | ✓*                      |                     |
| E. Rochman & Co Pty Ltd                   |               |                         | ✓                   |
| Rodda, Graeme                             |               | ✓                       |                     |
| Rous & Gamble                             |               | ✓*                      |                     |
| Samuel, Martin & Rogerson                 | ✓             |                         |                     |
| Shedden & Green Partners                  |               |                         | ✓                   |
| Smith, Leslie M                           |               | ✓                       |                     |
| Southwell-Keely Partners                  |               | ✓                       |                     |
| Taits                                     | ✓             |                         |                     |
| Barry M Thompson & Co                     |               | ✓                       |                     |
| Vivian Coetsee & Associates               |               | ✓*                      |                     |
| Walter and Turnbull                       |               |                         | ✓                   |
| Weston Woodley & Robertson                |               |                         | ✓                   |
| <b>Other</b>                              |               |                         |                     |
| Craswell, Prof. Allen                     |               |                         | ✓                   |
| Hancock, P J (plus P Robinson, J Kestel)  |               | ✓                       |                     |
| Wilkin, John                              |               | ✓                       | ✓                   |

\* These submissions either are form letters (dealing with the issues of public interest, accountant's skills and the registered company auditor designation) or incorporate material that has been taken from the form letter.

## AUSTRALIAN ACCOUNTING BODIES

B01. As noted in chapter 3, Australia's accounting bodies have developed comprehensive requirements for entry to membership, the supervision of members and 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 the following overview of the requirements of the accounting bodies will be of assistance to readers when they are considering the Working Party proposals.

### MEMBERSHIP

#### ICAA and ASCPA

B02. A prerequisite for membership of both the ICAA and the ASCPA is a university degree which has a major in accounting and which contains separate units in auditing, Australian taxation law and Australian business law.

B03. Before members of the ICAA or the ASCPA can provide public accounting services (including auditing), they are normally required to hold a public practice certificate issued by their respective professional body.<sup>51</sup> In general terms the requirements for a certificate of public practice are:

- (a) completion of the PY Program of the ICAA or the CPA Program of the ASCPA;
- (b) completion of the public practice program offered by the ICAA or the ASCPA;
- (c) appropriate experience in public practice;

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<sup>51</sup> There is one qualification to this statement. Members of the ASCPA whose gross annual income from public accountancy services is less than \$7,500, and who do not hold themselves out to the public as providing public accountancy services, are not required to hold public practice certificates and thus do not come within the scope of programs for monitoring the action of members in public practice.

- (d) completion of compulsory continuing professional education/development;
- (e) agreement to participate in a quality review program; and
- (f) agreement to take compulsory professional indemnity insurance.

B04. Members in public practice must comply with the Accounting Bodies Joint Code of Conduct.

## **ATMA**

B05. There are three membership levels within the ATMA:

- (a) Fellow (FTMA) — accountants who have fulfilled the requirements of ‘member’ status within the ATMA and have been qualified as an accountant for 10 years or more; or holders of post graduate qualifications leading to a masters degree with an accounting emphasis; or holders of post graduate diplomas with an accounting emphasis.
- (b) Member (MTMA) — accountants who have completed a degree with an accounting major from an Australian university or a former college of advanced education.
- (c) Associate (ATMA) — graduates with degrees in administration, banking and finance, law, local government or marketing; or accountants who have completed a TAFE diploma in accounting but do not hold a degree with an accounting major from an Australian university or former college of advanced education. Associates must complete a professional upgrade program at an Australian university within five years of joining the ATMA to advance to member status.

B06. ATMA members in public practice are required to hold a Public Practice Certificate. Members entering public practice certificate are required to complete a Public Practice Program, at an Australian University, before a Public Practice Certificate will be issued, if they did not hold a Public Practice Certificate as at 30 September 1994.

B07. Professional indemnity insurance will be compulsory from 1 July 1997, for holders of current Public Practice Certificates.

B08. ATMA members are expected to conform with the accepted accounting standards issued by the accounting profession.

## **NIA**

B09. The minimum academic qualification for Associate status membership of the NIA is the successful completion of an Advanced Diploma in Business (Accounting) from a College of TAFE. The Advanced Diploma is a two year full time course which covers the full range of accounting requirements.

B10. Historically, Member status of the NIA has been achieved in one of two ways. In the last two years, to qualify at Member status all Associates are required to either have successfully completed a Graduate Certificate in Professional Accounting from the University of New England, or hold an approved accounting degree. In addition, the applicant must demonstrate three years of work experience in an accounting or related field before Member status is obtained. Prior to the introduction of this requirement, an applicant for advancement to Member status had to demonstrate a minimum of five years work experience in an accounting or related field.

B11. Only members who have reached Member status or above are eligible to apply for a public practice certificate.

## **SUPERVISION**

### **ICAA and ASCPA**

B12. The ICAA and ASCPA have arrangements in place for the supervision of their members, including those who are RCAs. The accounting bodies require members holding public practice certificates to complete a minimum amount of continuing professional development (the ASCPA specifies 60 hours (structured) per triennium while the ICAA requires 40 hours each year (20 hours structured; 20 hours unstructured)).

B13. Quality review programs have also been implemented to ensure that members in public practice, including RCAs, undertake their work in accordance with professional requirements.

B14. The ICAA and the ASCPA introduced their quality review programs in 1994, commencing with pilot reviews and the training and review of reviewers. Both bodies then commenced the process of selecting and reviewing members and practices chosen at random.

B15. The reviews are conducted by trained reviewers who are principals in public practice, and have themselves been reviewed. All areas of the accounting practice are reviewed, with an emphasis on audit and accounting engagements.

B16. Both accounting bodies select members for review on the basis of a number of factors, eg type, size and location of practice. The actual reviews undertaken are similar in that they review adherence to professional standards by practitioners in the course of providing service to their clients. Integral to the review process is an examination of the practitioner's working papers. This last point is particularly sensitive as clients' consent must be obtained before reviewers can examine the working papers.

B17. The quality review programs of the accounting bodies have now been implemented on the basis of every public practice certificate holder being subject to review at least once in every five years. The emphasis of these programs in the first five year cycle is primarily educational.

### **ATMA**

B18. The ATMA requires its members to undertake a minimum of 20 hours continuing professional development in any one calendar year. Continuing professional development activities may be made up of structured and unstructured activities. The ATMA will be conducting, from 1 July 1997, random audits of CPD activities undertaken.

B19. A Quality Assurance program for all ATMA members will be implemented from 1 July 1997 to ensure that members, particularly those in public practice, undertake their work in a professional manner.

### **NIA**

B20. The NIA has the following arrangements in place for the supervision of members:

- (a) There is a requirement for all members of the NIA to undertake Continuing Professional Education. For Fellows and Members in Public Practice, there is a requirement for a minimum of 60 hours CPE per biennium. Members who are not in Public Practice are required to complete 40 hours CPE per biennium.
- (b) The requirement for NIA members to conduct their professional endeavours in a suitable manner is supported by an identifiable and enforceable Code of Ethics which is based on international ethical standards. The Code of Ethics is based on the concept that members will act legally at all times.

- (c) NIA public practitioners are required to complete a Public Practice Orientation Program and must hold and maintain a Public Practice Certificate.
- (d) Public liability insurance is mandatory for all NIA public practice certificate holders.
- (e) NIA public practitioners must abide by strict guidelines on 'conduct of members in public practice' as well as the Code of Ethics.
- (f) NIA public practitioners must adhere to the 'public practitioners manual' which includes a section on quality assurance (QA). Members are expected to implement the QA processes as appropriate to their particular practice.

## **DISCIPLINE**

### **ICAA and ASCPA**

B21. Both the ASCPA and the ICAA have established disciplinary procedures for dealing with members who have breached their code of ethics or committed a range of other transgressions. For example, a member may be penalised where he or she has breached ethical pronouncements, engaged in conduct that is dishonourable, derogatory or not in the best interests of the profession or has failed to observe proper professional standards. Penalties that may be imposed include forfeiture of membership, suspension from membership, cancellation of a certificate of public practice, remedial professional development, censure and admonishment and/or a fine of up to \$100,000<sup>52</sup> plus publication of the member's name with a summary of the transgression.

B22. The ASCPA and the ICAA have established similar institutional arrangements for handling disciplinary matters including the appointment of lay members to disciplinary committees.

B23. Complaints are typically considered by an investigation committee, which then advises a disciplinary committee whether, in its opinion, a member has a case to answer. Where there appears to be a case to answer, the disciplinary committee is required to conduct a hearing and, where it concludes that a complaint has been sustained, impose an appropriate penalty. The findings of the disciplinary committee

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<sup>52</sup> \$50,000, plus costs, in the case of ASCPA members.

may, in certain circumstances, be the subject of an appeal to an appeals committee. The investigation, disciplinary and appeals committees may include lay members.

## **ATMA**

B24. The ATMA has adopted the ethical pronouncements of the major accounting bodies. Non compliance with accounting and auditing standards and ethical pronouncements will result in disciplinary action being taken against the member and forfeiture of membership.

B25. The ATMA has established disciplinary procedures for dealing with members who have breached its code of ethics or have transgressed the fundamental principles of professional conduct as described in the *Members' Handbook*. Complaints are investigated by a subcommittee of the General Council and if there is a case to be answered, the General Council forms a disciplinary committee. The General Council shall have power by resolution to censure, fine or suspend a member or forfeit membership.

## **NIA**

B26. The NIA disciplinary system has three levels of operation: investigation, disciplinary and appeals. Although the Articles allow for this system to operate at a Divisional level, the current practice is for them to be handled at a National level. There are two national standing committees: the National Investigation Committee (ICN) and the National Disciplinary Committee (DCN). The Appeals Committee is brought into being on a 'needs' basis by National Council and normally comprises senior nominations with specialist knowledge/ experience in the area in which the breach has occurred.

B27. Actions by the ICN must be initiated by a written complaint. The ICN has the responsibility of deciding whether a member has a 'case to answer' for a breach of the NIA's Articles, By-laws or Pronouncements. If a decision is made that there is a 'case to answer', the information is passed to the DCN for a decision on whether the complaint has been proven and for an appropriate disciplinary award to be made. After the DCN decision, the member has 30 days in which to lodge an appeal. If an appeal is not lodged, the National Council's resolution on the DCN/Appeals decision is formalised by notification to the member, and if decided, by publication of the findings.

## **PROFESSIONAL STANDARDS**

B28. The Australian Accounting Research Foundation (AARF), which was established by the ICAA and the ASCPA and is jointly funded by those bodies, is responsible for the development of the auditing standards that company auditors, who are members of one or both of these bodies, are required by their professional ethics to use when they are undertaking an audit assignment. The Auditing Standards Board established as part of AARF is responsible for the day-to-day work on the development of auditing standards and audit practice statements.

**DISTRIBUTION OF AUDITORS**  
**within each State and Territory**  
*as at 2 April 1997*

**New South Wales**

| Region or area                                      | Uniform<br>Companies<br>Acts (ie<br>before 1.7.83) | Co-operative<br>scheme (ie 1.7.83<br>to 31.12.90) | National<br>scheme (ie<br>after 31.12.90) | Total — all<br>schemes |
|---|--|---|---|------------------------|
| <b>Sydney metro area</b>                            |  |   |   |                        |
| Sydney CBD  | 574  | 239   | 108                                       | 921                    |
| North Sydney  | 57   | 24  | 5   | 86                     |
| Parramatta  | 71   | 31  | 10  | 112                    |
| Other metro<br>areas                                | 1129   | 364   | 66  | 1559                   |
| <b>Total metro area</b>                             | <b>1831</b>  | <b>658</b>  | <b>189</b>                                | <b>2678</b>            |
| <b>Country areas</b>                                |  |   |   |                        |
| Blue Mountains                                      | 19   | 2   | 1   | 22                     |
| Gosford Central<br>Coast                            | 47   | 12  | 2   | 61                     |
| Newcastle and<br>the Hunter                         | 129  | 41  | 4   | 174                    |
| North Coast   | 106  | 52  | 12  | 170                    |
| New England   | 77   | 30  | 9   | 116                    |
| Wollongong and<br>the Illawarra and<br>South Coasts | 69   | 16  | 13  | 98                     |
| Southern<br>Highlands and<br>Tablelands             | 55   | 10  | 2   | 67                     |
| Other areas   | 143  | 44  | 14  | 201                    |
| <b>Total Country<br/>areas</b>                      | <b>645</b>   | <b>207</b>  | <b>57</b>                                 | <b>909</b>             |
| Norfolk Island                                      | 0  | 1   | 0   | 1                      |
| <b>Total RCAs in NSW</b>                            | <b>2476</b>  | <b>866</b>  | <b>246</b>                                | <b>3588</b>            |

## Victoria

| Region or area                | Uniform Companies Acts (ie before 1.7.83) | Co-operative scheme (ie 1.7.83 to 31.12.90) | National scheme (ie after 31.12.90) | Total — all schemes |
|-------------------------------|---|---|-------------------------------------|---------------------|
| <b>Melbourne metro area</b>   |   |   |                                     |                     |
| Melbourne CBD                 | 229                                       | 137   | 54                                  | 420                 |
| Balwyn                        | 26  | 8   | 0                                   | 34                  |
| Blackburn                     | 24  | 8   | 1                                   | 33                  |
| Camberwell                    | 17  | 15  | 0                                   | 32                  |
| Caulfield                     | 23  | 6   | 0                                   | 29                  |
| Essendon                      | 18  | 5   | 0                                   | 23                  |
| Frankston                     | 23  | 3   | 1                                   | 27                  |
| Hawthorn                      | 36  | 21  | 6                                   | 63                  |
| Melbourne (St Kilda Rd)       | 34  | 17  | 6                                   | 57                  |
| Mount Waverley                | 26  | 6   | 0                                   | 32                  |
| Sth Melbourne                 | 25  | 16  | 2                                   | 43                  |
| South Yarra                   | 27  | 9   | 1                                   | 37                  |
| Other metro areas             | 677                                       | 256   | 47                                  | 980                 |
| <b>Total metro area</b>       | <b>1185</b>                               | <b>507</b>                                  | <b>118</b>                          | <b>1810</b>         |
| <b>Country areas</b>          |   |   |                                     |                     |
| Ballarat                      | 20  | 7   | 1                                   | 28                  |
| Bendigo                       | 13  | 6   | 0                                   | 19                  |
| Geelong                       | 32  | 13  | 4                                   | 49                  |
| Shepparton                    | 5   | 6   | 0                                   | 11                  |
| Swan Hill                     | 7   | 1   | 2                                   | 10                  |
| Warrnambool                   | 8   | 2   | 1                                   | 11                  |
| Wodonga                       | 9   | 2   | 1                                   | 12                  |
| Other areas                   | 170                                       | 63  | 3                                   | 236                 |
| <b>Total Country areas</b>    | <b>264</b>                                | <b>100</b>                                  | <b>12</b>                           | <b>376</b>          |
| <b>Total RCAs in Victoria</b> | <b>1449</b>                               | <b>607</b>                                  | <b>130</b>                          | <b>2186</b>         |

## Queensland

| Region or area                  | Uniform Companies Acts (ie before 1.7.83) | Co-operative scheme (ie 1.7.83 to 31.12.90) | National scheme (ie after 31.12.90) | Total — all schemes |
|---------------------------------|---|---|-------------------------------------|---------------------|
| <b>Brisbane metro area</b>      |   |   |                                     |                     |
| Brisbane CBD                    | 152                                       | 70  | 21                                  | 243                 |
| Other metro areas               | 242                                       | 81  | 11                                  | 334                 |
| <b>Total metro area</b>         | <b>394</b>                                | <b>151</b>                                  | <b>32</b>                           | <b>577</b>          |
| <b>Country areas</b>            |   |   |                                     |                     |
| Cairns                          | 26  | 6   | 7                                   | 39                  |
| Gold Coast                      | 98  | 21  | 9                                   | 128                 |
| Mackay                          | 17  | 4   | 2                                   | 23                  |
| Rockhampton                     | 23  | 4   | 0                                   | 27                  |
| Sunshine Coast                  | 36  | 13  | 3                                   | 52                  |
| Toowoomba                       | 36  | 7   | 0                                   | 43                  |
| Townsville                      | 14  | 4   | 1                                   | 19                  |
| Other areas                     | 116                                       | 25  | 4                                   | 145                 |
| <b>Total Country areas</b>      | <b>366</b>                                | <b>84</b>                                   | <b>26</b>                           | <b>476</b>          |
| <b>Total RCAs in Queensland</b> | <b>760</b>                                | <b>235</b>                                  | <b>58</b>                           | <b>1053</b>         |

## **Western Australia**

| <b>Region or area</b>      | <b>Uniform Companies Acts (ie before 1.7.83)</b> | <b>Co-operative scheme (ie 1.7.83 to 31.12.90)</b> | <b>National scheme (ie after 31.12.90)</b> | <b>Total — all schemes</b> |
|----------------------------|--|--|--|----------------------------|
| <b>Perth metro area</b>    |  |  |  |                            |
| Perth CBD                  | 89   | 39   | 18   | 146                        |
| South Perth                | 23   | 9  | 3  | 35                         |
| Subiaco                    | 32   | 6  | 3  | 41                         |
| West Perth                 | 84   | 38   | 9  | 131                        |
| Other metro areas          | 223  | 51   | 23   | 297                        |
| <b>Total metro area</b>    | <b>451</b>                                       | <b>143</b>   | <b>56</b>                                  | <b>650</b>                 |
| <b>Country areas</b>       |  |  |  |                            |
| Albany                     | 4  | 2  | 0  | 6                          |
| Bunbury                    | 10   | 3  | 1  | 14                         |
| Esperance                  | 2  | 0  | 0  | 2                          |
| Geraldton                  | 6  | 1  | 0  | 7                          |
| Kalgoorlie                 | 3  | 1  | 0  | 4                          |
| Other areas                | 24   | 5  | 3  | 32                         |
| <b>Total Country areas</b> | <b>49</b>  | <b>12</b>  | <b>4</b>                                   | <b>65</b>                  |
| <b>Total RCAs in WA</b>    | <b>500</b>                                       | <b>155</b>   | <b>60</b>                                  | <b>715</b>                 |

## South Australia

| Region or area             | Uniform Companies Acts (ie before 1.7.83) | Co-operative scheme (ie 1.7.83 to 31.12.90) | National scheme (ie after 31.12.90) | Total — all schemes |
|----------------------------|---|---|-------------------------------------|---------------------|
| <b>Adelaide metro area</b> |   |   |                                     |                     |
| Adelaide CBD               | 125                                       | 25  | 12                                  | 162                 |
| North Adelaide             | 20  | 1   | 3                                   | 24                  |
| Wayville                   | 28  | 7   | 5                                   | 40                  |
| Unley                      | 20  | 4   | 0                                   | 24                  |
| Fullarton                  | 19  | 10  | 0                                   | 29                  |
| Kent Town                  | 38  | 9   | 3                                   | 50                  |
| Other metro areas          | 109                                       | 19  | 9                                   | 137                 |
| <b>Total metro area</b>    | <b>359</b>                                | <b>75</b>                                   | <b>32</b>                           | <b>466</b>          |
| <b>Country areas</b>       |   |   |                                     |                     |
| Mt Gambier                 | 8   | 2   | 0                                   | 10                  |
| Port Lincoln               | 2   | 0   | 0                                   | 2                   |
| Port Pirie                 | 3   | 0   | 0                                   | 3                   |
| Renmark                    | 2   | 0   | 0                                   | 2                   |
| Whyalla                    | 2   | 0   | 0                                   | 2                   |
| Other areas                | 16  | 3   | 0                                   | 19                  |
| <b>Total Country areas</b> | <b>33</b>                                 | <b>5</b>                                    | <b>0</b>                            | <b>38</b>           |
| <b>Total RCAs in SA</b>    | <b>392</b>                                | <b>80</b>                                   | <b>32</b>                           | <b>504</b>          |

## Tasmania

| Region or area                | Uniform Companies Acts (ie before 1.7.83) | Co-operative scheme (ie 1.7.83 to 31.12.90) | National scheme (ie after 31.12.90) | Total — all schemes |
|-------------------------------|---|---|-------------------------------------|---------------------|
| <b>Hobart metro area</b>      |   |   |                                     |                     |
| Hobart CBD                    | 38  | 10  | 8                                   | 56                  |
| Bellerive                     | 7   | 3   | 0                                   | 10                  |
| Glenorchy                     | 4   | 0   | 0                                   | 4                   |
| Other metro areas             | 19  | 5   | 1                                   | 25                  |
| <b>Total metro area</b>       | <b>68</b>                                 | <b>18</b>                                   | <b>9</b>                            | <b>95</b>           |
| <b>Country areas</b>          |   |   |                                     |                     |
| Burnie                        | 10  | 2   | 0                                   | 12                  |
| Devonport                     | 11  | 1   | 0                                   | 12                  |
| Launceston                    | 26  | 8   | 4                                   | 38                  |
| Other areas                   | 14  | 4   | 0                                   | 18                  |
| <b>Total Country areas</b>    | <b>61</b>                                 | <b>15</b>                                   | <b>4</b>                            | <b>80</b>           |
| <b>Total RCAs in Tasmania</b> | <b>129</b>                                | <b>33</b>                                   | <b>13</b>                           | <b>175</b>          |

### Australian Capital Territory

| Region or area             | Uniform Companies Acts (ie before 1.7.83) | Co-operative scheme (ie 1.7.83 to 31.12.90) | National scheme (ie after 31.12.90) | Total — all schemes |
|----------------------------|---|---|-------------------------------------|---------------------|
| <b>Canberra metro area</b> |   |   |                                     |                     |
| Canberra CBD               | 19  | 7   | 8                                   | 34                  |
| Other metro areas          | 37  | 13  | 3                                   | 43                  |
| <b>Total RCAs in ACT</b>   | <b>56</b>                                 | <b>20</b>                                   | <b>11</b>                           | <b>87</b>           |

### Northern Territory

| Region or area           | Uniform Companies Acts (ie before 1.7.83) | Co-operative scheme (ie 1.7.83 to 31.12.90) | National scheme (ie after 31.12.90) | Total — all schemes |
|--------------------------|---|---|-------------------------------------|---------------------|
| <b>Darwin metro area</b> |   |   |                                     |                     |
| Darwin CBD               | 4   | 13  | 1                                   | 18                  |
| Other metro areas        | 4   | 5   | 3                                   | 12                  |
| <b>Total metro area</b>  | <b>8</b>                                  | <b>18</b>                                   | <b>4</b>                            | <b>30</b>           |
| <b>Other areas</b>       |   |   |                                     |                     |
| Alice Springs            | 0   | 6   | 1                                   | 7                   |
| Nhulunbuy                | 2   | 0   | 0                                   | 2                   |
| <i>Total other areas</i> | 2   | 6   | 1                                   | 9                   |
| <b>Total RCAs in NT</b>  | <b>10</b>                                 | <b>24</b>                                   | <b>5</b>                            | <b>39</b>           |

**APPLICATION FOR REGISTRATION AS AN  
AUDITOR**  
*(FORM 903A)*

The following information must be disclosed in an application for registration as an auditor:

- (1) Name and residential address of applicant.
- (2) Date and place of birth of applicant.
- (3) Business occupation of applicant.
- (4) Whether applicant is a member of an accounting partnership.
- (5) The name under which the applicant proposes to practise as an auditor.
- (6) The address of the principal place at which the audit practice is or will be conducted.
- (7) Addresses of other places at which the audit practice is or will be conducted.
- (8) Name of the applicant's employer.
- (9) Particulars of the applicant's academic and professional qualifications.
- (10) Particulars of the applicant's employment and business activities for the past ten years.
- (11) The names of registered company auditors under whose direction the applicant has worked.
- (12) Whether the applicant has ever been excluded from practice as an auditor or liquidator, had registration as an auditor suspended or been subject to disciplinary action by any body having authority in Australia or elsewhere for the registration or disciplining of auditors or liquidators.
- (13) Whether the applicant has ever been subject to a prohibition under section 229, a civil penalty disqualification, an order under section 230 or section 599 or a notice under section 600.
- (14) Whether the applicant has ever had a status equivalent to that of an insolvent under administration under the law of a country other than Australia or under the law of an external territory.

(15) Whether the applicant has a conviction, in Australia or elsewhere, for an offence (other than a traffic offence).

(16) Whether the applicant has any legal or disciplinary proceedings pending that may result in action that would require disclosure under any of the above items.

(17) Whether, in the last five years, the applicant has resigned or been removed from office as an auditor or liquidator.

(18) The names of at least two referees.

(19) A form endorsed by the Australian Federal Police that the applicant is not adversely recorded.

## TRIENNIAL STATEMENT OF AN AUDITOR

(FORM 907)

The following information must be disclosed in a triennial statement prepared by or on behalf of a registered company auditor (RCA):

- (1) The period of time to which the statement relates.
- (2) Name and residential address of RCA.
- (3) Date and place of birth of RCA.
- (4) Business occupation of RCA.
- (5) Whether RCA is a member of an accounting partnership.
- (6) The name under which the RCA practises as an auditor.
- (7) The address of the principal place at which the audit practice is conducted.
- (8) Addresses of other places at which the audit practice is conducted.
- (9) Name of the RCA's employer.
- (10) Whether the RCA is still practising as an auditor.
- (11) Whether the RCA is resident in Australia.
- (12) Whether there was any period during the three years preceding the

date of the statement in which the RCA was not resident in Australia.

- (13) Whether the RCA has ever been excluded from practice as an auditor or liquidator, had registration as an auditor suspended or been subject to disciplinary action by any body having authority in Australia or elsewhere for the registration or disciplining of auditors or liquidators.
- (14) Whether the RCA has ever been subject to a prohibition under section 229, a civil penalty disqualification, an order under section 230 or section 599 or a notice under section 600.
- (15) Whether the RCA has ever had a status equivalent to that of an insolvent under administration under the law of a country other than Australia or under the law of an external territory.
- (16) Whether, during the three years preceding the date of the statement, the RCA has been convicted of an offence (other than a traffic offence).
- (17) Whether the RCA has any legal or disciplinary proceedings pending that may result in action that would require disclosure under any of the above items.

(18) Whether, in the last three years, the applicant has resigned or been removed from office as an auditor or liquidator.

(19) Details of a maximum of ten audits conducted by the RCA since the date of the last triennial statement or the date of the RCA's registration, whichever is the later.

## OTHER REPORTING REQUIREMENTS FOR AUDITORS

### **Particulars of cessation or change relating to a person registered as an auditor** *(Form 905)*

Subsection 1287(1) requires a registered company auditor to lodge the following information not later than 21 days after the date of the event that has to be reported:

- (1) Name and residential address of RCA.
- (2) The date on which the person ceased to practise as an auditor.
- (3) Details of any change to the person's name.
- (4) Details of any change to the name or style under which the RCA practises as an auditor.
- (5) Details of any change to the address of the principal place at which the audit practice is conducted.
- (6) Details of any change to the addresses of other places at which the audit practice is conducted.
- (7) Details of any change of employment or to the name of the RCA's employer.

### **Notification of a section 229 prohibition, a civil penalty disqualification, a section 230 order, a section 599 order or a section 600 notice** *(Form 906)*

Subsection 1287(4) requires a person who is registered as an auditor to lodge particulars in writing of the circumstances because of which he or she became subject to a section 229 prohibition, a section 230 order, a section 599 order, a section 600 notice or a civil penalty disqualification. The notification must set out the following information:

- (1) Name and residential address of RCA.
- (2) Date and place of birth of RCA.
- (3) Registration number of RCA.
- (4) Type of registration (liquidators may also be required to complete this form).
- (5) Particulars of the action affecting the auditor.