



MINISTER FOR FINANCIAL  
SERVICES AND REGULATION

PRESS  
RELEASE

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### Strengthening Audit Independence

The Minister for Financial Services & Regulation, Joe Hockey, today welcomed a report by Professor Ian Ramsay on audit independence in Australia.

"This Government wants to improve the safety and the security of investments. Improving auditor independence is a key way of doing this," the Minister said.

Key recommendations [see attachment for full summary] include:

- Stopping former audit partners from becoming a director of the company they audited, within two years of them leaving the audit firm;
- Preventing companies having directors who are also an immediate relative of someone auditing their company;
- Requiring the auditors to disclose the dollar value of non-audit work they do for the company; and,
- Changing the ASX Listing Rules to force all listed companies to have an audit committee.

"We must ensure the independence of auditors is preserved and that stakeholders are secure with the knowledge that the auditor is objective and independent.

"Professor Ramsay's recommendations strike a good balance between safeguarding shareholders' interests and preserving the commercial interests of public companies.

"Regulation of auditors must be workable for all companies -- from the smallest local bowling club to the biggest corporate, like Telstra. We want better regulation not more regulation.

"Professor Ramsay's report is another step in the Government's move towards greater transparency in business practice.

"It makes a substantial contribution to the debate and I urge industry to give it their careful consideration. The Government will consider implementing the report's recommendations."

The report is available at [www.joehockey.com](http://www.joehockey.com)

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### SUMMARY OF KEY RECOMMENDATIONS

Professor Ramsay is Director of the Centre for Corporate Law and Securities Regulation at Melbourne University.

Summary of key recommendations

- The recommendations cover five key issues concerned either directly with audit independence
- The specific recommendations would underpin a general requirement that an auditor must be independent of his or her audit clients.

**Employment relationships**

- An auditor would not be independent if any of the following employment relationships exist with the client:

- employment by client of current auditor / employee of auditor

: An auditor would not be independent if a current partner or professional employee of the audit firm is an officer of the client; a partner, employer or employee of an officer of the client; or a partner or employee of an employee of an officer of the client.

- employment by client of certain relatives of auditor

: An auditor would not be independent if an immediate family member of a member of the audit engagement team is a director of the client; or an officer or employee of the client who is in a position to affect the subject matter of the audit engagement.

- employment by client of former auditor / employee of auditor

: An auditor would not be independent if a former partner or professional employee of an audit firm is a director of the client; or an officer or employee of the client who is in a position to affect the subject matter of the audit engagement. Exceptions are allowed where the individual does not influence the audit firm's operations or financial policies and does not participate or appear to participate in the audit firm's business or professional activities; has no capital balances in the audit firm; and has no financial arrangement with the audit firm other than one providing for regular payment of a fixed pre-determined dollar amount which is not dependent on the revenues, profits or earnings of the audit firm.

- retired audit partner joining board of audit client

: An auditor would not be independent if a former partner of an audit firm who was directly involved in the audit of a client becomes a director of the client within a period of two years of resigning as a partner of the audit firm.

- employment by audit firm of former employee of client

: An auditor would not be independent if a member of the audit engagement team has, during the period covered by the audit report, been an officer of the client; or an employee of the client in a position to influence the subject matter of the audit engagement.

- remuneration from audit firm

: An auditor is not independent if an officer of the client, or an employee of the client in a position to influence the subject matter of the audit engagement, receives any remuneration from the audit firm for acting as a consultant to it on accounting or auditing matters.

- As section 324 of the Corporations Act currently deals with a number of employment relationships between auditors and clients, it is envisaged that the above requirements would also be included in the Corporations Act.

**Financial and business relationships**

- Investments in audit clients

- An auditor would not be independent if:

: the audit firm, any member of the audit engagement team, or any of his or her immediate family has a direct financial investment in the client; or a material indirect financial investment in the client;

: the audit firm has a material financial interest in an entity that has a controlling interest in the client;

: any other client service personnel, or any of his or her immediate family, has a direct financial interest or a material indirect financial interest in the client.

- Loans to and from audit clients

- An auditor would not be independent if:

- : subject to the exception contained in section 324(3) of the Corporations Act, a partner of the audit firm, or an entity which the partner controls, or a body corporate in which the partner has a substantial holding, owes more than \$10,000 (or such other amount as may be prescribed by regulation) to the client; or

- : the audit firm, any member of the audit engagement team, or any of his or her immediate family accepts a loan from a client; makes a loan to a client; has a loan guaranteed by a client; or guarantees client's loan, unless the loan that is made in the ordinary course of the client's business and the loan is made under normal lending procedures, terms and conditions.

- As section 324 of the Corporations Act currently deals with some aspects of financial relationships between auditors and clients, it is envisaged that the above requirements would also be included in the Corporations Act.

- Business relationships

- An auditor is not independent if a member of the audit engagement team has a business relationship with the client or any of its officers; or the audit firm has a business relationship with the client or any of its officers which is not clearly insignificant to both the audit firm and the client.

- A business relationship for this purpose does not include professional services provided by the audit firm, or the audit firm or members of the audit engagement team being a consumer in the ordinary course of business.

- As business relationships between auditors and clients are not currently dealt with in the Corporations Act, it is intended that this rule will be included in the revised Professional Statement of the accounting profession.

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

- It is recommended that the regulation of non-audit services provided by audit firms to their clients be dealt with in professional ethical rules, suitably updated to reflect the IFAC proposals.

- It is also recommended that the disclosure requirements for non-audit services be enhanced to require disclosure of:

- the dollar amount of all non-audit services provided by the audit firm to the client, divided by category of service, with appropriate discussion of those services;

- whether the audit committee of the board of directors, or if there is no such committee then the board of directors, has considered whether the provision of non-audit services is compatible with maintaining the auditor's independence.

### **Establishment of an Auditor Independence Supervisory Board**

- An independent supervisory board should be established. The Board would play a vital role in ensuring public confidence in the independence of auditors by monitoring implementation of the new regime, compliance with it, and important international developments in the area of auditor independence.

- The Board would comprise 12 members, with all appointments being on a part-time basis. The majority of members must be independent of the professional accounting bodies, although the expertise of the profession will provide a valuable contribution to the Board.

- Funding for the Board should not be a drain on scarce public resources. The profession has a large stake in the issue of auditor independence, and accordingly, the professional accounting bodies should be responsible for the financial support of the Board. This method of funding is in line with the UK model.

### **Audit Committees**

- A well structured and well functioning audit committee can play a very important role in ensuring that the auditor is independent of the company. It is recommended that the ASX Listing Rules be amended to require all listed companies

to have an audit committee.

- The Listing Rule should mandate the existence of a qualified audit committee; specify the composition of the audit committee; and require the board of directors to adopt a written charter to govern the audit committee.
- If the ASX does not amend its Listing Rules the Corporations Act should be amended to reflect these recommendations regarding audit committees.

#### **Other recommendations**

- Professor Ramsay also reviewed the recommendations contained in the 1997 report of the Audit Review Working Party and has recommended implementation of a number of those recommendations, including:

- Auditors of a listed company should be appointed and their remuneration determined on the recommendation of the company's audit committee.
- There should be mandatory rotation of the audit partners responsible for the audit of listed companies after a maximum period of seven years.
- Amendments to the institutional arrangements for, and the powers of, the Companies Auditors and Liquidators Disciplinary Board to facilitate its operation.
- The Corporations Act be amended to require a listed public company's auditor, or a representative of the auditor, to attend the AGM at which the auditor's report is tabled.
- The introduction of enhanced requirements for the registration and supervision of company auditors