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,[1] 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 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.

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1 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.

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'.[2]

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 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

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

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.