

Auditing in an Evolving Environment

(A Focus on Auditing Standards and Framework)

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1. Introduction

I appreciate the opportunity to address you this afternoon.

In this presentation I will be discussing auditing standards and the associated framework, as they currently stand. I say this because auditing standards and their framework are not stagnant. They are evolving, and need to continue to evolve, as a credible basis of audit activity which supports good organisation governance. As such, it is important to have a proper perspective of means and ends when we discuss these aspects.

As background, I will first provide a brief overview of the Australian and international framework of accounting and auditing bodies, and outline where my office, the Australian National Audit Office (ANAO), fits in. I call this the 'intellectual framework'. I will also be discussing the conceptual framework by reference to a newly revised Australian Auditing Standard AUS 108 *Framework for Assurance Engagements*¹ and AUS 202 *Objective and General Principles Governing an Audit of a Financial Report*². These Australian standards were based on their international equivalents issued by the International Auditing and Assurance Standards Board (IAASB) in early 2004.

Having set the scene, I will then elaborate on a number of the contemporary issues facing the auditing profession, and the changes that have arisen in recent times. In some respects, these changes may have been unsettling to the profession, although I am also reminded of the words of General Eric Shinseki, the former US Army Chief of Staff, who said, "if you don't like change, you're going to like irrelevance even less."³

The most significant of these issues relates to oversight and regulation of the accounting and auditing profession. As I will discuss in detail later, this issue arose by and large as a reaction to a number of national and international corporate collapses and its resolution has been approached in different ways, including via legislation, mixed regulation, and self-regulation.

Other contemporary issues I will touch on include:

- the impact of international standards for both accounting and auditing;
- the content of these standards, in particular their conceptual framework, whether sector neutral or not, and the use of 'plain language'; and
- increased expectations in relation to independence and the detection of fraud.

In concluding, I will endeavour to bring all of these issues together succinctly, and outline what I see as the role of assurance, as opposed to performance, auditing in enhancing public sector accountability and governance.

2. Overview of Intellectual and Conceptual Frameworks

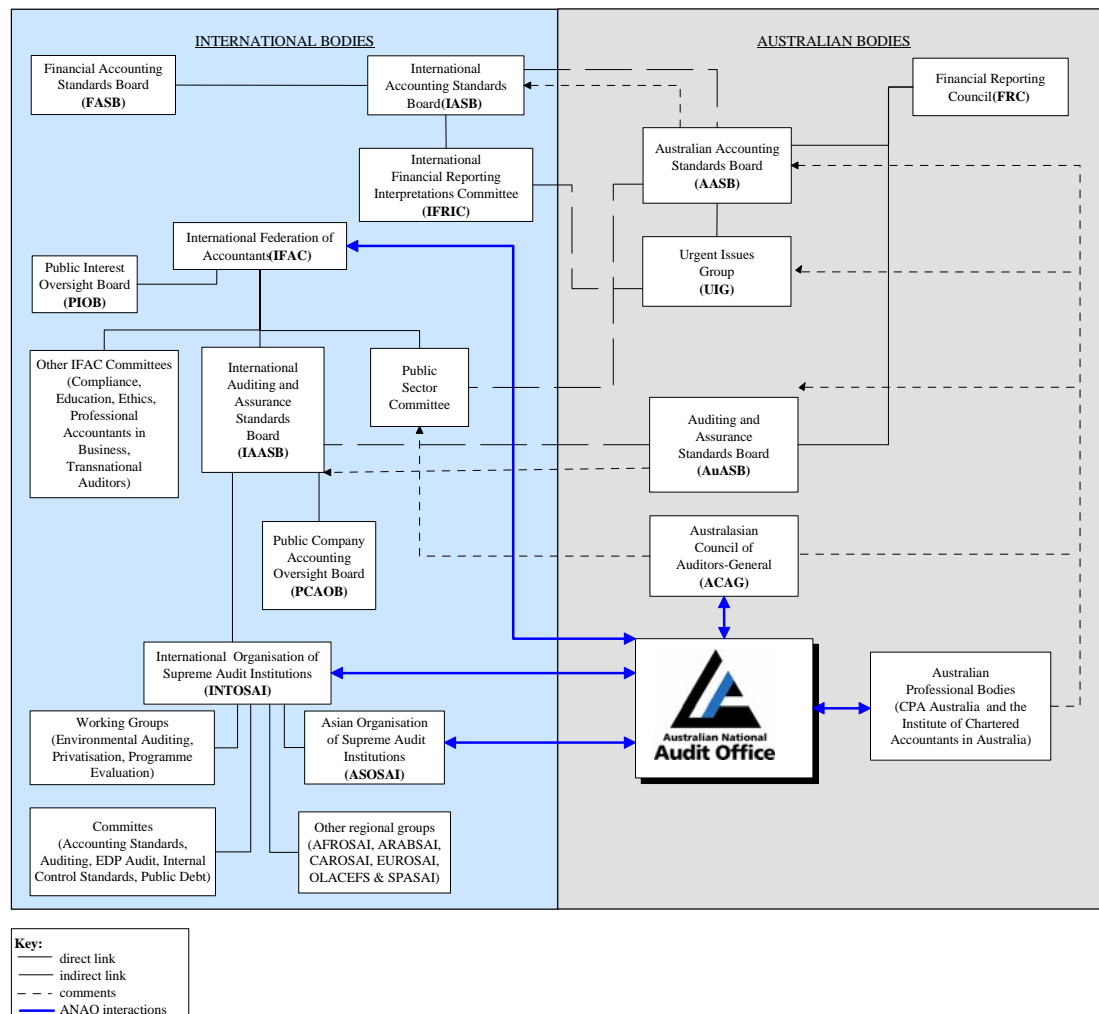
This brief overview of the intellectual and conceptual frameworks is designed to illustrate that, in both the Australian and international community, there is a significant body of work being performed in relation to accounting and auditing.

Overview of Intellectual Framework

First, I will cover what I call the ‘intellectual framework’ – the myriad of international and Australian bodies whose work both concurrently and in collaboration is for the betterment of the accounting and auditing profession.

Figure 1 reflects an interpretation of the interrelationships between a selection of Australian and international accounting and auditing bodies. (A brief outline of each organisation shown in Figure 1 is included in the Appendix to this Paper.) While not a complete coverage of every body, or every interrelationship between those bodies, it does, however, serve to illustrate the overlaps of intellectual investment in our profession.

Figure 1 – Overview of the linkages amongst and in between the International and Australian Accounting and Auditing Frameworks⁴



The Australian framework for the accounting and auditing professions is largely one that was traditionally self-regulated. There are various pieces of legislation to be complied with, and regulatory bodies to ensure compliance takes place. However, the professional bodies have had a significant role in the development and application of accounting and auditing standards. The extent of legislation to regulate auditing in Australia, as I will elaborate upon later, has recently been extended by virtue of the passage of the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004*.

There are a number of interrelationships within the Australian framework, and between the Australian bodies and their international counterparts. Within the Australian framework, the majority of the interaction relates to the corroborative and consultative approaches taken, whereby comments are sought on exposure drafts. In this respect, there are similarities between the Australian and international intellectual frameworks. It should be noted that the International Auditing and Assurance Standards Board (IAASB) has recently published, for comment by mid October, proposed amendments to its due process and working procedures.

Of the interrelationships in the international framework, interesting ones to note are the relationships between:

- the United States' Public Company Accounting Oversight Board (PCAOB) and the IAASB; and
- the United States' Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB).

To some extent, the United States has been seen to have 'gone its own way' with respect to standard setting for both accounting and auditing. Perhaps this is not surprising given its size in relation to global capital markets and its long history in standard setting. However, recent events have encouraged greater international collaboration, with support both from within and outside that country.

With respect to accounting standards, a Memorandum of Understanding was struck between the IASB and the FASB, 'The Norwalk Agreement', in September 2002. Under this agreement, the IASB and FASB are working towards the elimination of differences between the United States' generally accepted accounting principles and the IASB's International Financial Reporting Standards. As this work progresses, a number of amendments are expected to be made to both IASB and FASB standards.

Progress is also being made with respect to auditing standards. In May 2004, the PCAOB's Chief of Staff, Samantha Ross, appeared before the United States House of Representatives Committee on Financial Services to discuss regulatory dialogue between the PCAOB and the European Commission⁵. In her testimony for the Committee, Ms Ross outlined the cooperative approach being taken by the PCAOB and the European Commission⁶, and how both of these organisations have been given observer positions with the IAASB. Both bodies have also offered the IAASB observer status on their standard-setting advisory groups. Such moves to increase discussion between these auditing organisations is expected to assist with reducing duplication of efforts, and streamline auditing practices across the United States, the European Union and internationally.

To date, more than 70 countries have adopted the International Standards on Auditing (ISAs) issued by the IAASB, either in total or by identifying that there are no significant differences between their national standards and ISAs⁷. As I will discuss later, the Australian Auditing and Assurance Standards Board (AuASB) has a long-standing policy on convergence and harmonisation with the standards issued by the IAASB⁸. The Board is currently working towards the goal of compliance with Australian Auditing Standards also constituting compliance with International Standards on Auditing.

Both the international accounting and auditing standards have a specific private sector 'flavour' to them. As with other public sector bodies, the ANAO has an interest in the sector neutrality of the standards that are to be applied to the public sector. At least we would argue that there is merit in a common conceptual framework that is flexible enough to accommodate any specific sectoral or even industry differences. The ANAO, as well as many other public sector entities, is an active participant in both the Australian and international arena in working towards such an outcome. However, we are cognisant of the many practical issues involved not only for the public sector but also in not-for-profit entities, specific industry segments such as financial institutions and mining, and groups such as small and medium size entities. Insofar as the public sector is concerned, the issue is being impacted by the growing convergence between the public and private sectors, particularly where public services are actually being delivered by private sector firms.

In this respect, it may be of interest to illustrate the ANAO's interrelationships with a number of international and Australian bodies (see Figure 1). This is not to suggest we are a major player but indicates we are quite active and also demonstrates that there is a significant role for public sector auditing bodies to play in this environment. The ANAO currently enjoys interactions and involvement with a number of Australian and international bodies, through representation on working groups, councils and committees, as well as providing comments on exposure drafts and other documents.

Overview of the Conceptual Framework

The conceptual framework for auditing provides its basic *raison d'être*. In Australia, this is outlined in the following newly revised Australian Auditing Standards:

- AUS 108 *Framework for Assurance Engagements* issued in June 2004; and
- AUS 202 *Objective and General Principles Governing an Audit of a Financial Report* issued in February 2004.

These standards are based on their respective international equivalents, which were recently revised by IAASB.

AUS 202 succinctly summarises the objective of an audit as follows⁹:

The objective of an audit of a financial report is to enable the auditor to express an opinion whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework...

Although the auditor's opinion enhances the credibility of the financial report, the user cannot assume that the opinion is an assurance as to the

future viability of the entity nor the efficiency or effectiveness with which management has conducted the affairs of the entity.

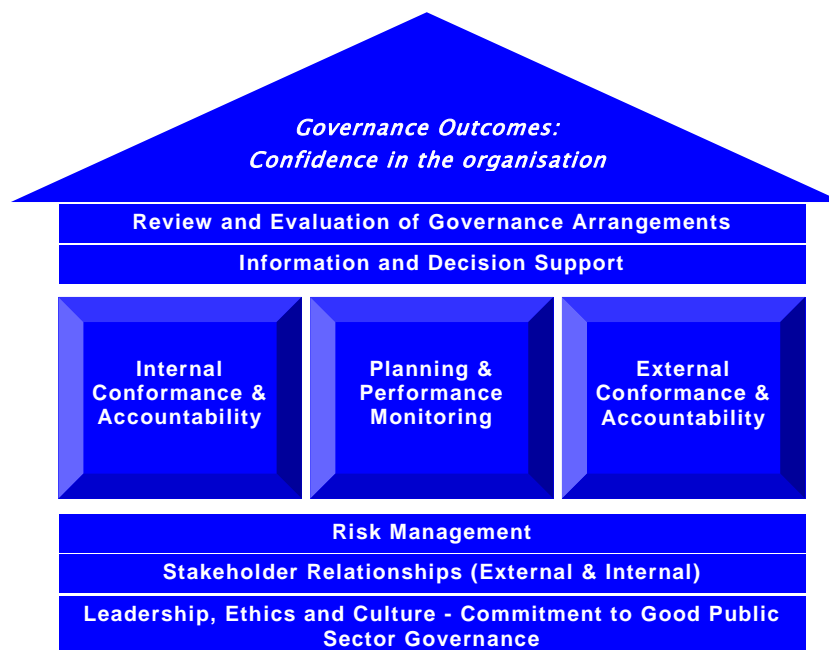
Even in times of enhanced scrutiny of the work by auditors, the key concepts and general principles of an audit are unchanged, being:

- the need for audit work to be performed ethically;
- the need for audit work to be performed with an attitude of professional scepticism;
- understanding of the limitations of an audit; and
- application of a structured risk-based approach to identify areas where greater audit efforts are required.

Overview of Financial Statement Auditing's Role in Enhancing Public Sector Governance

In July 2003 the ANAO issued a Better Practice Guide (BPG) entitled '*Public Sector Governance*'¹⁰. I will use a model from the Guide, referred to as the 'House of Public Sector Governance' (shown in Figure 2 as follows) to illustrate broadly how the various components, both individually and in terms of their interrelationships, can contribute to enhancing public sector governance.

Figure 2 – The House of Public Sector Governance¹¹



Implementing, maintaining and enhancing the elements shown above maximises the chances that the entity will enjoy the confidence of its stakeholders, clients, staff and management. Other benefits flowing to the entity from this approach include recognition for making sound, well-informed and accountable decisions that lead to appropriate and effective actions and results.

Components should not be considered solely in isolation, as the relationships established between the various elements of good governance are crucial.

In this model, stakeholder relationships influence the effectiveness of all three central components of the structure, that is, the ‘windows’ of:

- internal conformance and accountability;
- external conformance; and
- accountability, and planning and performance monitoring.

These ‘windows’ represent the core activities of governance for government organisations. They are the elements on which governance boards and committees should be focused. Each ‘window’ exerts an influence on the other two as follows¹²:

- planning and performance monitoring underpin the management framework within which external and internal conformance and accountability processes take place - accountability is integral to the performance of public organisations;
- internal conformance and accountability needs to be aligned with, and generate the information required for, external conformance and accountability; and
- external conformance and accountability establishes the base line for required internal processes, as information required for external purposes should generally form a subset of what is required internally.

Within this framework, financial statement auditing fits broadly within the external conformance and accountability ‘window’, and can have an influence over other aspects of public sector governance by virtue of audit recommendations made about the entity’s control environment, policies and procedures. Both the principles and broad practices involved are similar to those in the private sector. However, the application of this model also, very quickly, reflects the significant differences between the two sectors in specific areas, notably performance and accountability. These, of course, are central areas of interest for audit.

The audit contribution is very dependent on a full understanding of the environment and organisational framework as well as on audit expertise, analysis and reports. The latter, in turn, are dependent, to a not inconsiderable degree, on the professional audit framework and standards. In large part, the credibility of the audit contribution in the eyes of the various stakeholders is related to how well we support the governance framework, particularly our interaction with the Audit Committee. In Australia, all AGPS Bodies are legislatively required to have an Audit Committee as part of good governance.

The key message from this broad overview is that the various elements of the governance framework should be fully integrated and understood at all levels of an organisation. The outcomes and/or results are not simply the sum of the parts. The problem that has generally been identified is that good governance should not be simply seen as a ‘box ticking’ exercise. I would like to think that auditing should also not be similarly regarded, even in an assurance context. It is important that audit is seen as adding value to an organisation’s achievements and results.

3. Evolving Environment: Audit Oversight and Regulation

A significant change to the audit environment is that pertaining to oversight and regulation. In recent times, the profession in both Australia and the United States has seen the introduction of the legislative changes and higher ethical requirements placed upon the accounting profession. This has largely come about in response to the need to re-build and maintain credibility in the profession after a number of corporate collapses, and (rightly or wrongly) the catch-cry that followed of ‘why didn’t the auditor tell us about this earlier?’.

Restoring and Maintaining Confidence in the Accounting Profession

Questioning of the efficacy of the profession has resulted in the significant undermining in the level of confidence and trust the public holds in the profession’s work. Former United States Securities and Exchange Commission Chairman, Arthur Levitt Jr, recently explained just how essential the public’s trust and confidence is to the accounting profession, as follows:¹³

The accounting profession is a profession like no other, and, in my mind, one of the most noble in our marketplace. ...With that precious franchise come some unique pressures and challenges. In most businesses the watchword is “The customer is always right.” Accountants, however, are charged with telling the customer when he’s wrong. What other profession has that responsibility? What other profession is enshrined in our nation’s securities laws to serve no interest but the public’s? What other profession so directly holds the keys to public confidence – the lifeblood of our markets.

I can think of none other but the accounting profession.

In October 2002, the International Federation of Accountants (IFAC) commissioned a Task Force on Rebuilding Public Confidence in Financial Reporting to “...provide an international perspective on the causes of the loss of credibility in financial reporting and corporate disclosure and to recommend courses of action to restore credibility”¹⁴. In the report issued in July 2003, the independent task force made the following recommendations¹⁵:

- effective corporate ethics need to be in place and actively monitored;
- corporate management must place greater emphasis on the effectiveness of financial management and controls. In addition, incentives to misstate financial information need to be reduced;
- boards of directors need to improve their oversight of management;
- the threats to auditor independence need to be given greater attention in corporate governance processes and by auditors themselves. This includes greater control over auditor provision of non-audit services;
- audit effectiveness needs to be raised, primarily through increased attention to quality control processes;

- codes of conduct need to be put in place and their compliance monitored for other participants in the financial reporting process, such as financial analysts, credit rating agencies, legal advisers, and investment banks; and
- audit standards and regulations, accounting and reporting practices need to be strengthened. The standard of regulation of issuers also needs to be raised.

Most of these recommendations have already been incorporated in changes to requirements for companies subject to the Australian *Corporations Act 2001*, as well as for Australian accountants and auditors.

In response to the decline in confidence in the accounting profession, IFAC also started a series of consultations with international regulatory agencies and other regional and international organisations. The ultimate result was a number of reform proposals which the Council of IFAC unanimously approved at its meeting in November 2003. These reforms will be implemented during 2004. The objective of the proposals was "...to increase confidence that the public interest activities of IFAC (including the setting of standards by IFAC boards and committees) are properly responsive to the public interest and will lead to the establishment of high quality standards and practices."¹⁶

The importance of these reforms was reinforced in comments made by Jaime Caruana, Chairman of the Basel Committee on Banking Supervision and the Governor of the Bank of Spain, who stated¹⁷:

Over time, IFAC's reforms should result in improvements in international audit standards and practices that will help restore confidence of capital markets in the quality of audit services.

Of these reforms, the key element is the establishment of the Public Interest Oversight Board (PIOB), hopefully this calendar year. This Board will oversee IFAC's standard setting activities with respect to auditing, assurance, ethics, independence and compliance activities. The Board will also oversee the activities of the IAASB, and approve the IAASB's terms of reference and those of its Consultative Advisory Group, as well as nomination of members to the IAASB. (See Figure 5 in Appendix) The Board is comprised of ten members from regulatory and public interest groups involved in the development of the reform proposals.

The establishment of the PIOB has been broadly welcomed and is expected to have a broad reaching impact upon the auditing profession. Scott Taub, Chairman of Standing Committee No 1 of the International Organisation of Securities Commissions, explained "...because IFAC's standards are used by so many jurisdictions as the basis for local auditing standards, new oversight and regulatory mechanisms embraced by IFAC hold out the opportunity to improve audit quality in many parts of the world at once"¹⁸.

It has been suggested that "...implementation of risk management strategies (including ethical principles) may have alleviated if not avoided some of the corporate collapses."¹⁹ The authors argue, in particular, for the inclusion of good ethical practices as part of an overall approach to risk management. They assert "an ethical organisation is one where ethical conduct is promoted by the organisation leaders, where systems and procedures are in place to reward ethical behaviours and discourage unethical practices."²⁰ Their research shows that such an approach also

provides positive outcomes for the organisation, such as “...contributing to profits, reducing fraud, avoidance of litigation, mitigating legal penalties for lapses in legal compliance and ensuring a safe and healthy environment.”²¹

These comments, in particular those concerning the importance of the ‘tone at the top’, echo sentiments expressed in the Better Practice Guide (BPG) on ‘*Public Sector Governance*’²², referred to earlier. The ANAO has long recognised that governance practices often strongly influence the performance and accountability of Australian Government Public Sector (AGPS) organisations. It is also an area where many organisations are unsure about what actually constitute better practices and value assistance. As a result, the ANAO has produced a series of BPGs on the topic of public sector governance.²³ The latest guide updates two previous ANAO guides published in 1997 and 1999.²⁴

Like its predecessors, the aim of the latest guide is to assist AGPS entities to achieve better public sector governance by discussing the overarching public sector governance framework and proposing processes and practices aimed at addressing commonly encountered governance issues. The scope addressed is wider than in previous guides in that it provides more practical guidance, examines the effect of recent legislative changes, and reflects the current concerns of the AGPS. The guide is not prescriptive, and has no legislative backing. It clearly states that it is the responsibility of individual organisations to implement governance arrangements that are appropriate for their particular circumstances.

While there has been quite a rapid increase in documented guidance on ‘corporate governance’, especially by Professional Bodies, the Australian Stock Exchange and legal firms, these remain largely directed towards private sector needs and requirements. As a consequence of this, the ANAO has produced its guides specifically addressing public sector governance to provide better practice information and clarity for government organisations that may be audited.

The ANAO is likely to continue to provide guidance on public sector governance in the future. One way this will be achieved is by adding to the latest BPG, to address and provide guidance on major emerging governance issues. The ANAO is also currently participating in an Australian Research Council linkage grants project with the University of Canberra and other organisations, to examine governance on a multi-disciplinary basis, with the aim of producing an integrated cross-governance framework.²⁵

In the AGPS, ethical principles are enshrined in the legislation underpinning accountability and governance:

- the *Public Service Act 1999*;
- the *Financial Management and Accountability Act 1997*; and
- the *Commonwealth Authorities and Companies Act 1997*.

These Acts require the public service’s values to be upheld and promoted by agency heads. These values (see Table 1 below) are promoted by the Australian Public Service Commission, whose role also includes fostering organisational performance and evaluating the state of the AGPS.

Table 1 – AGPS Values²⁶

The Australian Public Service:

- is apolitical, performing its functions in an impartial and professional manner;
- is a public service in which employment decisions are based on merit;
- provides a workplace that is free from discrimination and recognises and utilises the diversity of the Australian community it serves;
- has the highest ethical standards;
- is openly accountable for its actions, within the framework of Ministerial responsibility to the Government, the Parliament and the Australian public;
- is responsive to the Government in providing frank, honest, comprehensive, accurate and timely advice and in implementing the Government's policies and programs;
- delivers services fairly, effectively, impartially and courteously to the Australian public and is sensitive to the diversity of the Australian public;
- has leadership of the highest quality;
- establishes workplace relations that value communication, consultation, co-operation and input from employees on matters that affect their workplace;
- provides a fair, flexible, safe and rewarding workplace;
- focuses on achieving results and managing performance;
- promotes equity in employment;
- provides a reasonable opportunity to all eligible members of the community to apply for APS employment;
- is a career-based service to enhance the effectiveness and cohesion of Australia's democratic system of government;
- provides a fair system of review of decisions taken in respect of employees.

The Australian Public Service Commissioner, Mr Andrew Podger, summarises the requirements of the aforementioned Acts as follows²⁷.

The Public Service Act 1999 sets out the values of the service, which must be upheld by all of us and promoted by agency heads. Breaches of the Code of Conduct, including the requirement to at all times behave in a way that upholds the APS Values and the integrity and good reputation of the APS, are subject to sanctions.

The Financial Management and Accountability Act 1997 sets out, amongst other things, our responsibilities for the proper use of resources. These include three particular requirements:

- *efficiency*
- *effectiveness*
- *ethical use of resources.*

The Act also requires all agencies to have chief executive instructions and procedural rules, which may include instructions on ethical use of resources. These also set out a number of requirements about good conduct and behaviour.

The Commonwealth Authorities and Companies Act 1997 also identifies the requirements of officers in relevant agencies, including care and diligence, good faith and proper use of position and information. Penalties for breaches are also included in that legislation.

These values and the related Code of Conduct underpin the culture and governance of the public sector and therefore the environment in which we conduct our audit activities.

Australian Measures Taken

Measures taken in Australia to re-build and maintain the profession's credibility include recent changes to:

- Australian corporate legislation; and
- ethical requirements of members of Australian accounting bodies.

Legislative Changes

Australia has been embarking upon a Corporate Law Economic Reform Program (CLERP) since 1997. The following extract provides an overview of this program²⁸.

The Corporate Law Economic Reform Program (CLERP) is a comprehensive initiative to improve Australia's business and company regulation as part of the Coalition Government's drive to promote business, economic development and employment. CLERP was announced by the Treasurer in March 1997 and is aimed at reforming key areas of corporate and business regulation.

After a long, arduous and well debated process, the ninth instalment, *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (colloquially referred to as CLERP 9) has just been completed. The Australian Parliament recently passed this Act, for application from 1 July 2004.

CLERP 9 is designed to enhance audit regulation and general corporate disclosure framework, and introduces a number of policy changes, designed to enhance audit regulation and general corporate disclosure framework. These changes are listed in Table 2 as follows.

Table 2 – Significant Changes Introduced by CLERP 9²⁹

- legal backing for auditing standards;
- rotation of auditors of listed companies after five years;
- Chief Executive Officers and Chief Financial Officers required to sign off on the financial statements, stating they are in accordance with the *Corporations Act 2001* and accounting standards, and present a true and fair view;

- the establishment of a Financial Reporting Panel to resolve disputes between Australian Securities and Investments Commission (ASIC) and companies concerning the company's accounting treatment in its financial report;
- additional licensing obligations to supplement the general duty to provide financial services 'efficiently, honestly and fairly' to manage conflicts of interest;
- additional powers for ASIC to issue infringement notices (of up to \$100,000) in relation to contraventions of the continuous disclosure regime;
- ASIC may apply to courts for extension of up to 15 years on the current five year automatic disqualification of directors for contraventions of the *Corporations Act 2001*;
- closer alignment of the exemptions from disclosure regimes that apply to sophisticated investors and wholesale clients with respect to fundraising, and financial services and markets; and
- a number of measures designed to promote transparency and accountability in relation to the remuneration of directors and company management.

In Australia, the professional bodies (CPA Australia and the Institute of Chartered Accountants in Australia (ICAA)) play a significant role in the self-regulation of the accounting profession. This is via the enforcement of the jointly issued *Code of Professional Conduct* for members, where sanctions were applied for proven breaches to this code. While still retaining this predominantly self-regulated approach to corporate governance, CLERP 9 does represent a step towards greater prescription (or regulation) for the Australian accounting profession which has been described as a 'mixed' regulatory approach.

Australian Government companies bound by the *Corporations Act 2001* will need to apply the changes introduced by CLERP 9. It would be considered better practice for other Australian Government agencies to also apply the principles of this legislation. The ANAO, for example, commenced reviewing the CLERP 9 proposals to identify policy implications in October 2003 – nine months before it was passed by the Parliament. Aspects of CLERP 9 that are particularly relevant to the ANAO include rotation of auditors (in particular Signing Officers), the authority for delegates of the Auditor-General to sign an audit opinion for a Commonwealth company, and the impact of the changes introduced by this legislation upon ANAO's outsourcing requirements, particularly bearing on independence and conflicts of interest issues, such as the provision of non-audit services. In relation to the latter, the ANAO's list of exclusions are similar to those in the US Sarbanes-Oxley legislation, discussed later, and are consistent with CLERP 9 provisions.³⁰

There are indications of the need for a strong policy position for regulation of government bodies to be consistent with that for commercial bodies. While there has been no official announcement that this will occur, this has been inferred in the second reading speech for the *Commonwealth Authorities and Companies Act 1997* made by the then Minister for Finance. In this speech, it was indicated that this Act would be maintained in ways that, as far as practical, would keep it in harmony with comparable provisions of the *Corporations Act 2001*. This could be an indication of changes resulting from CLERP 9 being the basis of possible changes to be applied to the *Auditor-General Act 1997*, the *Commonwealth Authorities and Companies Act*

1997 and the *Financial Management and Accountability Act 1997* some time in the future.

CLERP 9 gives the Australian auditing standards the force of law. This may have the effect of increasing the risk associated with performing the external audit function, as there is a risk of litigation should breaches of Australian auditing standards be found to have occurred. Interestingly, it has also raised the question as to what is an audit, which bears directly on the issue of the audit expectation gap. The challenge for the profession is just how far we can realistically close that gap. For example, at the 103rd American Assembly in November last year looking at the future of the accounting profession, the participants observed that:

*...auditors cannot reasonably be required to provide a certainty into the quality of the financial reporting prepared by management, into management's ability to run the business of the issuers and into the issuer's business model.*³¹

In Australia, there is debate about the legal status of auditing standards. While accounting standards have the legal backing of the *Corporations Act 2001*, previously the auditing standards did not. CLERP 9 redressed this issue, but in doing so has engendered concerns about the practicality of requiring legislative adherence where there is often an exercise of professional judgement. We would agree with the American Assembly that “auditors’ best professional judgement must play a greater role”³² in audits of financial statements.

Australia currently prides itself on its sound conceptual frameworks for accounting and auditing. However, as a result of auditing standards becoming law, they may potentially be subject to interpretation by the courts. In doing so, precedents could be made resulting in a quasi-rules based environment which may actually limit the exercise of professional judgement and/or create possible inconsistencies and contradictions which would simply add to the uncertainty rather than alleviating it. The success of this measure will therefore very much depend on the approach taken, and understanding of the overall audit framework and standards environment, by the courts.

Changes to Ethical Requirements of the Profession

Recent corporate collapses have also cast a light on corporate governance requirements in Australia. A very important aspect of corporate governance is auditor independence. This is a very important ‘tool’ in the external auditor’s ‘toolbox’, as it is the key aspect to what gives credibility to the auditing function. The “...perceived independence of auditors is vital to the maintenance of the auditing profession”³³.

Audit independence has been broadly discussed due to a number of high-profile corporate failures, in terms of the duration for which an auditor should be involved with auditing a specific client, and other services that auditors should (and should not) be able to perform concurrently with audit services. Changes to requirements for auditors are taking place in both Australia and internationally. In the United States, the *Sarbanes-Oxley Act* “...attempts to create a more independent environment for auditors to make their contribution to the corporate reporting supply chain”³⁴. The components of this legislation pertaining to auditor independence are intended to

“...remind all parties of their responsibilities to protect and safeguard the interests of investors”³⁵.

While the ANAO takes a professional interest in this ongoing debate, it is also set apart from it by virtue of its statutory and functional independence via the *Auditor-General Act 1997*. Section 8 of this Act (copied in Table 3) preserves the independence of the position of the Auditor-General, which is a “...a key feature of our democratic system of government.”³⁶ Such legislated independence gives both myself as Auditor-General and my staff at the ANAO “...all the professional and functional freedom required to fulfil, fearlessly and independently, the role demanded of them by Parliament.”³⁷

Table 3 – Section 8 of the Auditor-General Act 1997

<p>(1) The Auditor-General is an independent officer of the Parliament.</p> <p>(2) The functions, powers, rights, immunities and obligations of the Auditor-General are as specified in this Act and other laws of the Commonwealth. There are no implied functions, powers, rights, immunities or obligations arising from the Auditor-General being an independent officer of the Parliament.</p> <p>(3) The powers of the Parliament to act in relation to the Auditor-General are as specified in or applying under this Act and other laws of the Commonwealth. For this purpose, Parliament includes:</p> <ul style="list-style-type: none">(a) each House of the Parliament; and(b) the members of each House of the Parliament; and(c) the committees of each House of the Parliament and joint committees of both Houses of the Parliament. <p>There are no implied powers of the Parliament arising from the Auditor-General being an independent officer of the Parliament.</p> <p>(4) Subject to this Act and to other laws of the Commonwealth, the Auditor-General has complete discretion in the performance or exercise of his or her functions or powers. In particular, the Auditor-General is not subject to direction from anyone in relation to:</p> <ul style="list-style-type: none">(a) whether or not a particular audit is to be conducted; or(b) the way in which a particular audit is to be conducted; or(c) the priority to be given to any particular matter.
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Section 40(2) of the *Auditor-General Act 1997* compliments section 8 by stipulating that staff assisting the Auditor-General in performing his or her functions can only be directed in relation to these functions by either the Auditor-General or an authorised ANAO staff member.

Nevertheless, there is also an operational imperative for the ANAO to be concerned about independence of the auditor. This arises as the ANAO outsources a proportion of its audit work to private sector accounting firms. As well, with the increasing use of such firms by the public sector for internal audit, the ANAO often uses their work,

with some retesting, in coming to an audit opinion on organisations' control environments and financial statements. In the latter respect, the ANAO has to be satisfied that the work has been done consistently with the independence requirements of the auditing and assurance standards.

The principles of audit independence in Australia are detailed in the Professional Statement F1, entitled '*Professional Independence*', released by CPA Australia and the ICAA in 2002. Compliance with the revised Professional Statement F1 by CPA and ICAA members has been mandatory since 31 December 2003. Under the revised F1, independence is defined as³⁸:

- (a) *Independence of mind*—the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism; and
- (b) *Independence in appearance*—the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a *firm's*, or a member of the *firm's*, integrity, objectivity or professional scepticism had been compromised.

The revised Professional Statement is a lot more explicit than the previous version, outlining in some detail how the principles may be applied to specific situations. The AuASB's Guidance Note entitled *Auditor Independence and Other Services*, issued shortly after the revised Professional Statement, also serves to reinforce the practicalities of applying F1's principles.

Ethical principles applied in audits completed by the ANAO are those required by the AGPS values (previously discussed), the ANAO Code of Conduct and the ANAO's Auditing Standards. These principles are consistent with the International Federation of Accountant's (IFAC's) Code of Ethics.

Section 24 of the *Auditor-General Act 1997* requires the Auditor-General to set auditing standards to be complied with by auditors performing:

- the audit of the annual financial statements prepared by the Finance Minister in relation to the Commonwealth.
- financial statements audits of Commonwealth agencies, authorities, companies and their subsidiaries;
- performance audits of Commonwealth agencies, authorities, companies and their subsidiaries, including general performance audits; and
- financial statement and performance audits of the Australian National Audit Office.

These standards, referred to as ANAO Auditing Standards, prescribe the minimum standard of professional audit work expected of the Auditor-General, staff of the ANAO, and contractors appointed to assist in the performance of work on behalf of the Auditor-General. As Auditor-General, I have adopted as the ANAO Auditing Standards, the codified Auditing Standards and Auditing Guidance Statements issued by the AuASB.

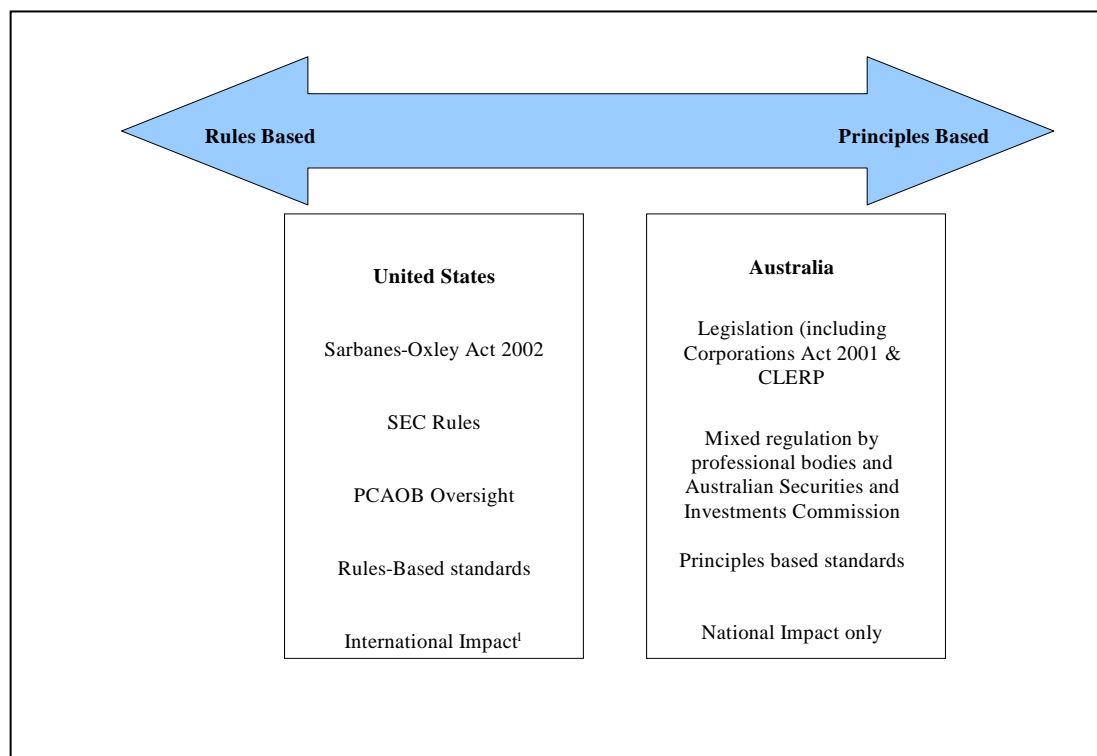
This will be further reinforced by recent revisions to AUS 202 *Objective and General Principles Governing an Audit of a Financial Report*, which will be encompassed by the ANAO Auditing Standards. This revised standard requires auditors to comply with the ethical requirements of CPA Australia and the ICAA, including³⁹:

- (a) independence;
- (b) integrity;
- (c) objectivity;
- (d) professional competence and due care;
- (e) confidentiality;
- (f) professional behaviour; and
- (g) technical standards.

Contrasting Approach in the United States

The United States reacted to a number of corporate collapses and subsequent public and political concern by introducing the *Sarbanes-Oxley Act of 2002*. This legislation is of a highly prescriptive nature which, it is said, mandates regulatory bodies seeking compliance from the profession by ‘wielding a big stick’. The rules based, highly prescriptive approach taken by the United States (US) contrasts to that used in Australia, as shown below⁴⁰.

Figure 3 – Comparison of Oversight and Regulation in Australia and the United States⁴¹



¹ For example, in the registration and oversight of foreign auditors which audit companies whose securities are listed in the US. Concerns have also been expressed about the US Authorities’ access to a foreign firm’s audit working papers.⁴²

This is not to say that Australia's approach to regulation is purely based upon principles. There are aspects of the Australian regulatory regime that are prescriptive, which are reflected in the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2003*. However, in comparison to the US, Australia is placed more towards the principles-based 'end' of the continuum. This was a deliberate action taken by the Australian Parliament when debating this piece of legislation. During these debates the Parliamentary Secretary to the Treasurer, the Honourable Ross Cameron MP, stated⁴³:

The government is taking what we would regard as a principles based approach. The alternative, which has been adopted in some other parts of the world – most particularly the United States – is a much more prescriptive black-letter law approach which seeks to micromanage the decisions being made across the private sector. Our approach has been more to adopt broad principles and seek to have them upheld.

The prescriptive approach taken in the United States is leading to concerns amongst the accounting profession about the high costs of compliance. PCAOB Chair William McDonough claims "...these costs are justified because "the goal is to obtain the best possible assurance that a company's financial statements are reliable""⁴⁴. However, others question whether the approach taken reasonably balances the cost of compliance and ultimate benefit to the shareholders and public⁴⁵ or, more broadly, if the entire profession has been "...unfairly tainted by the actions of a few bad auditors"⁴⁶. Participants at the 103rd American Assembly, referred to earlier, agreed 'they favoured accounting standards that contained fewer rules and permit more judgement'⁴⁷.

Questions are particularly asked in relation to smaller listed companies, which are essentially measured against the same rules as for larger ones. And more specifically, whether it is economically feasible for smaller companies to come into compliance, by putting in place an audit committee, code of ethics and meeting internal control documentation requirements. Kaland⁴⁸ suggests that the only alternative for some smaller companies would be to delist from US stock exchanges, which, of course, also has its own costs.

It is interesting to note that concurrent to concerns about the cost of compliance for smaller companies in the United States, the IASB has a task force in place to develop simplified global accounting standards for small and mid-sized entities (SMEs). The goal of this project is "...to reduce the burden of disclosure for companies, while preserving the recognition and measurement principles of international standards"⁴⁹. IFAC has established a permanent Task Force to examine issues relevant to SMEs. The IFAC Board has also commissioned a study by a former Board Member, Peter Wong, to examine issues relating to the implementation of standards by SMEs and those in Developing Countries. Peter is committed to presenting a Paper on the results of a largely questionnaire-based survey he has conducted in a public forum on 15 October next.

Recently there have been significant concerns raised about the requirements of section 404 of the *Sarbanes-Oxley Act of 2002*. This section requires:

- the management of public companies listed on US stock exchanges to assess the effectiveness of internal control over financial reporting, and include in the company's annual report to shareholders management's conclusion, as a result

of that assessment, about whether the company's internal control is effective;
and

- the company's auditor to attest to and report on the assessment made by the company's management.

The report from the auditor is in addition to the 'traditional' audit report on the company's financial statements. While there may appear to be some duplication of efforts, the PCAOB claims⁵⁰:

The information the auditor learns as a result of auditing the company's financial statements has a direct and important bearing on the auditor's conclusion about the effectiveness of the company's internal control over financial reporting.

From the company's perspective, section 404 requires them to analyse and document their internal control processes. The documentation has to be kept up to date to reflect any changes to the company's processes. The company will then issue its assessment of the controls, based on its evaluation of their design and operating effectiveness. These statements are then audited.

From the auditor's perspective, they are required to perform 'walk-throughs' of important processes and test the design and operating effectiveness of controls in place. There are limits upon how much the external auditor may rely upon the work of others, even internal auditors. These requirements may lead to a significant amount of work to be performed in addition to those required for the 'traditional' external audit function due to a broadening of the scope of the audit. This could lead to some duplication of efforts, which is said to potentially increase external audit fees "from 25% to more than 100% of current audit fees"⁵¹. These fee increases could be lessened to the extent to which external auditors are able to rely upon the work of competent and objective internal auditors. Putting in place a competent and objective internal audit function, or enhancing the current internal audit arrangements, may be a further cost incurred by the company in order to comply with the Act.

Debate about this section relates not only to the costs of compliance but also questions of what the impact upon the market will be if a publicly listed company is reported to have ineffective controls. Questions have also been raised about the mixed message that would be sent to the market should a publicly listed company have a 'clean' audit opinion for its financial statements and a report stating its controls are ineffective, or vice versa.

The answers to these questions won't be known for certain for some time yet. The application date for the auditing standard, entitled '*An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of the Financial Statements*'⁵², has been postponed to commence for companies with fiscal years ending on or after 15 November 2004.

In Australia, entities may request auditors to undertake a specific review of their internal controls. The AuASB has issued guidance for auditors when completing and reporting upon such a review in the Australian standard AUS 810 *Special Purpose Reports on the Effectiveness of Control Procedures*. The reporting of these audits is only to those who requested the work to be completed. The standard states either the entity's management (at the governing body or operational level) or a specified third party (such as a regulator or another auditor) can engage an auditor to complete this

work.⁵³ These reports therefore are not available for review by other users of the entity's financial statements.

The ANAO's clients are held to a higher level of accountability by virtue of the office's annual publication and tabling of a 'Controls Report'⁵⁴. This report provides Parliament, and the Australian public at large, with an overview of weaknesses found in the controls structures across the AGPS. Details of weaknesses noted are also provided by major entity. Many relate to systems issues. The ANAO has published and tabled this document for many years now (since 1999) and has received positive feedback from a number of sources on its usefulness.

4. Evolving Environment: Contemporary Issues for Auditors

There are a number of contemporary issues that are currently impacting upon auditors. They include:

- the impact upon financial statement audits of client's adopting International Financial Reporting Standards;
- changing requirements of auditors to the international convergence with International Standards of Auditing;
- the content of the standards themselves, including issues of a common conceptual framework and sector neutrality and the use of 'plain language'; and
- meeting increased expectations in relation to timely reporting and detection of fraud.

In this section, I will discuss each of these issues in turn and include references to work that the ANAO is currently doing to assist with addressing each of these challenges.

Adopting International Financial Reporting Standards

In July 2002 the Financial Reporting Council and the Australian Accounting Standards Board (AASB) announced that Australia would adopt the standards issued by the IASB for financial reporting periods beginning on or after 1 January 2005.

The reasons for adoption of international standards are reflected in CLERP 1, the first paper in a series of Government proposals to amend corporate law. For the private sector, entities will be able to list on more than one stock exchange around the world and only prepare one set of financial statements, enabling more open world investment markets and reduced cost of capital. Although Australia has sophisticated capital markets, it represents only 6 percent of world capital markets. By making Australian standards internationally compliant, it is of great advantage to the private sector.

The AASB's statutory charter requires it to produce standards for all sectors of the Australian economy. AASB policy is to produce a single set of sector-neutral standards and to harmonise with the relevant requirements of the International Public Sector Accounting Standards (IPSAS), issued by the Public Sector Committee of

IFAC. The benefits envisaged by the AASB include facilitating more meaningful comparisons of the financial performance and financial position of Australian and foreign public sector reporting entities; and improving the quality of financial reporting in Australia to best international practice.

It has long been accepted that a high degree of commonality exists between the private and public sectors and that a common accounting framework and standards should apply to the extent they are relevant to both. Therefore, the move to adopt IASB standards necessarily affects the public sector. At the same time, specific public sector issues will be catered for in the AASB equivalents to the IASB standards by the inclusion of not-for-profit requirements. These provisions will, where necessary, override any conflicting IASB requirements. As such, the standards are referred to as Australian equivalents to International Financial Reporting Standards (IFRS).

Some Australian Public Sector Issues

With deadlines for implementation so close, the full impact of adopting Australian equivalents to IFRS is becoming more apparent.

As previously mentioned, the introduction of these new standards represents not only harmonisation with the standards issued by the IASB, but also harmonisation with the relevant requirements of the IPSAS, issued by the Public Sector Committee of IFAC. To facilitate this 'dual harmonisation process' the AASB has inserted additional requirements for entities that meet the definition of a 'not for profit' entity. This definition is⁵⁵:

A not-for-profit entity is an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent entity and each of the entities that it controls.

As such, entities that meet this definition will need to be aware of the changes these standards bring to all Australian entities, and where there are specific requirements or exclusions for not-for-profit entities. Their auditors will also need to agree that the entity is in fact a 'not for profit' entity. The issue of classification as one type of entity or the other in some cases will be straightforward. In others, this issue will require considerable judgement and a detailed knowledge of the entity to identify their principal objective.

The application of consistent accounting policies within an economic group is required by AASB 127 *Consolidated and Separated Financial Statements*. This requirement will result in for-profit entities consolidated into the Australian Whole-of-Government accounts having to keep two sets of financial information to conform with the accounting treatments required of both for-profit entities and of their parent entity. This may need to be looked at again by the AASB.

Further complications arise for those applying Australian Accounting Standards AAS 29 *Financial Reporting by Government Departments* and AAS 31 *Financial Reporting by Governments*. Both AAS 29 and AAS 31 are earmarked for retention after the adoption of Australian equivalents to IFRS as they do not currently have international equivalents. These standards both contain overriding provisions where to the extent they differ from other accounting standards, they will prevail. The

impact of these mandatory requirements may result in public sector entities not being compliant with Australian equivalents to IFRS.

This inability for not-for-profit entities, including governments and government departments, to fully apply IFRS will be obvious from a user's perspective, as the entity will not be able to make the "explicit and unreserved statement of such compliance in the notes"⁵⁶ to their financial report. The AASB has already indicated this will be an overall issue for not-for-profit entities which, by virtue of applying the not-for-profit requirements in the Australian equivalents to IFRS, will not be compliant with international standards. The importance of the issue of public sector application of Australian equivalents to IFRS is reinforced by a staff paper recently published on the AASB's website.⁵⁷

Implementing IFRS from our Clients' Perspective

In addition to issues to be resolved prior to the implementation date for these standards, there is also the issue of managing the implementation itself. The implementation plan would ordinarily include:

- a structured methodology for identifying which issues will impact the organisation and how they will be resolved (although at this late stage, this aspect of the plan would be expected to have already been substantially completed);
- identification of major changes to accounting policies; and
- a communication strategy for ensuring the entity's progress is being regularly reported to the Audit Committee, and to those staff within the organisation who need to be aware of operational implications of the changes required.

In putting together this implementation plan, a number of issues should be considered, including strategies in relation to:

- collecting different data from the date of transition to Australian equivalents to IFRS and thereafter;
- making required changes to systems; and
- identifying changes in information to be disclosed.

Once the implementation process is under control, there are other longer-term impacts of adopting international standards that should be considered. These relate to the impact of changes to accounting standards on information and analyses that are dependent on accounting information. A 'chain reaction of interlocking effects' has been identified including⁵⁸:

- key performance indicators;
- employee long term incentive plans;
- taxation planning;
- valuation models;
- policies and procedures;
- debt covenants and earn-out;
- structured financial products;

- control environment;
- dividend policy;
- earnings volatility;
- systems and finance function efficiency; and
- investor relations.

Of particular importance to the process of transitioning to the new standards is the communication strategy used. This strategy needs to include keeping all interested parties informed about the entity's progress against its implementation plan, including an entity's Audit Committee and the entity's external auditors.

Another consideration within the implementation plan relates to the requirement for IFRS to be applied in a retrospective manner. In Australia, this is clearly espoused for first-time adoption in the pending standard AASB 1 *First Time Adoption of Australian Equivalents to International Financial Reporting Standards*, and later changes to accounting policies in AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*. Table 4 outlines the deadlines imposed by AASB 1.

Table 4 - Deadlines for transitioning to the Australian equivalents to IFRS.⁵⁹

Balance Dates	Key Dates and Events				
				Full reporting under harmonised standards	
	Prepare opening balance sheet	Start collecting comparative data	Full year comparative data figures	Half year reporting period ending	Annual reporting period ending
31 Dec	31 Dec 03	1 Jan 04	31 Dec 04	30 June 05	31 Dec 05
30 June	30 June 04	1 July 04	30 June 05	31 Dec 05	30 June 06

As shown in the table above, Australian entities will be required to prepare two sets of financial statements for the balance date before the first internationally compliant statements are published:

- one set compliant with current Australian accounting standards for publication, as normal; and
- another set compliant with the Australian equivalents to IFRS and will not be published immediately, but will instead form the comparative data for the following year's financial statements.

Both of these statements need to be audited by the entity's external auditors. The external auditors therefore become a key stakeholder in the entity's implementation plan. They will need to know when the entity will have its opening balance sheet and comparative data relating to 2004-2005 prepared to an auditable quality. This will assist with scheduling the audit of this information to suit both the entity's IFRS project plan and the auditor's availability to undertake this work.

A further implementation issue is that relating to disclosures made in the 2003-2004 and 2004-2005 financial reports via Australian Accounting Standard AASB 1047 *Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards*. This standard requires Australian entities to disclose the impact

of the transition to new standards. In 2003-2004, it requires narrative disclosure in the financial report as to:

- how the transition to Australian equivalents to IFRS is being managed; and
- key expected differences in accounting policies arising from the adoption of the Australian equivalents to IFRS.

In 2004-2005, entities will disclose any known or reliably estimable information about the impacts on the financial report, had it been prepared using the Australian equivalents to IFRS.

As these statements will form part of the financial report, the entity's external auditors will also audit them.

Implementing IFRS from an Auditor's Perspective

As well as the audit issues previously mentioned, a key impact of the implementation of these new standards is that the external auditors may be seen as a source of accounting advice during this time of change. While this is an excellent opportunity to add value to our clients, auditors also need to be aware of the boundaries of this role and ensure we do not compromise our independence.

The ANAO has undertaken a number of activities to assist our clients through this period of change. In addition to detailed information in our annual *AMODEL Illustrative Accounts* and quarterly newsletter (*Opinions*), the ANAO presented a series of client seminars to outline some of the information and issues our clients need to understand.

These sessions are complemented by the publication of Australian equivalents to IFRS reference guide entitled "*Comparison Between Pre-2005 Australian Standards & Australian Equivalents to International Financial Reporting Standards*". This guide outlines the proposed changes by standard, and the impact of these changes. This reference guide is accessible from the ANAO's web site at <http://www.anao.gov.au>. (under the heading of 'other publications')

By virtue of its unique position as the sole independent auditor for the AGPS, the ANAO has been invited to attend a series of meetings with representatives from a number of AGPS agencies to discuss issues which arise as a result of international harmonisation for General Government Sector entities. These are round table discussions where all parties can openly express their views, and at which it has been made clear that the ANAO's involvement does not in any way commit the Office to a particular position.

International Convergence of Auditing Standards

Background

The Auditing and Assurance Standards Board (AuASB) has a long-standing policy of convergence with International Standards on Auditing (ISAs). For some time now the AuASB has used these international standards as the basis for its corresponding Australian Auditing Standards (AUSs). Moving forward, it is the AuASB's goal to ensure, from the start of 2005, that compliance with AUSs will also constitute compliance with ISAs.

Similar to the rationale for a single set of world wide accounting standards, having a single set of high quality auditing standards world wide brings many efficiencies and benefits, including⁶⁰:

- giving users confidence of standardised audit practices in relation to financial statements, regardless of their jurisdiction; and
- enhancing the reputation and credibility of the auditing profession, as well as helping to restore public confidence in it.

The success of this approach will be influenced by the success of its implementation by both national auditing standard setters in each country and individual auditors applying their professional judgement.

The AuASB has recently undertaken a comparison of the “black-letter” requirements of the international and Australian auditing standards to determine the extent and nature of any differences. This review identified 35 differences between the current ISAs and AUSs. These differences will be addressed by revisions to both the ISAs issued by the International Auditing and Assurance Standards Board (IAASB) and the AUSs issued by the AuASB.

The ANAO has been reviewing, and will continue to review and respond to, exposure drafts addressing proposed revisions to auditing standards as they are issued. To date, the ANAO has responded to exposure drafts either in its own right or as part of a collaborative response with other Auditors-General through the Australasian Council of Auditors-General (ACAG). As revised standards are issued, the ANAO is taking steps to make appropriate policy changes. In addition, a companion guide to the IFRS reference guide, addressing the convergence of Australian Auditing Standards with International Standards on Auditing, is currently being researched and written for ANAO staff to complement their on-going training on such matters.

Revisions and Proposed Revisions to Date

The ANAO’s reviews of the proposed amendments to date show the proposed new standards are more prescriptive than the current Australian standards. These changes may result in additional work for Australian auditors to ensure their work fully complies with the new standards, and some diminishing of the level of professional judgement exercised by auditors.

In the collaborative response from ACAG to the proposed amendments to ISA 240 *The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements*, there was discussion as to whether the amendments were too prescriptive and took away the auditor’s use of professional judgement. Looking at the revised standard that has been subsequently issued, its prescriptive nature has been lessened, to a degree, by inclusion of suggested audit procedures in appendices, rather than in the text of the document. There are still some elements of prescription, however, especially in relation to assessing the risk of fraud in relation to improper revenue recognition or management override of controls.

It would be of concern to many if these more prescriptive overtones were indicative of future directions of auditing standards. Hopefully, an appropriate balance will be struck which provides both guidance and the need to exercise professional judgement in an area of obvious public concern.

Content of Standards

The philosophical approach to auditing standards is important, but their content is just as important, particularly in applying commonly accepted concepts. When discussing content of auditing standards, I am referring to their application across the private and the public sectors, as well as the way in which they are actually phrased.

A Common Conceptual Framework and Sector Neutrality

The IAASB produces the international standards that the Australian standards are being harmonised with. Arrangements have been made for that Board to liaise with the International Organisation of Supreme Audit Institutions (INTOSAI) to reflect public sector requirements, with the intention of ensuring that the needs of public sector auditors are met. This approach has the goal of ensuring that a common conceptual framework applies, which is sector neutral, but which also allows for any particular public sector standards requirements to be developed consistent with that framework.

The importance of this latter point is reiterated by INTOSAI, through its Auditing Standards Committee, which has established a working party to consider alignment between the INTOSAI standards and those of the IAASB.⁶¹ The ANAO is a member of that committee. The working party has already recognised the need for transitional arrangements to accommodate the different standards, experiences, mandates and operations of the more than 180 country members of INTOSAI.

The International Standards on Auditing, like the current Australian auditing standards, ultimately rely on the auditor's professional judgement. This contrasts with the current approach in the United States, which includes the creation of the PCAOB as regulator and upholder of the *Sarbanes-Oxley Act* requirements and American auditing standards. Concerns have been expressed that, by going alone and setting their own auditing standards, the United States approach is likely to reduce the benefits from global harmonisation that I outlined earlier. Nevertheless, it is hoped that the cooperative arrangements put in place with the IAASB will ameliorate such concern. Ensuring that the standards are comparable would at least facilitate any move towards acceptance of one set of international auditing standards.

Plain Language Standards

Not only should standards be broadly applicable to all sectors, but they should also be consistently applied and interpreted. That latter requires the use of plain language so that the standards are interpreted and applied as the standard setters intended. The 'plain language' cause has become so important that lobby groups⁶² are forming and proactively campaigning for documents to be written so they can be readily understood.

Defining what is 'plain language' is in itself difficult task, as it would be hypocritical to use ambiguous terminology. The United Kingdom's Plain English Campaign defines the term 'plain English' as follows (emphasis added)⁶³:

We define plain English as something that the intended audience can read, understand and act upon the first time they read it. Plain English takes into account design and layout as well as language.

Some critics argue that the problem is in the English language itself. And there has been debate about the use of terms, such as ‘shall’, ‘should’ and ‘must’. The issues are still being considered.

A key point of distinction between documents written in plain language and those that are not is often the use of large and complex terms. Winston Churchill, the English Prime Minister during World War II, referred to the needless use of large difficult words as ‘terminological inexactitude’. The following excerpt from the BBC’s “Yes Minister” television program shows how Sir Humphrey’s terminological inexactitude almost led to Jim Hacker not understanding the intended message being communicated.

Table 5 – Demonstration of ‘terminological inexactitude’ in “Yes Minister”⁶⁴

Sir Humphrey:	Minister, I think there is something you perhaps ought to know.
Jim Hacker:	Yes Humphrey?
Sir Humphrey:	The identity of the Official whose alleged responsibility for this hypothetical oversight has been the subject of recent discussion, is NOT shrouded in quite such impenetrable obscurity as certain previous disclosures may have led you to assume, but not to put too fine a point on it, the individual in question is, it may surprise you to learn, one whom your present interlocutor is in the habit of defining by means of the perpendicular pronoun.
Jim Hacker:	I beg your pardon?
Sir Humphrey:	It was...I.

Recently, a study was undertaken by the University of Newcastle and Macquarie University in Sydney⁶⁵ of the variability in interpretation of a number of key uncertain expressions in Australian accounting and auditing standards. Variability in interpretation was measured for a number of remarkably common accounting and auditing terms, including:

- virtually certain;
- assured beyond any reasonable doubt;
- expected beyond any reasonable doubt;
- reasonable assurance;
- expected;
- reasonable expectation; and
- possible.

This study concluded that auditors show a reasonably high degree of variability in interpretation of ‘uncertain’ expressions. Greater variability of interpreting such terms comes with more, rather than less, experience in the profession. This problem is markedly exacerbated by translation issues which also owe something to cultural differences. The IAASB undertakes some translation itself and sells these products. IFAC is a facilitator in this respect, by assisting organisations to translate standards.

The implication of this research for standard setters is to ensure that sufficient guidance material is included in the standard to explain their intentions and how they

should be applied in practice. To a degree, this is already occurring with respect to auditing standards, which are generally shorter and more succinct than accounting standards, and contain fewer complications such as transitional provisions. Nevertheless, there is a requirement for length and complexity of standards to be well managed, including their overall construction, to assist national adoption or convergence. There would be general agreement that auditing standards should be articulated clearly and should be capable of consistent application and without ambiguity about the professional obligations to be fulfilled by the auditor. Of particular relevance to Australia now is that professional requirements should be in a form that is appropriate for legislative application. In this respect, it is important that there be clarity between those requirements and explanatory material.

Meeting Expectations – Timely Reporting

Both the Australian and international accounting conceptual frameworks cite timeliness of financial information as a factor when considering relevance of financial information. The more timely information is, the more relevant it is for decision-making. This links back to a key objective of financial reporting - the provision of information "...useful to users for making and evaluating decisions about the allocation of scarce resources."⁶⁶

AGPS Reporting Timetable

Timeliness of financial information is a topical issue in the AGPS. The *Charter of Budget Honesty Act 1998* requires Australian Government entities to provide financial information within tight timetables to the Department of Finance and Administration. This facilitates the preparation of the Consolidated Financial Statements and Final Budget Outcome Report each year. In accordance with the *Charter of Budget Honesty Act 1998*, the Final Budget Outcome Report needs to be prepared for public release "no later than 3 months after the end of the financial year."⁶⁷

In 2002, these deadlines were further tightened after the publication of *Estimates Memorandum 2002/13 Budget Estimates and Framework Review – Recommendations*. This publication was endorsed by a subsequent Cabinet decision.

Amongst others, the Department's goal is to provide the Parliament with the Final Budget Outcome Report within 45 days of the end of the financial year. To achieve this goal, the Department is proposing to incrementally tighten the reporting timetable for Australian Public Sector entities, as summarised in the Table 6.

Table 6 – Summary of Current and Future Financial Reporting Timetables⁶⁸

Financial year ending	Audit clearance required from ANAO of financial information of larger entities	Final Budget Outcome provided to Parliament
30 June 2004	30 July 2004	20 August 2004
30 June 2005	20 July 2005	14 August 2005

The challenges with this tightening timetable lie with both agencies and the ANAO, to ensure that the required information is made available to the Department of Finance and Administration when required, without a reduction in the quality of that information.

ANAO's strategies for providing assurance within these timetables

This additional requirement impacts upon the workload, pressures and resources of agencies and of the ANAO. The ANAO has already put strategies in place to facilitate audit clearance of financial information within earlier reporting timetables, without diminishing the quality of the audit work performed.

A key strategy, which the ANAO is endeavouring to implement, is to shift audit efforts away from the peak period, that is, after the end of the financial year. We do this by completing an additional phase in our audits, called a 'hard close'. A hard close is the stage at which audit teams perform tests upon a full set of financial statements prior to the year-end balance date. Then after balance date, when time is at a premium, audit teams review the intervening period between the date of the hard close and balance date to verify the year-end balances.

Performing a hard close benefits both the client and the ANAO in a number of ways. A hard close may identify certain areas of concern, leaving the client with enough time to rectify the situation prior to year-end, where time to do so is at a premium due to the tight reporting timetable. The ANAO benefits by reducing the amount of work required at year-end, with some of the work having already been completed, and so easing the peak workload with benefits to all concerned. The importance of hard close procedures is likely to increase, with Commonwealth financial reporting timeframes set to compress even further next year.

As public sector managers use their financial information as part of their everyday management, it is possible that we could have continuous reporting which will require the need for continuous auditing to provide management with adequate assurance. This will require more sophisticated and secure systems. However, in Australia, the major challenge is not only to encourage public sector managers at all levels to manage their programs/activities on an accruals basis, but also to ensure that our financial management information systems deliver the relevant information on the desktop in a timely and user-friendly manner.

Performing a hard close is one step towards 'real time auditing'. Such an approach assists agencies more expeditiously and is of "...increasing value to our audit clients."⁶⁹

Another strategy currently used by the ANAO is greater use of specialist information technology (IT) auditors and computer aided audit techniques (CAATS) to more efficiently and effectively obtain sufficient appropriate audit evidence. For many years, the ANAO has invested in the use of technology to provide more efficient and effective audit products to the Australian Parliament. The ANAO's IT Audit Section provide an integrated audit support service to all business units within the ANAO, with responsibility for management and delivery of both performance and assurance audit activities.

The ANAO's long-standing practices of integration of information technology specialists into its audit teams, reflects comments made in late 2000 by the then United States Public Oversight Board. In its report, the Board noted that integration of IT specialists with auditors should include "...assessing the risks of erroneous information affecting a financial statement, the adequacy of controls, and the tests designed for operating effectiveness"⁷⁰. This mirrors the overriding objectives for the ANAO's IT Audit section, which are to provide independent IT assurance through the

identification and assessment of risks presented by the adoption, and use, of new and emerging technologies within AGPS entities. Interestingly, the need for such close partnership between audit and IT, and more broadly between Chief Financial Officers and Chief Information Officers, should be reinforced by the Sarbanes-Oxley requirements, but some see the latter as a ‘disconnect’⁷¹. The link will be most apparent where material changes to financials are required to be reported in real time (Sarbanes-Oxley Section 309).⁷²

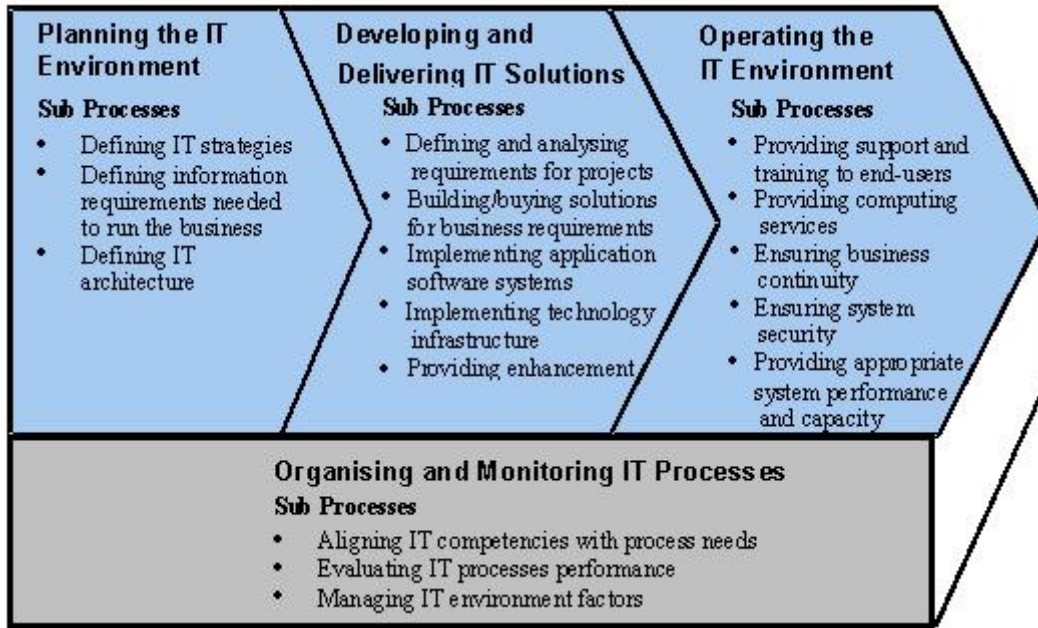
The ANAO’s strong interest in the use of specialist IT auditors is also brought about by the Australian Government’s significant and growing investment in information and communications technology (ICT). The opportunities made available through advancements in ICT have allowed the Government to increase service efficiency and improve service delivery, supported by a robust Internet transactional presence that is second only to the United States⁷³ in leading the transition to e-government.⁷⁴ Moreover, Commonwealth entities are increasingly using e-commerce to transact with suppliers online, thereby minimising the inefficiencies of traditional paper-based trading mechanisms.

Consequently, this new technology has introduced increased complexity, speed, interconnectivity and dependence on information systems within the IT environment, which can involve substantial costs and increased risks, but also improved productivity. With reliance on information systems growing rapidly, Government entities must establish adequate IT governance practices to ensure that their deployment of IT meets corporate goals through increased productivity, within a cost effective, prudent control environment.⁷⁵

IT governance practices, including the IT control environment, are reviewed during the financial statement audit process to assess the level of reliance that can be placed on them.⁷⁶ In assessing the efficiency and effectiveness of an entity’s sub processes which form their overall IT process, the ANAO has adopted a maturity model⁷⁷ approach, based on the Control Objectives for Information and related Technology model (CobiT).⁷⁸ Once completed, this assessment is used by the ANAO as a guide to determining audit risk and specifying the extent of audit testing to be undertaken.

Figure 4 below outlines the IT process methodology applied by the ANAO. Each sub-process of the information system is documented according to the model, allowing for a sound understanding of IT processes to be gained. From this understanding, auditors are able to test identified controls to confirm their operational effectiveness.⁷⁹

Figure 4 – ANAO’s CobiT based IT process methodology⁸⁰



In order to ascertain how Government entities are performing against the CobiT based approach, the ANAO has developed maturity rating categories to provide benchmarks when evaluating each IT sub-process. The following table provides a synopsis of the rating categories, including a generic high-level description of each category.

Table 7 – CobiT based maturity rating categories and descriptions⁸¹

Category	Detailed Description
Non-existent	There is a complete lack of any recognisable process.
Initial/Ad-hoc	No standardised processes, but there are ad-hoc approaches. The entity recognises that issues exist and need to be addressed. Management is reactive in addressing any issues.
Repeatable but Intuitive	There is global awareness of issues. Processes are developed where they are repeatable and some of them begin to be monitored. There is no formal training and the communication on standard procedures and responsibilities is left to the individual. There is high reliance on the knowledge of individuals and errors are therefore likely.
Defined Process	Systems and procedures have been standardised, documented, communicated and implemented. Training and application of standards is up to the individual. The need to act is understood and accepted. Most processes are monitored against some metrics and deviations are acted upon mostly through individual initiative.
Managed and Measurable	There is full understanding of the issues at all levels. Responsibilities are clear and process ownership is established. A completed set of policies, procedures and standards have been developed, maintained and communicated and is a composite of internal best practices.
Optimised	There is an advanced and forward-looking understanding of issues and solutions. Processes have been refined to a level of external best practice,

	based on results of continuous improvements and maturity modelling with other organisations.
<p><u>Explanatory Notes:</u> Assigned CobiT ratings given within this report are based only upon assessment of systems related to the ANAO financial statement audits (i.e. revenue and payment systems). Any assessment that incorporates a broader whole of entity perspective, which includes non-financial business processes, could result in a different rating.</p>	

Progression through the ratings scale means that an entity’s IT processes are aligning more closely with their organisational objectives. This enables the entity to maximise the benefits from its IT investment decisions by managing IT risks more appropriately and by utilising IT resources more effectively.⁸²

Within the Australian public sector environment, the ANAO considers the ‘defined process’ maturity rating as the minimum baseline category for assuring that suitable IT governance arrangements are in place. Exceptions to this rule include where Government policy on information security is required to be managed effectively and where larger entities make strategic use of IT for more than accounting purposes. Both instances indicate that a ‘managed and measurable’ rating may be more appropriate for determining baseline requirements.⁸³

Meeting Expectations – Detection of Fraud

The dichotomy between the public’s expectations of auditors to find fraud and the legal standard is interesting. My previous comments in relation to the Australian Auditing Standard on fraud were not intended to downplay responsibilities in this regard. Senator Andrew Murray⁸⁴ took time out of his busy schedule to address ANAO staff recently as part of the ‘ANAO Staff Seminars’ series, where speakers are regularly invited to speak on a range of audit and/or public sector related topics. In discussing the role of financial statement auditing in providing assurances to Parliament, Senator Murray raised what he considered to be an important point for users of auditors’ work – how is the auditor covering the risk of shrinkage in the entity’s accounts – that is, the risk of fraud.

It is interesting to note that this is a matter that is very close to the hearts of users, with ever increasing expectations that auditors will detect fraud, when legally the auditor’s role has not changed since 1896 when the House of Lords⁸⁵ stated that an auditor is “a watchdog, not a bloodhound.” I should note that the ANAO has only limited forensic auditing capability as it has been a long term policy to refer fraud related matters and/or evidence to the Australian Federal Police for investigation in accordance with sub-section 36(2) of the *Auditor-General Act 1997*.

Currently, in Australia, auditors are required to consider the risk of fraud by virtue of Australian Auditing Standard AUS 210 *The Auditor’s Responsibility to Consider Fraud and Error in an Audit of a Financial Report*. This standard is based on its international equivalent, and provides both guidance and requirements for considering the risk of fraud. The main requirements of this standard include⁸⁶:

- during the planning stage, discussion amongst the audit team and with the entity’s management about the susceptibility of the entity to material misstatements resulting from fraud and error;

- consideration of the risk of fraud when assessing inherent risk and control risk, including consideration of whether fraud risk factors are present, as outlined in the Appendix to the Standard;
- should fraud risk factors be present, specific procedures should be included in the test program to reduce the risk of misstatements from fraud and error to an acceptably low level;
- consideration of misstatements noted during the audit may be indicative of fraud;
- the audit team should obtain written representations from management about the disclosure of all facts relating to any fraud or possible fraud; and
- emphasis of the importance of the auditor's use of professional scepticism while planning and executing the audit.

Both the international and Australian standards make a clear distinction between two different types of fraud – employee fraud and management fraud. Employee fraud is that which relates to misstatements resulting from misappropriation of assets, including theft, embezzlement or causing the entity to make payments for goods and services not received. Management fraud, on the other hand, relates to misstatements from fraudulent reporting, arising from intentional misstatements or omissions of amounts or disclosures to deceive financial report users. While there are audit procedures to assist an auditor detect employee fraud, the ability for auditors to gather sufficient appropriate audit evidence to definitively support allegations of management fraud may be more difficult.

In relation to reporting of fraud and other significant matters, Australian auditors are driven by requirements in both the Australian Auditing Standard AUS 710 *Communicating with Management on Matters Raised from an Audit* and legal precedence. AUS 710 requires issues of significance noted by the auditor at any time during an audit to be reported to an appropriate level of management on a timely basis.⁸⁷ More specifically in relation to fraud, Justice Moffat ruled in the *Pacific Acceptance case*⁸⁸ that it is an auditor's duty to report all suspected fraud to management, even if the financial effect of the fraud is not material to the financial statements. To not do so would be negligent. AUS 210 also reinforces the importance of reporting misstatements resulting from fraud and error to be reported to an appropriate level of management in a timely manner.

From an international convergence perspective, there is now little difference between the requirements in AUS 210 and those in ISA 240. This is due to the amendments to the Australian standard being based upon those made to its international equivalent so that "...compliance with AUSs will also constitute compliance with ISAs."⁸⁹

There are also broad similarities with the recently revised auditing standard for auditors in the United States, SAS 99 *Consideration of Fraud in a Financial Statement Audit*. There are concerns that SAS 99 will result in higher audit fees due to its broader requirements from the previous standard, which only required "...auditors to make a reasonable effort to find fraud"⁹⁰. The revised standard, however, requires broadly the same professional scepticism and overall requirements as the international and Australian equivalent standards.

These similarities did not happen by accident. A Joint Working Group, comprised of standard setters from the US, Canada and United Kingdom, formed and issued a report in May 2000. This report specifically addressed the group's views on the growing divergence between audit practices and external audit as described in professional standards. The IAASB and the American Institute of Certified Public Accountants' Auditing Standards Board (ASB) then formed a task force to respond to this report. This evolved to become the Joint Risk Assessments Task Force. The overall result of their work, as described below by the AuASB, is to improve consistency in international auditing standards⁹¹.

The ASB will be issuing proposed Statements on Auditing Standards (SASs) that are the proposed ISAs modified to conform to certain specific U.S. requirements. The proposed ISAs and the proposed SASs are therefore expected to be the same in substance, except to the extent of additional requirements that are included in the U.S. versions to conform with other U.S. standards.

Despite these arrangements, there is still potential for diversions between US standards and international standards due to the impact of the US *Sarbanes-Oxley Act*. This Act directs the PCAOB to "...establish auditing and attestation standards, quality control standards and ethics standards ..."⁹². To date, the PCAOB's influence has been to mandate more prescriptive measures as opposed to auditors exercising more professional judgement. This key conceptual difference in approach to standard setting is seen as making international convergence more difficult to achieve, as I have noted earlier. Nevertheless, in an environment of greater focus on internal control, and an audit expectation gap in relation to fraud detections, we in the ANAO have been giving consideration to the need to enhance our forensic auditing capability. I should, however, note that we have conducted a series of fraud oriented performance audits aimed at reviewing what public sector entities have put in place to deal with fraud (prevention and detection), including appropriate fraud control plans.⁹³

5. Concluding Comments

In conclusion, I would like to draw together for you my observations of how the contemporary issues raised will impact upon the financial statement auditing in the future.

A number of the changes and contemporary issues were a consequence of questions raised about the accounting profession following a number of corporate collapses, resulting in reduced confidence in auditors and the accounting profession. In this respect, the actions of only a few have resulted in political and public pressure for accountants and auditors to 'lift their game' with respect to ethics. These concerns have turned into actions by legislators and regulators, which has led to greater attention, tighter legislation and greater interest in the oversight and regulation of the accounting profession. My hope is that the changes made to date are suffice to restore and maintain the public's confidence in our profession, and we can all move forward to the future with the dignity of our profession and the credibility of our professional judgement intact. However, action speaks louder than words.

Changes towards an international set of accounting standards will impact upon our clients and, depending on how well the process is managed, may result in both clients

and their external auditors being placed under pressure to resolve issues within the timetables national standard setters have in place. For Australian entities, this pressure period has arrived and may serve as a testing time for the relationship developed between client and auditor. From an audit perspective, the desire to assist the client and add value will be, in part, necessarily mitigated by our need to remain independent.

Concurrent international convergence of auditing standards will change the way we go about our business. In a climate where auditors are blamed, at least in part for corporate collapses, the fact that Australian auditing standards now have the force of law will require extra caution to ensure that all that should be, and can be, done during an audit is completed and appropriately documented.

To this end, the profession needs standards that are clear and unambiguous in their applicability to all sectors and in their ultimate intent. Nevertheless, even in an era of increasing litigation, I would find it difficult, as an accountant, to imagine that the meaning of commonly used terms such as 'virtually certain' or 'reasonable assurance' would be satisfactorily clarified by way of legal precedence over the exercise of professional judgement.

The market's increasing demands upon preparers of financial statements to issue reports in shorter time frames places pressures on auditors to complete their work faster. This same market also demands a more comprehensive audit. It is expected that auditors will detect and report fraud, despite what the professional standards and legal precedence may state about the role of financial statement auditing. It is equally expected that auditors will complete additional tasks to ensure compliance with increased professional and legislative requirements. Some also expect that the fees charged for external audit services, now a higher risk industry than ever before, will not increase dramatically. The question remains whether the profession has gone far enough to bridge the expectation gap between that which is required of it, and that which is often expected. Or, as the American Assembly at Columbia University last year suggested, is too much being demanded of the auditing profession.⁹⁴

Overall, the impact of financial statement auditing is broader than simply 'external conformance and accountability'. From the changes to the requirements of auditors and the work they are required and expected to complete, I see the role of auditing expanding as auditors are asked to examine and comment on the internal operations of the entity, as is currently required by the *Sarbanes-Oxley Act* in the United States, rather than just its financial report. And it is these type of changes that will ensure the future of auditing, protecting it from irrelevance, placing due importance upon the work of this profession, and engendering trust and confidence in both Regulators and the general public.

6. Abbreviations

AASB	Australian Accounting Standards Board
ACAG	Australasian Council of Auditors-General
AGPS	Australian Government Public Sector
ANAO	Australian National Audit Office
APS	Australian Public Service
ASB	Auditing Standards Board
ASIC	Australian Securities and Investments Commission
ASOSAI	Asian Organisation of Supreme Audit Institutions
AuASB	Auditing and Assurance Standards Board
AUS	Australian Auditing Standard
BPG	Better Practice Guide
CAAT	Computer aided audit techniques
CLERP	Corporate Law Economic Reform Program
CLERP 9	<i>Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) (CLERP 9) Act 2004</i>
CobIT	Control objectives for information and related Technology
FASB	Financial Accounting Standards Board
FRC	Financial Reporting Council
IASB	International Accounting Standards Board
ICAA	Institute of Chartered Accountants in Australia
ICT	Information and communications technology
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
INTOSAI	International Organisation of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
IT	Information technology
PCAOB	Public Company Accounting Oversight Board
PIOB	Public Interest Oversight Board
SAS	Statements on Auditing Standards
UIG	Urgent Issues Group
US	United States of America

7. Appendix: Overview of International and Australian Accounting and Auditing Organisations

Overview of International Organisations

International Organisation of Supreme Audit Institutions (INTOSAI)

INTOSAI was established in 1953 and has grown from a membership of 34 countries to over 180 countries today. A 'supreme audit institution' is defined as a public body that exercises by virtue of law, the highest public auditing function of a member country. The ANAO is Australia's supreme auditing body, has been a member of INTOSAI for some time now.

Internationally recognised as the leader in public sector auditing, INTOSAI is responsible for the development and issuance of auditing standards and guidelines, related methodologies and other practical reference material. INTOSAI members who actively participate by attending technical sessions, joining committees and commenting on committee products perform most of this work. Australia's Auditor-General is a member of the Auditing Standards Committee. It is important to note that, while INTOSAI auditing standards have no mandatory application, they reflect the 'best practice' consensus amongst members. Supreme audit institutions must then individually assess the extent to which the standards are compatible with the achievement of their own audit mandate.⁹⁵

INTOSAI also plays a pivotal role in supporting its members by providing a platform whereby information and experiences relating to public sector auditing can be exchanged. This is achieved through a variety of different publications and the hosting of triennial congress conferences.

INTOSAI's Regional Groups

INTOSAI has a number of Regional Groups. Australia is a member of the Asian Organisation of Supreme Audit Institutions (ASOSAI). This is one of seven regional working groups designed to promote INTOSAI's goals on a regional level, thereby providing members with an opportunity to focus on region specific matters. ASOSAI has 42 members of which the ANAO is an active participant, often taking on a significant role in many areas of activity, such as research reports and training programs.

INTOSAI's Committees and Working Groups

Committees and working groups complete much of INTOSAI's technical work. This work is undertaken to advance the accounting profession by developing and issuing professional standards, guidelines, methodologies, bibliographies and other practical reference materials. INTOSAI members, including the ANAO, participate in this aspect of INTOSAI by joining committees, commenting on committee products, and attending technical sessions at congresses.

International Federation of Accountants (IFAC)

IFAC serves as a truly global organisation for the accountancy profession. It consists of 158 member organisations spanning 118 countries, representing 2.5 million accountants employed in public practice, government, academe, industry and commerce.⁹⁶ The Auditor-General was appointed as Australia's representative on the Governing Board of IFAC for three years from 19 November 2002. As a member of IFAC, the ANAO also has significant influence on the ongoing international harmonisation of international standards.

The purpose of IFAC is to protect the public interest, strengthen the position of the accountancy profession worldwide, and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession's expertise is most relevant.⁹⁷

Public Interest Oversight Board (PIOB)

The PIOB is to be established as part of the recent reforms approved by the Council of the International Federation of Accountants. These reforms were in response to a need to improve the public's confidence in the accounting profession.

The PIOB will be comprised of ten members and will oversee IFAC's standard setting activities with respect to auditing, assurance, ethics, independence and compliance activities.

International Auditing and Assurance Standards Board (IAASB)

The IAASB is an independent standard setting body within IFAC. The Board's mission is to⁹⁸:

...establish high quality auditing, assurance, quality control and related services standards and to improve the uniformity of practice by professional accountants throughout the world, thereby strengthening public confidence in the global auditing profession and serving the public interest.

To achieve its mission, the IAASB focuses on the following broad strategic objective areas:

- **development of standards** – establishing high quality auditing, assurance, quality control and related services standards;
- **global acceptance** – promoting the acceptance and adoption of International Standards on Auditing (ISAs);
- **convergence and partnership** – supporting a strong and cohesive international auditing profession by coordinating with the IAASB Consultative Advisory Group, regional organisations, member bodies and national standard setters; and
- **communications** – improving the quality and uniformity of auditing and assurance practices and related services throughout the world by encouraging debate, presenting papers and issuing pronouncements on a variety of audit and assurance topics.

The IAASB currently has 18 members from all over the world, comprising practitioners in public practice and public members. Each member is substantially experienced in the field of auditing and assurance services and is appointed by the IFAC Board on the basis of recommendations made by the IFAC Nominating Committee. Australia's representatives on the IAASB are Mr Roger Simnett and Mr Ian McPhee.

In developing and promoting international standards, the IAASB works closely with the world's major standard setting bodies. As a stakeholder, the ANAO provides comment on proposed international draft standards through the Auditing and Assurance Standards Board (AuASB) as part of a coordinated Australian response.

Public Sector Committee

The focus of the Public Sector Committee is on the accounting, auditing, and financial reporting needs of national, regional and local governments, related governmental agencies, and the constituencies they serve. The committee addresses these needs by:

- issuing and promoting benchmark guidance;
- conducting educational and research programs; and
- facilitating the exchange of information among accountants and those who work in the public sector or rely on its work.

In recent years, the World Bank has provided funding for the Committee.

International Accounting Standards Board

Based in London, the International Accounting Standards Board is an independent, privately funded accounting standard setting body, with board members from a variety of countries and functional backgrounds. The Board is committed to developing a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. The Board cooperates with national accounting standard setters to achieve convergence in accounting standards around the world.

International Financial Reporting Interpretations Committee

The International Financial Reporting Interpretations Committee (IFRIC) is a committee of the IASB that assists in the establishment and improvement of standards. IFRIC reviews the following issues on a timely basis, with a view to reaching a consensus on the appropriate treatment for:

- newly identified financial reporting issues not specifically addressed in International Financial Reporting Standards;
- issues where unsatisfactory or conflicting interpretations have developed; or for
- issues that seem likely to develop in the absence of authoritative guidance.

Public Company Accounting Oversight Board (PCAOB)

The Public Company Accounting Oversight Board is a private sector not-for-profit corporation, which was established in the United States by the *Sarbanes-Oxley Act of 2002*. The Board oversees the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports.

The US Financial Accounting Standards Board

The US Financial Accounting Standards Board establishes standards of financial accounting and reporting for guidance and education of issuers, auditors and users of financial statements in the United States.

Overview of Australian Organisations

Financial Reporting Council (FRC)

The FRC is a statutory body⁹⁹ responsible for providing broad oversight of the accounting standard setting process in Australia. The Council interfaces with the two international standards bodies (IAASB and IASB) and monitors the progress of both the Australian Accounting Standards Board (AASB) and AuASB.

The FRC also give the Treasurer reports and advice pertaining to the standard setting process. More specifically, the FRC's responsibilities include¹⁰⁰:

- overseeing the operations of the Australian Accounting Standards Board (AASB), including:
 - appointing its members (other than the Chair, who is appointed by the Treasurer);
 - approving and monitoring its priorities, business plan, budget and staffing arrangements;
 - determining its broad strategic direction;
 - giving it directions, advice or feedback on matters of general policy and its procedures; and
 - monitoring the effectiveness of its consultative arrangements;
- monitoring the development of international accounting standards and accounting standards that apply in major international financial centres;
- promoting the adoption of international best practice accounting standards in the Australian accounting standard setting process if doing so would be in the best interests of the Australian economy;
- monitoring the operation of Australian accounting standards to assess their continued relevance and effectiveness in achieving their objectives; and
- seeking contributions towards the costs of the Australian accounting standard setting process.

The FRC is restricted from becoming directly involved in the standard setting process of the AASB. The Committee is not permitted to direct the AASB in relation to the

development of any standard, or to veto any standard put forward by the AASB. These limitations are designed to ensure the independence of the standard setter.¹⁰¹

Australian Accounting Standards Board (AASB)

The AASB is responsible for the development of accounting standards for use by the public and private sectors in Australia. A key committee of the AASB is the Urgent Issues Group (UIG), which is charged with providing prompt guidance on urgent, emerging financial reporting issues where the standards are either silent or ambiguous. Responsibility for identifying such issues lies primarily with UIG members and observers, with other persons able to propose issues for possible consideration by writing to the UIG Chair. The guidance provided by the UIG may ultimately be reflected in revisions to Australian accounting standards.

Urgent Issues Group

The Urgent Issues Group was initially established in 1994. Its role is to provide timely guidance on urgent financial reporting issues, to avoid the development of divergent or unsatisfactory financial reporting practices in areas not dealt with, or not dealt with specifically, in Accounting Standards.

Auditing and Assurance Standards Board (AuASB)

The AuASB is responsible for developing high quality professional standards and related guidance for auditors and providers of other assurance services, as a means to enhance the relevance and reliability of information provided to users of these services. The ANAO provides comment on draft standards, either individually or as part of a coordinated response from the Australasian Council of Auditors-General (ACAG).

The audit framework and standard-setting process in Australia is currently in a state of flux. Under CLERP 9 law reform, auditing standards receive legislative backing and the profession loses the power to independently implement auditing standards. This issue has been, understandably, the subject of significant discussion between politicians and the profession as the legislation was drafted and debated in the Parliament.

Such reform will see the AuASB operate under the FRC, with the Council assuming responsibility for the monitoring of auditor independence and overseeing the auditing standard setting regime. With these additional powers, the FRC's mandate will be significant and it 'may need to undergo certain changes in order to cope with its expanded set of responsibilities'.¹⁰²

Australasian Council of Auditors-General

The Australasian Council of Auditors-General was established following the 19th Biennial Conference of Australasian Area Auditors-General in Perth in 1993. It provides consultative arrangements for the structured sharing of pertinent information and intelligence between Auditors-General in a time of increasing complexity and rapid change. Its objectives are to foster and promote the development of Public Sector Auditing in the Australasian Region through:

- developing and promulgating authoritative pronouncements as to the nature, scope, independence and role of Auditors-General in the context of the Australasian scene;
- promoting educational activities which will contribute generally to the efficiency and effectiveness of Audit Offices' performance;
- contributing to the development of mutually beneficial methodologies for, and approaches to, the discharge of audit mandates;
- promoting co-operation in the conduct of audits;
- promoting the development of a professional quality assurance peer review program for participating Offices;
- contributing to enhancements of parliamentary liaison functions across jurisdictions, particularly with the Australasian Council of Public Accounts Committees; and
- identifying and promulgating, where appropriate, the collective opinion of Auditors-General on draft accounting and auditing standards and other relevant issues.

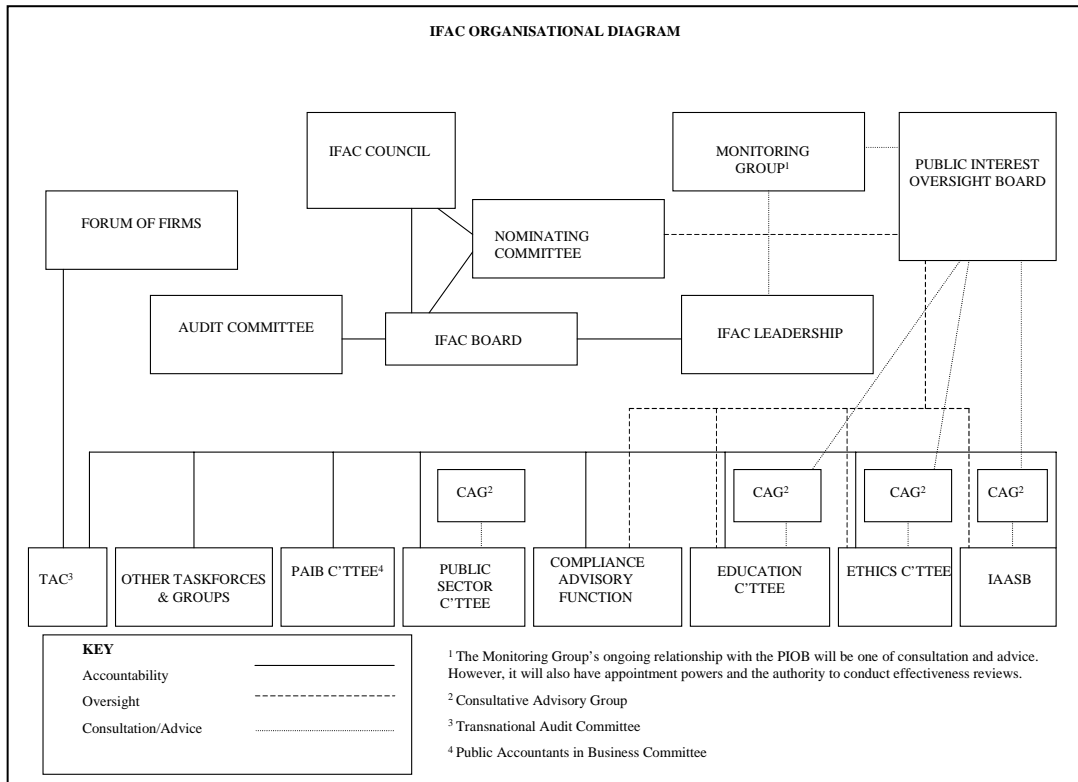
Australian Professional Bodies

CPA Australia is the nation's largest professional body with more than 97 000 members in Australia and overseas. CPA Australia plays a large role in the Australian business community by shaping and leading debate on issues affecting professional accountants and the wider business environment.

The Institute of Chartered Accountants in Australia (ICAA) was constituted by Royal Charter in 1928. The ICAA now operates under a Supplemental Royal Charter (amended from time to time) granted by the Governor-General on behalf of Queen Elizabeth II on 23 August 2000. The core purpose of the ICAA is to enhance and promote the reputation and role of Chartered Accountants that in turn will benefit the business community and the public interest.

Both bodies require completion of their respective postgraduate study programs for full membership. Members must adhere to professional and ethical codes and meet professional development requirements.

Figure 5 – IFAC Organisational Diagram



8. Notes and References

- ¹ Issued by the Australian Accounting Research Foundation on behalf of CPA Australia and The Institute of Chartered Accountants in Australia in June 2004.
- ² Issued by the Australian Accounting Research Foundation on behalf of CPA Australia and The Institute of Chartered Accountants in Australia in February 2004.
- ³ Former US Army Chief of Staff
- ⁴ ANAO internal assessment, June 2004.
- ⁵ Ms Ross' transcript is available at http://www.pcaob.org/transcripts/2004--05-13_Samantha_Ross_Testimony.asp
- ⁶ The European Commission is the politically independent that represents and upholds the interests of the European Union (EU) as a whole. The European Commission has four main roles:
1. to propose legislation to Parliament and the Council;
 2. to manage and implement EU policies and the budget;
 3. to enforce European law (jointly with the Court of Justice); and
 4. to represent the European Union on the international stage, for example by negotiating agreements between the EU and other countries.
- For further information, please refer to “*How the European Union works - A citizen's guide to the EU institutions*” available at http://europa.eu.int/comm/publications/booklets/eu_documentation/06/en.pdf
- ⁷ IAASB Action Plan 2003-2004, available at http://www.ifac.org/IAASB/downloads/action_plan_01_27.pdf
- ⁸ For further information, please refer to “*Auditing and Assurance Standards Board (AuASB) Policy on Harmonisation and Convergence with International Standards on Auditing (ISAs)*” available at <http://www.aarf.asn.au/publications.htm>
- ⁹ AUS 202 *Objective and General Principles Governing an Audit of a Financial Report*, paragraphs .02 and .03
- ¹⁰ Available from <http://www.anao.gov.au>
- ¹¹ Adapted from a model developed by the Queensland Department of Transport in its *Corporate Governance Framework for Queensland Transport and Main Roads: Final Report*, July 2001.
- ¹² ANAO, *Public Sector Governance Volume I*, Better Practice Guide, issued July 2003, pp. 14-15
- ¹³ Levitt A Jr, 2004, ‘Reclaiming the Profession's Heritage’, *The CPA Journal*, Volume 74, No. 2, pp 24-25.
- ¹⁴ IFAC Task Force on Rebuilding Public Confidence in Financial Reporting, 2003, “*Rebuilding Public Confidence in Financial Reporting An International Perspective*”, p.1
- ¹⁵ Ibid, pp 23-24.
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- ³⁰ The ANAO's policy is that the following kind of services would generate a financial or commercial relationship which would be presumed to impair independence:
- internal audit services
 - taxation advice
 - actuarial services
 - accounting policy advice
 - services relating to the setting up and/or maintenance of significant accounting records and systems
 - the preparation of accounts and records or financial statements of the agency, and
 - any other services related to fundamental aspects of the entity's business and/or strategic planning, including Information Technology.
- In respect of taxation advice, tax services of a compliance nature are permitted under ANAO policy, while taxation advice, such as advice of a strategic or tax planning nature, is not permitted. In respect of accounting policy advice, a response to account issues arising from Financial Statement Audits to ensure compliance with accounting standards and reporting frameworks is appropriate. It is considered that provision of account policy advice could give rise to a commercial relationship and, therefore, may result in a conflict of interest.
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- ⁵³ AUS 810 *Special Purpose Reports on the Effectiveness of Control Procedures* paragraph .01

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