

August 2002 in Review

Last month's edition of *Current Affairs in Auditing* reported the passing into United States law of a major Act reforming financial reporting and auditing. The *Sarbanes-Oxley Act 2002* is named after the legislators who drafted it. The style of regulation prescribed in this Act is rules-based or black letter law. The dominant theme in July/August's review of financial reporting and auditing has been the style of regulation needed in Australia. Prominent individuals such as the Prime Minister and the Treasurer have commented on this issue. The academic literature clearly shows that setting standards and devising regulations is a political process, and we will see evidence of this process in this debate. The debate about the style of regulation appropriate for Australia is the basis for this month's *Current Affairs in Auditing*. This is currently an important issue because the federal government has yet to react to the recommendations of the Ramsay Report and is soon to issue a discussion paper, 'Commercial Law Economic Reform Program (CLERP 9)', outlining its thoughts on regulation in Australia.

The government's discussion paper will address reforms to be considered for Australian financial reporting and auditing system. Events reported in the media during July and August indicate that these recommendations will be based on a self-regulatory approach, centred on the principle that companies adopt corporate governance systems. Such systems were popularised in Australia as a means to control the corporate excesses occurring among the companies that collapsed in the late 1980s. Pressures on the Australian Stock Exchange to be more active in prescribing acceptable corporate governance practices suggest that the federal government perceives corporate governance systems adopted by companies to be an important part of any system of regulation. The US Sarbanes-Oxley Act is rules-based, but the government feels this type of regulation is unacceptable in Australia.

Unfortunately, it is impossible to quantify the benefits and disadvantages of any system of regulation. Each system has its benefits and costs. The government is arguing that excessive rules-based or black letter regulation will be burdensome on Australian industry. Some change is inevitable for auditing. The accounting profession has supported the recommendations of the Ramsay Report, and it is reasonable to expect that the government will, as a minimum, adopt the recommendations of the Report.

Westpac's chairman, Leon Davis, has stated that, following deregulation, companies must respond to rising community unease by becoming more open and accountable (Davis et al. 2002, p. 1). It is generally agreed that only a minority of companies collapse as a result of corporate excesses, and that these companies would abuse a deregulatory environment and might not be more open and accountable. Yet, as the collapse of Enron and HIH Insurance shows, company collapses can cause hardship in the community. The dilemma facing regulators is how much corporate regulation should honest companies bear in order to prevent dishonest management of companies that adopt practices ultimately leading to distress in the community. Some have even argued that including the cost of company collapse in any cost-benefit evaluation of regulation would not warrant the introduction of greater rules-based regulation. They see the costs of corporate collapse as an integral part of corporate life. It is with these comments in mind that we await the publication of the government's discussion paper on corporate regulation.

References

Davis, M, Cornell, A, and Clearly, P 2002, 'PM rejects corporate regulation push'. *The Australian Financial Review*, 18 July, p. 1.