

Audit independence

The government will follow the recommendations of the Ramsay Report and amend the Corporations Act to include a General Statement of Principle requiring the independence of auditors. The law will also be amended to require auditors to make an annual declaration that they have maintained their independence (para. 2, Reform Proposals) and to strengthen restrictions on employment relationships between auditors and their clients (para. 3, Reform Proposals). The most notable restriction is a mandatory period of two years during which an audit partner who is directly involved with a client cannot become a director or take a position with the client involving responsibility for fundamental management decisions (para. 4, Reform Proposals).

Commentary

It is hoped that the amendments to the Corporations Act to include provisions requiring auditors to be independent and to give annual declarations that they have maintained independence will draw their attention to the importance of independence, and thus help to keep their minds focused on independence while they conduct audits. The problem with such provisions is regulating their enforcement. As noted above, an audit is a confidential review of a company's financial statements, and it may be difficult for regulators to obtain evidence of breaches of auditor independence. Furthermore, independence is defined as a state of mind, and it is impossible to enter an auditor's mind in order to ascertain whether breaches of independence occurred in the auditor's decision making. Throughout history there has been a never-ending, irresolvable debate over whether the provision of non-audit services has affected audit independence and quality. It is suggested that defining independence as a state of mind is one reason for the futility of this debate. The question remains as to whether enforcement of the above proposals will suffer from the same problems.

The restriction relating to auditing partners' taking positions with client companies arose during the HIH Insurance inquiry and is already included in *Professional Statement FI: Professional Independence*. This amendment to the Corporations Act was expected.

Reference

Institute of Chartered Accountants in Australia, 2002, *Professional Statement F1: Professional Independence*, ICAA Member's Handbook June 2002, ICAA.