

Andersen failed to do enough work

Auditors at Andersen failed to do enough work during their 1999 and 2000 audits of the collapsed insurer HIH to test management assertions on accounting matters, according to the published findings of the HIH Royal Commission released in the past fortnight.

Justice Neville Owen says the now-defunct accounting firm did insufficient work to verify claims made in relation to the financial statements, as well as failing to take proper action to manage the relationship with a client that was deemed high risk by the practice itself.

He said it was surprising the audit firm appeared prepared to accept positions put by HIH management “without obtaining sufficient audit evidence in respect of those positions”. “Users of financial statements have varying expectations about the audit certificate. In my view Andersen’s approach to the audit in 1999 and 2000 was insufficiently rigorous to engender confidence in users as to the reliability of HIH’s financial statements,” Justice Owen states. “This detracted from the users’ ability to properly appreciate HIH’s true financial position.”

While the Andersen audit teams are criticised on the way the audit was executed in the two audits examined as a part of the Royal Commission’s proceedings into the \$5.3 billion collapse, there is no recommendation for action against the firm’s partners or staff. Justice Owen did, however, express surprise at the fact the firm ignored the immense risk posed by the general insurer the firm failed to do enough of the right sort of audit work to get the information necessary to test management representations on a broad range of issues.

“Rather than taking concerted action to deal with the increased risk posed by HIH, for example by squarely addressing, both within Andersen and with HIH, the factors that gave rise to the risks and whether they could be mitigated or eliminated, Andersen’s regional practice directors limited their involvement simply to monitoring the situation and considering the options available to Andersen in the event of litigation.” Justice Owen’s report states.

“I find it surprising that, despite the clear risk that HIH posed to the firm and its reputation, Andersen decided to retain HIH as a client without a carefully constructed risk management plan. Such a plan could, for example, have addressed how Andersen should assess the reliability of the actuary on whose work Andersen relied in relation to the most significant liability of HIH.”

The risk management issues were only one of the areas of criticism in the conduct of the audit. A recurring theme is the inadequacy of work done to verify claims made by management on transactions that were to appear in the financial statements. Justice Owen, for example, says in the report the firm did not satisfy the requirements in the auditing standard on audit evidence, known as AUS 502, when looking at deferred acquisition costs capitalised by HIH.

The Royal Commissioner says the expert evidence provided by Greg Couttas, a partner at Deloitte Touche Tohmatsu, indicates Andersen's examination of those costs left much to be desired.

"On the basis of the documents presented to him, Couttas expressed the opinion that there was no evidence that Andersen had considered the recoverable value of deferred acquisition costs determined in accordance with the requirements of AASB 1023 [the accounting standard on general insurance] by reference to the present value of both expected future claims and settlement costs (in relation to business written to the reporting date) and the related unearned premiums," Justice Owen explains.

"It follows, in my opinion, that Andersen did not obtain sufficient appropriate audit evidence concerning the assessment of the recoverable amount of deferred acquisition costs as at 30 June 1999 or 30 June 2000 as required by AUS 502."

There are also no findings against Andersen related to a lack of independence during the conduct of the audits in Justice Owen's analysis of the events leading up to the collapse of HIH.

He says auditors must both be independent and seen to be so for the external audit to have any value. Some circumstances existed, according to the Royal Commissioner, where Andersen may have appeared to have its independence compromised.

"One such matter in the case of HIH was the presence of three former Andersen partners on its board. One of them was the chairman and the recipient of continuing benefits from Andersen, including fees from a consultancy arrangement," Justice Owen says.

"Another noteworthy matter was the removal from the HIH audit of the long-standing engagement partner in 1999, following his decision to meet with some of the non-executive directors of HIH in the absence of management."

The Royal Commissioner said the pressure on Andersen partners to increase the revenue flow from particular clients by cross-selling services was also a matter of concern to him. "In my view, the combined effect of these features of the relationship between Andersen and HIH gave rise (or would give rise to those aware of the relevant facts) to a perception that Andersen was not independent of HIH," Justice Owen explains. "Nevertheless, a close analysis of the conduct of the 1999 and 2000 audits reveals no reason to conclude that Andersen's independence was in fact compromised."

This article was supplied by Tom Ravlic. Tom is a financial journalist who has spent the past seven years covering the accounting profession, accounting and audit standard setting and corporate governance. His work has appeared in various publications

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